

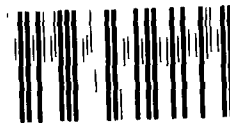
**GAO**

Report to the Chairman, Subcommittee on  
Intergovernmental Relations, Committee  
on Governmental Affairs  
United States Senate

July 1986

**LOCAL  
GOVERNMENTS**

**Targeting General  
Fiscal Assistance  
Reduces Fiscal  
Disparities**



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United States  
General Accounting Office  
Washington, D.C. 20548

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Human Resources Division

B-223595

July 24, 1986

The Honorable Dave Durenberger  
Chairman, Subcommittee on  
Intergovernmental Relations  
Committee on Governmental Affairs  
United States Senate

Dear Mr. Chairman:

In your letter of January 13, 1986, you expressed concern that localities with few resources have to incur a relatively high tax burden to meet their basic public service needs. You concluded by stating your intention to "propose the creation of a targeted fiscal assistance program aimed at maintaining the capacity of the nation's most vulnerable communities to meet their most important public service needs," and you asked us to provide information and analysis on this issue.

This report provides information on the magnitude of revenue disparities among 38,880 local units of general purpose governments. It also compares the efficiency of the general revenue sharing program to more targeted approaches to narrowing these disparities. It summarizes our analysis of revenue disparities and how their reduction can be achieved more efficiently within a climate of budgetary restraint.

As arranged with your office, we are sending copies of this report to other interested members; the Director, Office of Management and Budget; the Secretary of the Treasury; and state and local government interest groups. Copies will also be made available to other interested parties who request them.

Sincerely yours,

Richard L. Fogel  
Director

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# Executive Summary

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## Purpose

General Revenue Sharing may not be renewed when its authorization expires on September 30, 1986. This possibility concerned the Chairman, Subcommittee on Intergovernmental Relations, Senate Committee on Governmental Affairs, because the fiscal condition of local governments serving low-income communities may be eroded. The Chairman asked GAO to evaluate the effectiveness of revenue sharing in reducing revenue raising disparities between local governments serving high- and low-income communities and to assess alternatives for reducing these disparities. Specifically, the Chairman requested GAO to provide information on:

1. The magnitude of existing disparities in the revenue raising ability of local governments serving residents of high- and low-income communities.
2. The extent to which the general revenue sharing program has served to offset the revenue raising disadvantage of local governments serving low-income communities.
3. How more targeted formulas could lower the cost of reducing revenue raising disparities between high- and low-income communities.

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## Background

The State and Local Fiscal Assistance Act of 1972, commonly known as general revenue sharing, has provided \$4.6 billion annually to 38,880 units of local government. In addition to decentralizing decision-making to state and local governments, general revenue sharing was intended to provide fiscal assistance to communities with high public service needs and low revenue raising capacities.

Funds are allocated to local governments within each state based on population, per capita income, and tax effort. All general purpose local governments—cities, counties, and townships—receive revenue sharing funds. Alternatives have been proposed in the Congress to provide fiscal assistance on a more targeted basis to lower income communities.

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## Results in Brief

Disparities in the ability of high- and low-income communities to finance traditional, local public services are substantial and widespread. Due to their stronger economic bases, higher income communities raise more than twice the revenues per person of lower income communities.

The revenue sharing program moderately targets funds to low-income communities and therefore reduces revenue disparities somewhat (less than 15 percent). However, since revenue sharing funds are provided to all local governments including the highest income communities, the program can only reduce disparities to a limited extent. A fiscal assistance program that targets a greater share of funds to lower income communities could achieve a greater reduction in disparities at a lower cost.

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## GAO Analysis

Nationwide, general purpose local governments collected \$264 in local taxes per person in fiscal year 1983. However, local governments in the nation's wealthiest counties raised nearly \$338 per person compared to \$150 in the poorest counties. These disparities exist within both urban and rural areas; for instance, central cities are at a revenue raising disadvantage compared to their wealthier suburbs in 18 of the 20 largest metropolitan areas. Consequently, poorer communities in these areas must either accept lower service levels or tax themselves more heavily than their better-off neighbors to provide the same array of services.

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## Formulas Provide Modest Reduction in Disparities

The revenue sharing program produces only a modest reduction in these disparities, because the program has provided substantial funding to even the wealthiest communities. The program's modestly targeted formulas, funded at \$4.6 billion in fiscal year 1985, produced less than a 15-percent reduction in revenue disparities between high- and low-income communities.

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## More Targeting Would Reduce Costs

Increased targeting of available funds to local governments serving low-income communities lowers the cost of reducing revenue raising disparities. Targeting available funds only to communities with incomes below 125 percent of their state's average would double the efficiency of revenue sharing. For example, the same \$4.6 billion funding level would nearly double the amount of disparity reduction or, alternatively, half the current funding would continue to provide the same level of disparity reduction as exists now. Efficiency could be increased even more by targeting available funds only to those communities with below average income. In this case, \$1 billion annually could reduce revenue disparities by 25 percent, compared to the less than 15-percent reduction produced by general revenue sharing with \$4.6 billion.

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## Matters for Congressional Consideration

While a general fiscal assistance program could reduce the revenue raising disadvantage of local governments serving low-income communities, the Congress must ultimately decide if such assistance should be provided given other competing demands for limited federal resources. If the Congress decides that such an effort represents an appropriate use of federal funds, mitigating this problem could be achieved more efficiently by using a more highly targeted formula to distribute available funding.

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## Recommendations

This report makes no recommendations, but it does identify the estimated costs of reducing revenue raising disparities under differing assumptions regarding eligibility standards and the amount of disparity reduction desired.

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## Agency Comments

GAO did not obtain agency comments because the report does not address the administration of general revenue sharing. However, GAO did informally discuss its work and analyses with officials from the Department of the Treasury and their suggestions were incorporated where appropriate.



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# Introduction

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The focus of this report is on the comparative fiscal ability of local units of government to raise funds for traditional local public services. These include police, fire, sanitation, road, and health services financed primarily from local revenue sources and paid by the citizens of these communities. Other services made available at the local level, such as Medicaid and new highways, are outside the scope of our analysis because they are typically funded in part by the federal and state governments and can therefore be viewed as fiscal responsibilities of these higher governmental levels.

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## Fiscal Disparities Defined

Differences among communities arise in the relative mix of services and the level at which they are provided depending on local preferences and needs. The level of all services combined, however, is governed by a community's tax revenues, which in turn depend on both the community's level of taxable resources and its willingness to tax them.

Fiscal disparities refer both to differences in the levels of taxable resources available to communities and to differences in public service needs among communities. Given the same tax rate, a community with a lower economic resource base will derive fewer tax dollars than one that has more taxable resources per resident. Therefore, poorer communities must either accept lower levels of public services or tax themselves more heavily than their better-off neighbors to provide the same traditional array and level of services. Also, communities vary in their needs for traditional public services. Given the same economic base, a community whose population requires a higher level of services will have to tax itself at a higher rate than those with lesser needs.

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## Causes of Fiscal Disparities

The two cases that follow illustrate the nature of these two sources of fiscal disparity.

Case I compares a high-income community—Community A—to one with 35 percent less income—Community B. Basic service needs are assumed to be equal in both communities (column 2), and therefore the same level of per capita taxes is collected in each (column 3). However, Community A's higher income (column 1) permits the same taxes per capita to be collected as in Community B, but at a 35 percent lower tax rate (column 4). The fiscal disparity here results from the lower economic base of Community B.

**Table 1.1: Case I: Disparities Because of Different Resource Bases**

	(1) Average income per capita	(2) Service needs per capita	(3) Taxes collected per capita	(4) Tax rate (taxes as a percent of income)
Community A	\$11,500	\$345	\$345	3 00
Community B	7,500	345	345	4 60

Case II illustrates the effect of differences in public service needs on tax rates. In this case, both communities have the same economic base, \$8,500 in per capita income (column 1), but Community C has greater service needs (column 2). Even though both communities have equal per capita incomes, Community C's residents must have a higher tax rate to provide for their higher basic service needs (column 4).

**Table 1.2: Case II: Disparities Because of Greater Service Needs**

	(1) Income per capita	(2) Service needs per capita	(3) Taxes collected per capita	(4) Tax rate (taxes as a percent of income)
Community C	\$8,500	\$320	\$320	3 75
Community D	8,500	213	213	2 50

## Review Objectives

The Senate Subcommittee on Intergovernmental Relations is considering legislation that would provide targeted fiscal assistance to units of general purpose local governments. The proposed targeted fiscal assistance program would replace the general revenue sharing program, which expires September 30, 1986. To better weigh the advantages and disadvantages of a Targeted Fiscal Assistance program, the Subcommittee Chairman requested us to:

1. Develop estimates that quantify disparities in the revenue raising capacity of high- and low-income general purpose local governments, as defined by the Bureau of Census. This definition excludes local school districts and other special purpose districts.
2. Estimate the amount of fiscal assistance that would be required to reduce the disparities in communities' revenue raising capacity.
3. Assess how well general revenue sharing formulas reduce revenue raising (fiscal) disparities.

4. Provide alternatives to the existing revenue sharing program to more effectively reduce fiscal disparities among local governments.

## Scope and Methodology

In order to provide comprehensive information on the revenue raising capacity of the 38,880 units of general purpose local governments, we have used data from the Bureau of the Census on population, taxes collected by these governments, and resident money income. This is the same data that were used by the Department of the Treasury to allot general revenue sharing funds to local governments for fiscal year 1985.

The data are used to calculate fiscal disparities for the 38,880 local units of government. Fiscal disparities were identified both by measuring the differences in per capita tax collections of governments in high- and low-income county areas and by calculating the differences in per capita taxes governments in high- and low-income areas could raise if they taxed themselves at the national average rate.

We then estimated the levels of federal and/or state funding required to place the per capita taxes of lower income communities on a par with five alternative definitions of higher income communities, ranging from the state average income to 150 percent of the state average. Finally, these estimates were used as a benchmark to measure the efficiency of the general revenue sharing program and other options in reducing these disparities.

In measuring revenue disparities we have excluded revenues used to finance local education. This was done to provide comparability with the general revenue sharing program, which specifically excludes aid for education. In addition, we have excluded other intergovernmental revenues received from the federal and state governments. Including them would have required us to also evaluate the targeting of these funds, which is beyond the scope of this review.

While the data used are the only data readily available for all 38,880 units of general purpose local government, they are subject to several qualifications:

- Per capita taxes (based on 1982 Bureau of Census population estimates) were used to measure locally raised revenues available to finance local public service needs. However, taxes do not reflect local user charges,

which are an increasingly important source of local government revenues. Thus, communities which rely on this revenue source have their residents' tax effort<sup>1</sup> understated.

- The fiscal year 1983 tax data include sales, property, and payroll taxes paid by both residents and nonresidents to local units of government. Since nonresidents are also subject to these taxes, resident tax effort is overstated in communities able to "export" a large proportion of local revenues to nonresidents (such as commuters) through payroll taxes.<sup>2</sup> Also, communities with higher tax burdens may experience lower private housing costs.
- Resident money income for calendar year 1982 was used to approximate economic income. This is a narrow definition of income that excludes in-kind income, such as the rental value of owner-occupied housing or that of food raised at home. Consequently, communities with a high share of income received in kind have their real income understated.

While these qualifications are important, especially for some individual communities, we believe these data provide a reasonably accurate picture of the relative fiscal capacities of most local governments.

Although the report provides estimates of the national cost to reduce disparities among local units of government, the funding of a fiscal assistance program could be borne completely by the federal government or the cost could be jointly shared by the federal and state governments. But the appropriate fiscal role of either governmental level is not addressed in this report.

The Chairman also asked us to evaluate the targeting of general revenue sharing in terms of its ability to reduce revenue raising disparities between governments serving high-and low-income communities. Consequently, this report does not evaluate revenue sharing or how well it satisfies other objectives attributed to it, such as (1) relieving fiscal pressures on the state/local sector due to rising demands for services

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<sup>1</sup>Tax effort is measured by expressing tax revenues as a percentage of resident income

<sup>2</sup>The ability of local governments to "export" taxes to nonresidents is of significance when comparing the relative ability of local governments to meet public service needs out of actual revenues. For example, a city with a large nonresident commuter population can augment its revenues by taxing their income. Because the data presented in this report reflect only residents' incomes, they understate the actual revenue capacity of those governments with a greater potential to export taxes to nonresidents. For a full discussion of this issue see Katherine L. Bradbury and Helen E. Ladd, "Changes in the Revenue Capacity of U.S. Cities, 1970-82," *New England Economic Review*, Federal Reserve Bank of Boston, Mar/Apr. 1985, pp. 20-33.

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**and slow growth in local tax revenues or (2) promoting greater decentralization in fiscal decision making to units of local government. Also, the report does not address the Department of the Treasury's policy regarding the General Revenue Sharing program or its administration. Accordingly, the Chairman asked us not to obtain agency comments.**

**Except as noted above, our work was done in accordance with generally accepted government audit standards.**

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# Fiscal Disparities Among Units of Local Government Are Substantial

The revenues available for financing local public services vary among communities. Local governments serving communities in the nation's poorest counties raise less than half the per capita revenues raised by those in the nation's wealthiest counties. After taking tax rate differences into account, the revenue raising ability of communities in the lowest income counties is approximately half that of those in the wealthiest counties. While some of these disparities are due to income differences between urban and rural areas, revenue raising disparities within each group are also significant.

Table 2.1 shows the magnitude of revenue raising disparities of local governments in high- and low-income county areas on a nationwide basis. The table uses three alternative definitions of high- and low-income counties: (1) counties whose incomes are more than 25 percent above or below the state average, (2) more than 10 percent above or below the state average, and (3) above or below the state average.

**Table 2.1: Revenue Disparities Among Units of General Purpose Local Government Located in High- And Low-Income Counties<sup>a</sup>**

County income (percent of state average) <sup>b</sup>	(1) No. of counties	(2) Percent of population	(3) Taxes as a percent of income	(4) Per capita taxes	(5) Revenue disparities
(1) 75 or less	705	5.7	2.6	\$150	2.25 to 1
More than 125	52	7.7	2.9	338	
(2) 90 or less	1,971	27.7	2.6	181	1.65 to 1
More than 110	217	25.7	2.9	300	
(3) 100 or less	2,592	54.1	3.3	253	1.09 to 1
More than 100	542	45.9	2.8	276	
U S	3,134	100	3.0	\$264	

<sup>a</sup>The nation's 3,134 county areas were ranked on the basis of their residents' money income expressed as the percentage of the average income of the state in which it was located. Taxes of all general purpose governments within each county were aggregated to measure tax effort and per capita taxes collected.

<sup>b</sup>The state average income was chosen as the base rather than the national average income because current revenue sharing law uses state income as a base in computing revenue sharing payments to county areas. This measurement convention is used in all tables in this report.

<sup>c</sup>Not applicable.

Source: GAO calculations based on data provided by the Office of Revenue Sharing, Special Computer Tabulations, Entitlement Period 16, U.S. Department of the Treasury.

As shown in table 2.1, local governments serving communities in the 705 poorest counties—those with less than 75 percent of the state average



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income—collect \$150 per person in taxes<sup>1</sup> compared to \$338 for governments in the 52 wealthiest counties. Thus, the highest income counties collect \$2.25 in tax revenue for each \$1.00 raised in the lowest income counties. The revenue disparity for governments above and below the state average income (row 3) is relatively small due to the greater effort made by the below average group to finance their public service needs. Nevertheless, the low-income group generates 10 percent less revenue (\$253 compared to \$276) with a level of effort more than 15 percent above the high-income group (3.3 percent of income compared to 2.8 percent).

Part of the revenue disparities shown in table 2.1 is due to differences in the tax effort high- and low-income areas make to provide for their public service needs. To better reflect their capacity to raise revenues (instead of their effort), table 2.2 shows the revenues each group would raise if the governments in each area had made the same tax effort as the national average (3 percent of income).

**Table 2.2: Revenue Disparities Among High- And Low-Income Counties After Adjusting for Differences in the Effort Made to Finance Their Public Service Needs**

County income (percent of state average)	(1) Actual tax effort	(2) Average effort	(3) Average effort	(4) Effort adjusted taxes	(5) Revenue disparity
(1) 75 or less	2.6	\$150	3.0	\$173	\$2.02 to 1
More than 125	2.9	338	3.0	350	
(2) 90 or less	2.6	181	3.0	209	1.48 to 1
More than 110	2.9	300	3.0	310	
(3) 100 or less	3.3	253	3.0	230	1.29 to 1
More than 100	2.8	276	3.0	296	
U.S.	3.0	\$264	3.0	\$264	

<sup>a</sup>Not applicable

Source: GAO calculations based on data provided by the Office of Revenue Sharing, Special Computer Tabulations, Entitlement Period 16, U.S. Department of the Treasury

After making adjustments for differences in tax effort, high-income jurisdictions still have a significant revenue raising advantage. Column 3 shows the average tax effort local governments undertake to finance their public service needs, and column 4 represents the revenues they could raise if they undertook the average level of effort. If one compares

<sup>1</sup>Throughout the remainder of this report, tax revenues are understood to mean per capita revenues

the first group—counties below 75 percent or above 125 percent of state average income—the highest income counties have a \$2.02 to \$1.00 revenue raising advantage over the lowest income group. If one compares areas whose incomes are 10 percent above or below average, the high-income group is able to raise 1-1/2 times more revenue than the low income group.

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## Fiscal Disparities Among Governments in Rural and Urban Areas

Tables 2.1 and 2.2 gave a total measure of revenue raising disparities by including all local governments in both rural and highly urbanized counties. The following tables show that within more rural counties there are substantial revenue raising disparities among high- and low-income communities and, similarly, that disparities among local governments in highly urbanized counties are also substantial.

Table 2.3 shows substantial revenue disparities among local governments serving rural counties. For these rural counties,<sup>2</sup> taxes as a percent of income (tax effort) are consistently greater in the low-income group, yet this greater tax effort produces less revenue to finance local public services. For example, tax effort in the lowest income counties is 9 percent greater than in the wealthiest counties (2.33 percent compared to 2.14 percent in column 3). This higher effort, however, produces \$126 in revenues in the low-income counties compared to \$197 in the high-income group. Thus, the high-income group generates \$1.56 for each \$1.00 raised by the low-income group.

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<sup>2</sup>We have defined rural counties as those containing 40 percent of the U.S. population with the lowest percentage of residents living in urbanized areas within the county. This represents 2,761 of the nation's 3,134 counties, ranging from 799 almost entirely rural county areas to 103 county areas with only slightly more than a quarter of the population classified as rural. The median county area was 67 percent rural.

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**Table 2.3: Revenue Raising Disparities Among High- And Low-Income Local Governments in Rural Counties**

County income <sup>a</sup> (percent of state average)	(1) No. of least urban counties	(2) Percent of population in least urban counties	(3) Taxes as a percent of income	(4) Per capita taxes	(5) Revenue disparities
(1) 70 or less	403	6.2	2.33	\$126	\$1.56 to \$1
More than 110	87	6.2	2.14	197	
(2) 80 or less	1,096	23.0	2.28	141	\$1.23 to \$1
More than 100	329	21.6	2.01	173	
(3) 90 or less	1,893	51.5	2.18	146	\$1.15 to \$1
More than 90	868	48.5	2.05	168	
U.S. least urban counties' average	2,761	100	2.11	\$157	<sup>b</sup>

<sup>a</sup>Because these counties tend to have lower incomes compared to the national average, for this table we redefined high- and low-income groups to be those with income (1) less than 70 percent or more than 110 percent of the state average, (2) less than 80 percent or more than 100 percent of the state average, and (3) above or below 90 percent of the state average.

<sup>b</sup>Not applicable.

Source: GAO calculations based on data provided by the Office of Revenue Sharing, Special Computer Tabulations, Entitlement Period 16, U.S. Department of the Treasury.

Because there is such diversity among communities in the most highly urbanized counties, comparing such counties with one another would ignore these differences. Instead we decided to compare the revenue raising disparities between central cities and their suburbs for the 20 largest metropolitan areas.

Figure 2.1 demonstrates that revenue raising disparities exist between central cities and suburbs in 18 of the 20 largest metropolitan areas.<sup>3</sup> For example, the suburbs of Newark, New Jersey, can raise \$2.18 for each \$1.00 the central city raised in tax revenue. Similarly, Cleveland's suburbs can raise \$1.58 for each tax dollar collected by the central city. At the other extreme, the suburbs of San Diego can raise \$0.98 per tax

<sup>3</sup>Revenue disparities between central cities and suburbs of metropolitan areas give a measure of fiscal imbalance that reflects both differences in economic capacity and perceived needs. However, these disparity figures do not account for unmet needs in poorer central cities, which would require much higher tax efforts than currently exerted. In such cases, disparities in per capita revenues do not fully reflect the underlying fiscal disparities between city and suburban communities. One attempt to measure imbalances in needs between city and suburban areas solely on the basis of a direct measure of need was by Richard P. Nathan and Charles E. Adams, Jr. They developed a "hardship" index, which indicated that 43 central cities in 55 metropolitan areas were more fiscally distressed than their suburban counterparts. See Richard P. Nathan and Charles E. Adams, Jr., *Revenue Sharing: The Second Round*, The Brookings Institution, Washington, D.C., (1977), pp. 81-107.

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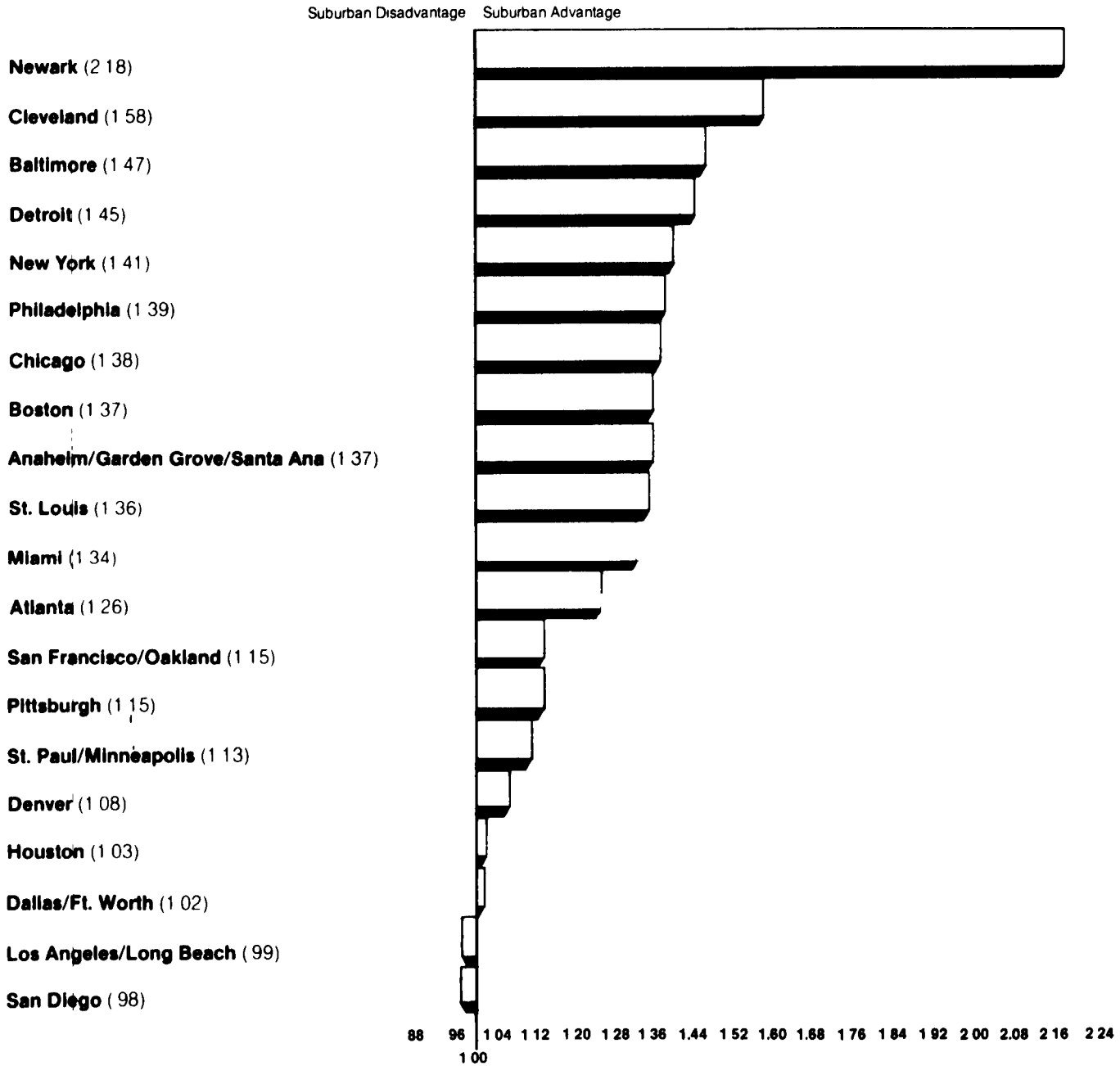
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dollar collected by the central city. In the 20 largest metropolitan areas, 18 suburbs have a revenue raising advantage over their central cities.

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**Figure 2.1: Ratio of Suburban to Central City Revenue Raising Capacity for the 20 Largest Metropolitan Areas**



Source: Office of Revenue Sharing, Special Computer Tabulations, Entitlement Period 16, U.S. Treasury Department, Bureau of Census definitions of Standard Metropolitan Statistical Areas

# General Revenue Sharing Produces a Modest Reduction in Revenue Disparities

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The formula used to distribute general revenue sharing provides somewhat larger payments to low-income jurisdictions, thereby moderately reducing revenue disparities. The targeting produced by the formula reduced revenue disparities by approximately 15 percent during fiscal year 1985.

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## Revenue Sharing Aid Is Moderately Targeted

Funds are first allocated among states based on population, urbanized population, per capita income and tax effort. Within each state, all funds are allocated among local governments based on population, per capita income, and tax effort. Use of the per capita income factor provides some targeting to lower income communities.

Table 3.1 shows that general revenue sharing payments are targeted more to city and county governments serving lower income residents.<sup>1</sup> Payments to the lowest income county governments average \$12.79 per person compared to the national average county payment of \$8.41. In contrast, the highest income county governments receive payments averaging \$7.12. Revenue sharing payments represent 16.2 percent of taxes collected by the lowest income county governments, compared to 4.1 percent in the highest income group.

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<sup>1</sup>Unlike the tables in chapter 2 that reported figures for all local governments within a county, table 3.1 provides revenue and income data separately for all county government and city government residents.

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General Revenue Sharing Produces a Modest  
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**Table 3.1: General Revenue Sharing Payments to High- And Low-Income County and City Governments**

Percent of state per capita income	Taxes		Revenue sharing payment	
	Percent of income	Per capita	Per capita	Percent of taxes
<b>County governments</b>				
75 or less	1.4	\$ 79	\$12.79	16.2
90 or less	1.2	83	10.45	12.6
100 or less	1.2	90	9.49	10.6
More than 100	1.2	113	7.24	6.4
More than 110	1.2	125	7.02	5.6
More than 125	1.5	173	7.12	4.1
<b>U.S. average</b>	<b>1.2</b>	<b>\$101</b>	<b>\$ 8.41</b>	<b>8.31</b>
<b>City governments</b>				
75 or less	2.6	158	\$18.34	11.6
90 or less	2.9	201	18.46	9.2
100 or less	3.5	269	19.37	7.2
More than 100	2.2	221	13.69	6.2
More than 110	2.1	231	12.50	5.4
More than 125	1.8	232	9.85	4.2
<b>U.S. average</b>	<b>2.8</b>	<b>\$248</b>	<b>\$16.86</b>	<b>6.81</b>

Source: GAO calculations based on data provided by the Office of Revenue Sharing, Special Computer Tabulations, Entitlement Period 16, U.S. Department of the Treasury

Revenue disparities among cities are greater than among county governments. Revenue sharing payments compensate for this disparity by providing significantly larger payments to low-income cities than to high-income cities. Nationally, payments to cities average \$16.86 per resident, ranging from an average of \$9.85 per person in high-income cities to \$18.34 in the lowest income cities. Nationwide, revenue sharing payments represented 6.8 percent of city taxes, ranging from over 11 percent in low-income cities down to 4.2 percent in the highest income group.

**Revenue Sharing Produces a Modest Reduction in Revenue Disparities**

Table 3.2 shows that general revenue sharing moderately reduces revenue disparities between governments in high- and low-income areas.

**Chapter 3  
General Revenue Sharing Produces a Modest  
Reduction in Revenue Disparities**

**Table 3.2: The Impact of General Revenue Sharing on Reducing Revenue Disparities Among Units of General Purpose Local Governments**

County Income (percent of state average)	Effort adjusted taxes		+	Revenue sharing payment	=	Revenues		(6) Disparity reductions (percent)
	(1) Per capita <sup>a</sup>	(2) Revenue disparity	(3) Per capita	(4) Per capita	(5) Net revenue disparity			
(1) 75 or less	\$173	\$2.02 to \$1	\$22	\$195	\$1.87 to \$1	-14.7 <sup>c</sup>		
More than 125	350		15	365				
(2) 90 or less	209	1.48 to 1	20	230 <sup>b</sup>	1.43 to 1	-10.4		
More than 110	310		18	328				
(3) 100 or less	230	1.29 to 1	21	251	1.25 to 1	-13.8		
More than 100	296		18	314				
U.S. average	\$264	<sup>d</sup>	\$20	\$284	<sup>d</sup>	<sup>d</sup>		

<sup>a</sup>Numbers are the same as shown in table 2.1

<sup>b</sup>Figures may not add due to rounding

<sup>c</sup>Before revenue sharing, the high-income group raises \$1.02 more than the low-income (\$2.02-\$1.00). After revenue sharing, they collect \$0.87 more, a 14.7-percent reduction. Calculations for rows 2 and 3 were made in a similar fashion.

<sup>d</sup>Not applicable

Source: GAO calculations based on data provided by the Office of Revenue Sharing, Special Computer Tabulations, Entitlement Period 16, U.S. Department of the Treasury.

Without revenue sharing, the highest income communities have a 2-to-1 revenue raising advantage over their lowest income counterparts, as illustrated in column 2. The formula used to distribute general revenue sharing, funded at \$4.6 billion, provides \$22.06 per person in the lowest income counties, compared to \$15.24 in the highest income group. After receipt of their revenue sharing payment, the revenue disparity between the highest and lowest income areas is reduced by 14.7 percent. Rows 2 and 3 make the same calculations using the other definitions of high- and low-income counties indicating disparity reductions of 10.4 and 13.8 percent, respectively. Thus, the formulas used to distribute general revenue sharing aid to local governments reduce revenue disparities by a relatively modest amount.





# Targeting Funds Lowers the Cost of Reducing Revenue Disparities

The cost of reducing or eliminating revenue disparities is directly related to the extent to which funds are targeted to lower income communities. These costs progressively increase as increasingly higher income groups are made eligible for funding.

If funding is targeted only to low-income communities, all funding contributes to a reduction in the revenue raising disparities that exist between high- and low-income communities. Alternatively, if some funding is provided to high-income communities, funding for low-income areas must be increased that much more in order to achieve a given disparity reduction. This in turn, raises the total cost of such a program. For example, if even modest levels of funding are provided to more affluent communities, such as Beverly Hills, California, this requires higher funding for lower income communities in order to achieve a given reduction in existing disparities.

## Procedure Used to Calculate the Cost of Disparity Reduction

We have estimated the cost of eliminating revenue disparities by calculating the added revenues needed by low-income local governments to close the gap between the revenues they could raise based on the national average tax rate and what they could raise if they had incomes equal to various income eligibility standards, defined as a percentage of a state's average income. The selection of an income eligibility standard determines which communities will be eligible to receive funding. Since this is a choice to be made by policymakers, we have used several assumed eligibility standards.

An example of this calculation is shown in table 4.1 for a hypothetical state with three counties using two income eligibility standards. Applying the national average local tax rate of 3 percent to the differing county area, per capita incomes generates differing tax revenues (column 3). For example, County A with an income of \$4,000, would generate \$120 while County C, with an income of \$8,000, would raise \$240. Thus, with an \$8,000 income eligibility standard (shown in the upper portion of column 4) low-income County A would require \$120, County B would need \$60 and County C \$0 to close their respective revenue gaps (column 6). Eliminating disparities with this income eligibility standard would cost \$180. An income eligibility standard of \$9,000 (shown in the lower portion of column 4) would result in revenue gaps of \$150, \$90, and \$30, respectively. In this case, the total cost of disparity reduction would be \$270 per person. This occurs because even County C, with the highest per capita income, receives aid. This

increases the size of the revenue gap for low-income counties, thus raising the cost of the program.

**Table 4.1: Hypothetical Example of the Funding Required to Eliminate Revenue Raising Disparities Among Local Governments**

County areas	(1) Average tax rate	(2) Per capita income	(3) Per capita tax revenues (1) x (2)	(4) Income eligibility standard	(5) Per capita revenues with income equal to to eligibility standard (1) x (4)	(6) Per capita revenue gap (5) - (3)
A	03	\$4,000	\$120	\$8,000	\$240	\$120
B	03	6,000	180	8,000	240	60
C	03	8,000	240	8,000	240	0
<b>Total cost</b>						<b>\$180</b>
A	03	\$4,000	\$120	\$9,000	\$270	\$150
B	03	6,000	180	9,000	270	90
C	.03	8,000	240	9,000	270	30
<b>Total cost</b>						<b>\$270</b>

## Cost of Reducing Revenue Disparities

We have estimated the cost of reducing or eliminating revenue disparities by calculating revenue gaps for local governments in the nation's 3,134 counties using the methodology illustrated in the previous example. We have made these calculations using five income eligibility standards ranging from states' average income to incomes of up to 150 percent of states' average income. The cost of eliminating revenue disparities is obtained by totaling each county area's revenue gap as was illustrated in table 4.1.

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Revenue Disparities**

**Table 4.2: Estimated Funds Required to Eliminate or Partially Reduce Revenue Disparities Among Local Governments<sup>a</sup>**

Dollars in billions

	Disparity reduction (percent)	Income eligibility standard (state average = 100 percent)				
		(1)	(2)	(3)	(4)	(5)
		100%	110%	125%	135%	150%
(1)	100	\$3.9	\$7.9	\$15.7	\$21.6	\$30.6
(2)	50	2.0	3.9	7.8	10.8	15.3
(3)	30	1.2	2.4	4.7 <sup>b</sup>	6.5	9.2
(4)	25	1.0	2.0	3.9	5.4	7.7
(5)	20	0.8	1.6	3.1	4.3	6.1
(6)	15	0.6	1.2	2.4 <sup>b</sup>	3.2	4.6 <sup>b</sup>
(7)	10	0.4	0.8	1.6	2.2	3.1

<sup>a</sup>The estimated funding requirements should be regarded as conservative estimates that understate actual funding requirements. The 3-percent tax rate used in these calculations represents the national average local government tax rate. As we stated earlier, this excludes user fees and charges that have become an increasingly important revenue source for local governments. If these data were available for inclusion in our calculations, it would produce higher funding estimates.

<sup>b</sup>These entries are discussed in the text.

Source: GAO calculations based on data provided by the Office of Revenue Sharing, Special Computer Tabulations, Entitlement Period 16, U.S. Department of the Treasury.

The first row of table 4.2 shows the cost of eliminating revenue disparities under each of the assumed income eligibility standards. Column 1 shows that eliminating revenue gaps among communities with incomes below their respective state averages could have been achieved with \$3.9 billion in fiscal year 1985. At the other extreme, if local governments in counties with incomes of up to 150 percent of the state average income are eligible, eliminating the revenue gaps would cost over \$30 billion (column 6).

The cost of partially reducing disparities is shown in succeeding rows of the table. For example, the figures in column 1 show that disparities among counties with incomes below the state average could be reduced by 50 percent with \$2 billion, and a 25-percent reduction could be achieved with \$1 billion. In contrast, attempting to reduce revenue disparities among communities with incomes of up to 150 percent of the average would cost considerably more; a 50-percent reduction would require over \$15 billion annually.

In chapter 3, we said that general revenue sharing achieved less than a 15-percent reduction in revenue disparities with \$4.6 billion. A targeted fiscal assistance formula that uses an income eligibility standard equal to 150 percent of each state's per capita income achieves approximately

the same 15-percent reduction as revenue sharing (see row 6, column 5) Complete fiscal disparity reduction with a 150-percent eligibility standard would require a \$30.6 billion funding level. This is approximately 6-1/2 times as large as the fiscal year 1986 authorization level.

## **Increased Targeting Lowers the Cost of Disparity Reduction**

The information in table 4.2 also demonstrates that reducing revenue raising disparities can be achieved at lower cost if formulas are used to target available funds only to lower income communities. For example, column 3 shows the cost of disparity reduction if funds were targeted only to communities with income below 125 percent of the state average. Row 3 of this column shows that \$4.7 billion could reduce revenue disparities by 30 percent, twice that achieved by the revenue sharing formulas at the same annual cost. Alternatively, row 6 shows that a 125-percent income eligibility standard could produce the same 15-percent disparity reduction as revenue sharing, but with \$2.4 billion instead of \$4.6 billion. If funding were restricted to local governments in counties with incomes below their state's average (column 1) \$2.0 billion could provide a 50-percent reduction and \$1 billion could provide a 25-percent reduction.

Greater targeting, however, reduces the number of governments that receive funding and therefore the number of residents benefiting from such a program. For example, if eligibility were limited to local governments with incomes equal to or below their respective state averages, 17 percent of the nation's counties serving 46 percent of all county residents would be ineligible. A higher income eligibility standard equal to 125 percent of the average income would provide benefits to all but 2 percent of county governments and all but 8 percent of county residents. An income eligibility standard equal to 150 percent of average income would provide benefits to over 99 percent of all county governments and their residents.

# Conclusions

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Substantial revenue raising disparities exist among the nation's local governments. While federal general fiscal assistance designed to eliminate or reduce these disparities could ameliorate these problems, the Congress must ultimately decide if such assistance should be provided given other competing demands for limited federal resources.

If the Congress decides that such an effort represents an appropriate use of federal funds, the fiscal disparity reduction objective of the revenue sharing program could be achieved more efficiently (i.e., a greater reduction in disparities at less cost) by using a more targeted formula to distribute funds.

A program limiting eligibility to communities with incomes below 125 percent of state averages would either double the degree of disparity reduction compared to general revenue sharing at the same funding level or achieve the same disparity reduction at half the cost. An even more targeted formula, providing funds only to governments below their state average incomes, would achieve over three times the disparity reduction at less than half the cost of the current revenue sharing program.

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