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THE NEW REALITIES OF FISCAL FEDERALISM: U.S LOCAL GOVERNMENT BUDGETING IN THE 21ST CENTURY*

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Abstract: Amassing sufficient revenues to balance the annual budget is a perpetual and daunting challenge for local government officials in the United States (U.S). While local governments depend primarily on own-source types of revenue to cover anticipated expenditures, they nonetheless count on money that comes from the federal, state, and other local governments—that is intergovernmental revenue—to augment funds raised through internal means and thus assist them in making ends meet. The purpose of this paper is to examine the contribution that state and federal aid as well as revenue derived from other local governments has made to the revenue side of the budgets of five types of local government (counties, municipalities, townships, special districts, and school districts) from 1962 to 2017. From this perspective, it is hoped that we can gain a better sense of what many have referred to as the "new

realities" of fiscal federalism and what the implications may be for these five types of local governments going forward.

I. INTRODUCTION

Preparing the local government budget in the United States (U.S) has always been an annual exercise filled with numerous challenges and frustrations, since local officials are required to constantly reconcile citizen service needs and expectations with the fiscal resources available to them. Some have even alluded to this painstaking task as one in which local officials are constantly trying to "hit a moving target." Circumstances change yearly—and sometimes more often—and therefore make it difficult to gauge citizens' service priorities and what they are willing to pay in the way of taxes and fees and charges for services. More times than not, local officials have to deal with the conundrum of citizens wanting more and better services but are also not willing to pay more. Adding to the trials and tribulations of having to play a guessing game with their citizens, local government officials also have the unenviable task of having to estimate the yield of fluctuating sources of revenue. One such revenue is intergovernmental funding, but especially fiscal assistance received from their state government.

The purpose of this paper is to examine the important—indeed, pivotal—role played by intergovernmental revenue (IR) in local governments' efforts to balance their budgets on an annual basis. More specifically, the paper will look at the proportion of the total revenue of five types of local governments (counties, municipalities, townships, special districts, and school districts) that is accounted for by IR (that is, federal aid, state aid, and revenue received from other local governments). The time frame of this study will begin in 1962 (the first year of reliable Census of Governments data) and will go through 2017 (the most recent available data for our five types of local government when viewed on an individual basis). However, we are able

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to present 2020 data when examining IR in the aggregate. For reasons which will be discussed later in the paper, the time frame will be extended to 2022 whenever that data becomes available which is currently estimated to be sometime in late 2024 or early 2025. Before moving to the analytical sections of the paper, a brief history of and rationale for IR will be provided.

II. WHY INTERGOVERNMENTAL REVENUE?

There are a number of compelling reasons for the federal and state governments to provide local governments with financial aid and for local governments to consider the prospect of contracting to "sell" services to other local governments to obtain additional revenue. A brief examination of some of them will suffice for the purpose of setting the stag/contest for the analysis that follows.

The provision of grants—from a higher to a lower level of government—historically can be done to achieve/satisfy a number of objectives or rationales: Each of these possible reasons for fiscal assistance may not apply equally across various types of governments in a federal system. Some may be relatively more appropriate for federal-to-state interaction, whereas others may apply more in the case of state-to-local intervention. In addition, the importance of each rationale varies from state to state and for different state and local public services.

1. Provide Regional Redistribution

Grants-in-aid may be used for the purpose of redistributing resources among the states or localities with the states and to achieve equity (Ladd 2005). On the one hand, if taxes that are collected by a state government are then allotted or distributed to local governments in that state using any factor other than "origin" or "derivation," then some redistribution among localities is likely to occur (Scheppach and Hildreth 2012). On the other hand, if state

funds are dispersed inversely proportional to local area income or property value, then this results in a clear transfer from taxpayers in higher-income jurisdictions to governments in lower-income jurisdictions (Scheppach and Hildreth 2012).

Redistribution of resources traditionally has been a primary purpose behind state grants to local governments for education purposes (Kenyon 2007). More specifically, state grants are usually intended to adjust for large differences in educational spending given the substantial differences in local property-tax bases that typically exist within a state. However, resource redistribution also can be an explicit or implicit objective of state grants for general-purpose local governments like counties and municipalities. This is especially the case for unrestricted or revenue-sharing grants to these governments.

2. Encourage Efficiency in Revenue Collection

Grants also may be instrumental in substituting one tax structure for another or one tax collection administration for another and thereby realize scale economies. In simple terms, intergovernmental grants essentially substitute the granting government's tax revenue or tax collection system for that of the recipient government (Hamilton 2012). If it so happens that the taxes used by the granting government are more efficient than the ones they replace, then this tax substitution becomes a means by which grants may improve the efficiency of the fiscal federalism.

For the most part, inefficiency in tax collection at the local level in the United States is the consequence of economic mobility which is much more common between local jurisdictions than among states. Therefore, a tax levied statewide may generate less inefficiency than a set of similar local taxes. In addition, centralized revenue collection may also provide economies of scale in tax collection. In this way, the revenue can be generated through the state

government but spent locally, with a system of intergovernmental grants. This is part of the logic that is used for support of revenue-sharing programs. For instance, rather than instituting a set of county or municipal income taxes, a state might increase the state income-tax rate (or adopt a state income tax) and distribute the revenue to local governments. This is something that California and some other states have used for years. On the one hand, if the revenue is distributed to local governments based on the origin of the funds, then there is no local redistribution and the singular objective or benefit of this structure is the efficiency in centralized revenue production. (Fisher and Bristle 2012). On the other hand, if the revenue is allocated by some factor other than origin, then the grant program may serve both to improve the efficiency of tax collection and to redistribute resources for equity or public service reasons (Fisher and Bristle 2012).

3. Correct for Externalities and Spillovers

Grants may be envisioned to stimulate additional spending on the part of the recipient governments and even correct for externalities or spillovers that arise from the structure of subnational governments. This is yet another way that grants may improve the efficiency of fiscal decisions. The existence of interjurisdictional externalities or spillovers can cause service decisions by individual local governments to be inefficient from their citizen's perspective.

According to Fisher and Bristle (2012), if nonresidents benefit from a locally provided service, but those nonresident benefits are not considered in the decision about the amount of the service to provide, social marginal benefits will be underestimated and too little of the service provided. In such a situation, an intergovernmental grant can be utilized to encourage the local government to provide more of that specific service, as efficiency requires (Scheppach

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and Hildreth 2012). Furthermore, because the grant funds are generated from taxes collected by the state government, those nonresidents who benefit from the service end up paying for part of the service through their state taxes.

Individual migration among local communities also may involve a type of externality, if that migration imposes costs on the other residents (Flatters 1974). As is often, individuals may move to avoid subnational taxes or to gain services (Tiebout 1956). If the new residents pay less than the average cost of services they consume, existing residents confront the prospect of either service reductions with constant taxes or higher taxes to maintain services. The potential migrants, however, have no incentive to include those costs imposed on other residents in their decision about whether to relocate; therefore, the distribution of population among local governments may become inefficient. In that case, intergovernmental grants is a ready-made tool that can be utilized to resolve this problem. In fact, grants to high-tax or low-service local governments may prevent some of the migration in search of lower taxes or more services and contribute to a more efficient structure of local government. While such grants may be viewed as efforts to bring about greater resource redistribution, they may bring about greater efficiency.

4. Promote Marco-economic Stabilization

In addition, grants-in-aid can be used as a macroeconomic stabilizing mechanism for subnational governments. This is especially the true for federal grants. It is common during significant downturns in the economy —as it was during the Great Recession or the COVID-19-induced recession—for the federal government to provide additional financial support to state and local governments through the intergovernmental grant system. In such instances, the federal government is following traditional fiscal policy objectives by attempting to maintain or

increase demand (spending) by using state and local governments as the spending vehicle (Fisher and Bristle 2012).

However, state governments are much less likely to engage in the kind of action. In fact, the opposite is often the case. In some instances, state governments target particular grants or components of specific grants to local governments that are exhibiting characteristics of "fiscal distress" (Fisher and Bristle 2012). . Rather than being part of an effort to stimulate overall economic growth or stability in a state, such targeted aid is often a short-run measure to preempt a fiscal crisis in a local government. The effort of the State of Michigan with regard to the impending fiscal meltdown in Detroit is a case in point. As will be discussed later, it is more common for states to react to state government fiscal problems by reducing state government aid to local governments, especially for local revenue sharing or K-12 schools. In contrast to common federal-to-state interaction, a state government's fiscal difficulties often are transferred on to local governments within that state and results in what has been termed as "fend-for-yourself federalism" (Shannon 1987).

Besides these common objectives and rationales for state and federal aid, there are some other more subtle but important reasons why the federal and state governments have created grant-in-aid programs. First, state aid to local governments has been in place forever and for the simple reason that states expect (or even mandate) that their local governments service as administration arms or political subdivisions of the state and assist in the provision of provide state-level services at the local level. Second, since the Great Depression of the 1930s (and especially as part of the Lydon Johnson administration's Great Society policy initiatives during the 1960s), the federal government used grants-in-aid as an inducement to get local governments (and states) to do things that Congress had identified as

national priorities or serve to "promote the general welfare."

As to the rationale for local governments to provide services to other local governments for a charge or fee, the motive is plain and simple. That is, local governments may view the opportunity to bring in this kind of additional revenue as a means to supplement what always seems to be not enough money from own-sources and state and federal aid to pay for services that the public expects. However, the employment of this tactic to generate extra money must be tempered with a realistic assessment of how much additional money results once the cost of providing the service is subtracted from the fee that is charged the other local government for the provision of these contracted services.

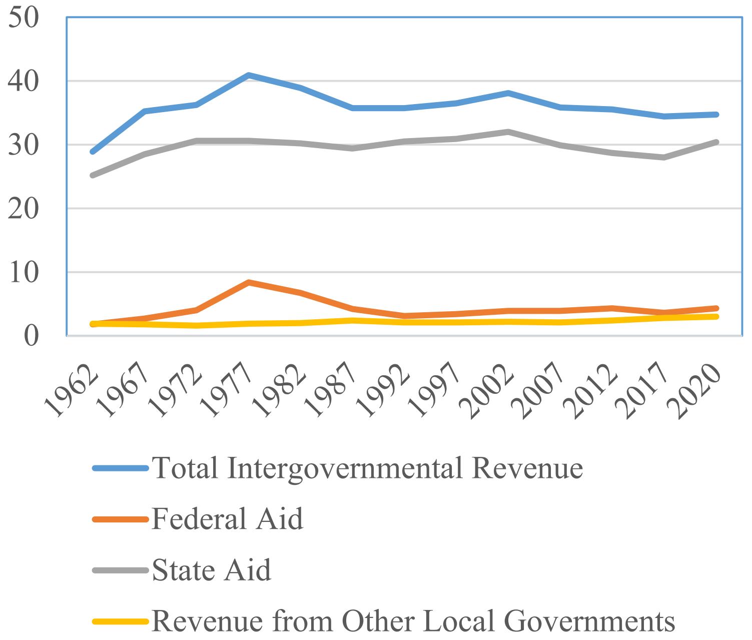
III. GENERAL TRENDS AND PATTERNS OF INTERGOVERNMENTAL REVENUE ACROSS ALL LOCAL GOVERNMENTS

Outside money or funding from other governments has always been an important source of revenue for local governments. Although local governments have usually depended on own-source revenue to supply about two-thirds of the money needed to provide myriad services and programs to their residents, these governments could not survive without the consistent infusion of money from outside sources. Simply put, money that local governments receive via federal and state aid and revenue derived from other local governments permit them to do things that they otherwise could not do with the limited amount of revenue they collect from their own-sources. Without access to IR, local governments would have but two choices if perchance this outside money were no longer available. One alternative would be to significantly cut back service levels and/or eliminate some services altogether. The other option would be to replace IR with an increased amount of own-source revenue; to do this,

however, would likely require local government officials to make the unpopular decision to raise taxes and user fee/charges, since an overwhelming amount of own-source is obtained from these two forms of revenue. Obviously, while both alternatives would be doable—if not necessary—from a budgetary standpoint, service cutbacks and/or higher taxes/charges/fees would be painful, unsettling, and politically and economically unpalatable. The only other possible way for local governments to survive a backlash from the public would be to practice what some scholar and practitioners have referred to as “doing more with less” (that is, adopting cost-efficient and cost-effective ways of doing business).

Just how important is the contribution that IR makes to the local government finances and efforts to balance the budget? Over the past 60 years, total IR supplied to local governments has accounted for, on average, a little more than one-third of the intergovernmental revenue (TR) of all local governments (see Figure 1). Moreover, this proportion has grown steadily over time. That is, while IR comprised around 29 percent of total local government TR in 1962, this proportion had reached 36 percent by 2012, although it had dropped slightly to 35 percent by 2020. Yet, the high-water mark for IR was in 1977 when it climbed to 41 percent in a period of double-digit inflation during the late 1970s of the Carter administration.

Figure 1: Intergovernmental Revenue for All Local Governments as a Proportion of Total Revenue (TR), 1962-2020



Further examination of Figure 1 reveals a number of other important trends and patterns for three types of IR. By far, state aid is the greatest source of IR for local governments.[1] Since 1962, state aid has accounted for at least one-fourth of local government TR. However, the state aid proportion of TR began to rise after 1962 (see Figure 1), and by the early part of the first decade of the 21st century, it represented well over one-third of these governments' TR (38 percent in 2002). This increase—but especially during the 1960s and early 1970s and then again between 1987 and 2002—is likely attributable to the concerted efforts of civic reformers who pushed for larger amounts of state aid while also lobbying for greater fiscal home rule authority for these governments.[2] After 2002, there was a visible decline in the state aid proportion that was caused by the fallout from the Great Recession. Simply

stated, state governments who were also left reeling in the aftermath of the sharpest downturn in the economy since the Great Depression were not in the financial position to provide customary levels of state aid to their local governments; in short, they were have serious difficulties in making ends meet due to experiencing a significant reduction in their own revenue. As a result, local governments found themselves caught in a financial dilemma aptly referred to by as "fend-for-yourself federalism" (Shannon 1987; Pagano and Hoene 2003, Benton 2018a).

Unlike state aid, federal grant-in-aid money has always been a relatively minor source of revenue for local governments, if viewed from a strict accountability perspective. In 1962, direct federal aid to local governments accounted for a little less that 2 percent of these governments' TR. Due to the proliferation of the federal grant-in-aid system during the mid-1960s and throughout the 1970s, the proportion of local government TR composed of direct federal aid more than quadrupled and reached a high of almost 9 percent in 1977. Much of this increase in federal aid was fueled by the Johnson administration's Great Society programs and the launching of the general and specific revenue sharing programs by the Nixon Program in the early 1970s. With his election to the presidency in 1980, Ronald Reagan (with the acquiescence, if not the outright support, of Congress) embarked on a concerted effort which minimally slowed down the growth in federal grant-in-aid programs and eventually transfer greater funding responsibility for many of them (for example, the old Aid to Families with Dependent Children and Food Stamp programs) to the states and their local governments with the ultimate goal to reduce the overall amount of federal aid (Benton 1986). Although he was not able to get either of his Big Swap proposals enacted by Congress, he nonetheless was successful in bringing about significant cuts in federal aid money flowing to state and localities

(Benton 1986, 1992). Consequently, the proportion of local government revenues deriving from federal aid began taping off noticeably by 1982 with the unveiling of the Reagan "Big Swap" programs and throughout the remainder of the Reagan presidency and continued through the duration of the George Herbert Walker Bush administration until it had reached around 3 percent by 1992 (Benton 1986, 1992) . The federal aid proportion of local government TR did begin to tick upward slightly to around 4 percent during the George W. Bush administration as a result of a congressional anti-recessionary fiscal bailout to state and local governments in 2003—that is, $10 billion for Medicaid and $10 billion in general revenue sharing money (see Benton 2007 and Scheppach and Hildreth 2012). The small rise in this proportion continued during the Obama administration due to efforts by Congress to stimulate the economy during the Great Recession with enactment of the American Recovery and Reinvestment Act (ARRA) in 2009. According the Scheppach and Hildreth (2012), the 2003 and 2009 fiscal relief packages, along with congressional enactment of the Patient Protection and Affordability Care Act (ACA) in 2010, are "clear harbingers for the future" and "'game changers' in the intergovernmental fiscal system," in that these events will require additional fiscal relief by the federal government every couple of years.

However, if a "follow the money" accounting of federal grant-in-aid money is used to determine the exact amount of federal dollars received by local governments, then there is likely to be an underestimation of the amount and hence percentage of local government TR that is derived from the federal government. Therefore, it is reasonable to argue that federal aid makes a larger contribution to local government coffers than meets to eye. The reason for this is that a lot of federal money initially goes to state governments which in turn must pass-on some of this money to their local governments per language embedded in congressional appropriate bills. In 2020, for example, we

know that state governments received 36 percent of their TR (that is, $828 billion) from the federal government. What we also know is that not all of this money was kept and spent directly by state governments, as an undetermined part of it had to be "passed on" to localities and thus effectively can be considered federal grant money received by local governments. Furthermore, some appropriation legislation is written in such a way so as to permit the states to use their discretion as to whether they wish to share a portion of their grant proceeds with their local governments. In sum, it is a certainty that local governments receive a larger proportion of their TR from the federal government than is captured in the figures revealed in Figure 1. But, how much more money local governments receive is subject to a lot of guessing and can only be determined on a grant by grant and state by state basis.

Revenue that local governments obtain from other local governments is relatively small in comparison to state and even federal financial assistance. Local governments (usually larger ones) have always provided a number of services to other local governments (typically smaller ones) on a contractual basis whenever economies of scale are not achievable on the part of the latter type governments. For instance, a smaller local government may realize that it is much cheaper to provide services such as police and fire protection, water supply, sewage disposal, solid waste management, libraries, recreation, housing of prisoners, and sending out tax and fees notices and collection the same. As such, contracting out to another government results in cost savings, thus permitting to them to spend more money on other services or even initiate the provision of newer services. In short, local governments can get the most utility for their limited fiscal resources.

Over the last 50 years, the proportion of TR that local governments receive from other local governments has changed very little. In 1962, local government revenue derived from other local governments constituted just

under 2 percent of revenue from all sources (TR). Over the next three decades, this proportion increased slowly until it reached 2.4 percent in 1987, only to decline to around 2 percent and remain at that level until 2007. By 2012, the proportion began to increase to 2.4 percent again and had reached 3.0 percent by 2020. Does this most recent increase suggest that local governments were more inclined to seek out opportunities to "sell" services as a means to augment own source and state aid revenues that had declined significantly during the Great Recession? That is probably not the case. At any rate, this trend is something that warrants carefully monitoring in the years ahead. With traditionally stable revenues shrinking and less reliable unstable and the historic unreliability of federal fiscal assistance due to politics in Washington, revenue that local governments could potentially derive from other governments could be vital to the solvency of some local governments.

These general trends and patterns in intergovernmental revenue notwithstanding, it is equally important to examine patterns and trends for state aid, federal aid, and revenue obtained from other local governments for each of the five types of local government.

IV. GENERAL TRENDS AND PATTERNS BY TYPE OF INTERGOVERNMENTAL REVENUE

An examination of state aid to counties, municipalities, townships, special districts, and school districts will be presented first, since the largest part of local government IR derives from this source.

1. State Aid

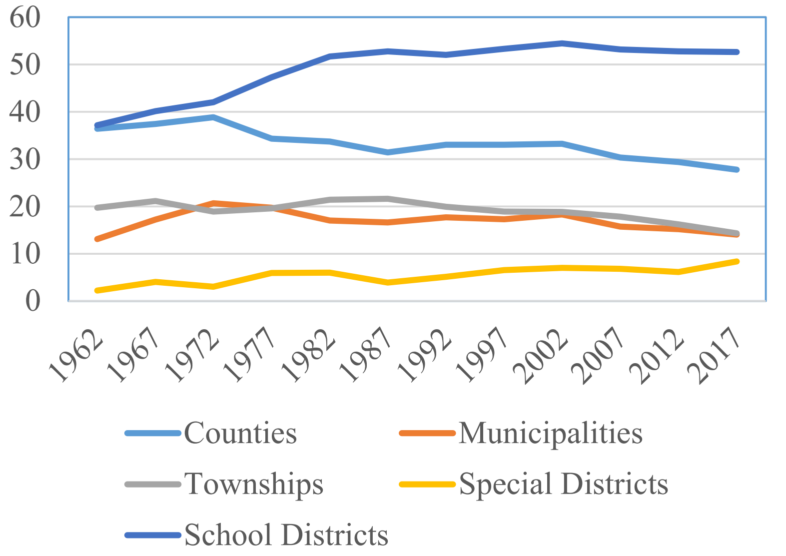
Among general purpose local governments (counties and municipalities) and even limited general-purpose governments (townships), county governments historically have received a larger proportion of their TR from

state aid than have municipalities and townships. This is as expected, given the rationale for states creating county governments and the service roles that they were expected to play. Technically speaking, counties or their equivalent (parishes in Louisiana and boroughs in Alaska) in 48 states (exceptions being Rhode Island and Alaska which have not had organized county governments since 1849 and 1958, respectively) are political and administrative subdivisions or arms of their states. In fact, county governments have been referred to as “branch” or “satellite” offices” of the states (see Benton 2002, 2009, 2024). The primary purpose for their establishment was to carry out or enforce state laws and administer state programs (registering people to vote, keeping track of births and deaths, recording legal documents like titles, deeds, and marriage licenses, and assessing property for tax purposes) or deliver state-level services (health care, public welfare, construction and maintenance of roads and bridges, operation of criminal and civil courts and provision of other judicial services, dissemination agricultural information, and enforcement of health and safety standards and codes) at the local level. Therefore, it is reasonable to predict that states would supply a considerable proportion of the funds necessary to carry out these service responsibilities that are often mandated (see Fisher and Bristle 2012).

From the data presented in Figure 2, it is evident that county governments have received around one-third of the TR from state aid over the last 50 years. In fact the state aid proportion was actually closer to 40 percent of these governments’ TR from the 1960s until about midway through the 1970s before tapering off to roughly the one-third level. This slight drop in this percentage is probably due to county governments (but especially, medium- to highly-populated and rapidly growing ones) having to depend more on revenue generated from own-sources (taxes and charges for services) to pay for the provision of more purely local (that is, municipal-type) services and less

state-mandated ("arm of the state") services being demanded by residents and businesses located in a more urban, densely populated setting (see Benton 2002). However, after the state aid proportion remained fairly stable for about the next 30 years, the proportion declined noticeably after 2002 (it dropped to around 30 percent by 2007 and to about 29 percent by 2012) and likely the result of the deleterious effects of the Great Recession. In short, state governments whose own revenue collections were suffering from the most significant downturn in the economy in the Great Depression of the 1930s were in no position to provide the level of state aid to local governments that they had provided in the past. And, with the lingering effects of the Great Recession continuing past 2010 as well as these governments beginning to experience the deleterious impact of the COVID-19-induced recession, many states were still not able to provide to same level of state aid to counties like they had done in the 1960s, 1970, 1980s, and 1990. This evident from Figure 2, where it can be seen that state aid as a proportion of TR had dropped just under 28 percent by 2017. While there are no more recent data available at this writing, it is reasonable to speculate that this proportion may have decreased further as a result of the full effect of the recession caused by the health pandemic began to take hold over the U.S. economy and the sudden surge in inflation that surfaced during the first few years of the 2020s.

Figure 2: State Aid to Individual Local Governments as a Percentage of Total Revenue (TR), 1962-2017



In looking again at Figure 2, it is clear that state aid has accounted for a much smaller percentage of municipal government TR than has been the case for county governments. In fact, the municipal proportion has averaged approximately one-half the size of what it has been for county governments. It never rose above about 21 percent (1977) and then declined somewhat until it began to increase slightly to 18 percent by 2002. However, as was seen with counties, the state aid proportion declined visibility as a result of the Great Recession and its aftermath, dropping to 16 percent by 2007 and to 15 percent by 2012 and even further to 14 percent by 2017. Like what was found with counties, it is likely that state aid as a proportion of municipal TR probably has decline more since 2017. The smaller state aid proportion for municipal governments can be explained by the fact that municipalities historically have not been assigned the kinds of extensive service responsibilities like health, welfare, roads, and courts that states have

given to their county governments. That is, municipal governments are more involved with the provision of optional local type services and less with mandated "arm of the state" kinds of services

While townships may fit the description of a more limited type of general purpose local governments, they however do provide a number of services that are more akin to those provided by both counties and municipalities (see Benton 2002). On the one hand, township governments serve to assist counties in the provision of some state level services at the local level (e.g., health care, public welfare, roads, and even some administrative and judicial functions). On the other hand, townships, more often than not, resemble municipalities in that they provide a number of services normally associated with municipalities (e.g., fire and police protection, utilities, libraries, snow removal, street repair and maintenance, protective inspections, parks and recreation, etc.). Therefore, it is not surprising to see from Figure 2 that the percentage of township TR obtained from their state governments, while falling somewhere between the levels received by counties and municipalities, tend to be closer to the typical county state aid proportion. The township state aid proportion basically ranges from 19 to 21 percent from 1962-2002, but like the proportion for counties and municipalities, the level of state fiscal assistance visibility declines after 2002, dripping to 16 percent by 2012 and to 14 percent by 2017. Here again, it appears that the Great Recession, the lingering effects of the Great Recession into the second decade of 21^{st} century, along with the initial impact of the COVID-19-induced recession were responsible for states' inability to provide a higher degree of monetary assistance to these type local governments as well.

Further examination of Figure 2 indicates that the state aid proportion of special district TR is the lowest among the five kinds of local governments. In 1962, state aid supplied only 2 percent of special districts' TR. This figure

had climbed to 6 percent by 2012 but had reached as high as 7 percent in the early part of the 21st century. Nevertheless, the special district state aid proportion of TR—like that for counties, municipalities, and townships—was negatively affected (although not as much so) by the Great Recession, as is evident from the data for 2007 and 2012 (slipping from 7 to 6 percent), although the state aid proportion did rise to a little more than 8 percent by 2017. Actually, special districts, for the most part, have never functioned as administrative arms of state government like counties (and thereby provided very few state-levels services) and can explain why they receive so little of their TR from their states. In point of fact, special districts are significantly more reliant on charges for services/fees, property taxes, and even federal aid for most of their TR.

In sharp contrast, school districts are the most dependent of all local governments when it comes to financial assistance from their states (see Figure 2). However, that has not always been the case. From 1962-1972, the proportion of school district TR derived from state aid was similar to what it was for county governments. But, as the data presented in Figure 2 suggest, the state aid proportion for school districts had begun to increase noticeably by the mid-1970s and then began to take an even sharper trajectory by the end of the 1970s and early 1980s and eventually peaking at around 55 percent in 2002. By 2012, state aid still accounted for almost 53 percent of school districts' TR and stayed at that level through 2017. In short, it appears that state governments, in spite of the hit they took from the Great Recession and the COVID-19-induced recession, remained steadfast in maintaining their financial support for public education and contrary to what we saw for counties, municipalities, townships, and to a lesser extent for special districts.

The findings for school districts are not at all surprising, since the provision of K-12 education as well as higher education opportunities has always been a long-standing

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state-local passion, undertaking, and partnership in the U.S. As part and parcel of this partnership, states anticipated that they would assist school districts in financing the cost of public education, since they had created school districts (like county governments) for the explicit purpose of providing a state-level service to citizens at the local level. Evidence of this is that spending for education over the years has consistently been the top expenditure priority for state governments. Moreover, the emphasis placed on education by both the states and their localities is certainly consistent with the American creed and value system that touts the availability of an affordable education as a fundamental right of every American and a likely pathway to a better life for everyone and his/her family (see Donovan, Mooney, and Smith 2009).

The abrupt rise in the state aid proportion of school districts' TR that occurred in the late mid- to late 1970s is not without a plausible explanation. From the outset, the public has viewed state aid to education as a positive thing for school districts because it would permit the state to address likely funding inequities that may exist between districts. That is, states would be able to devise state aid funding formulas in such a way as to allocate more money to those districts with less ability to generate adequate property tax revenues due to having lower real estate values. In other words, states could provide all districts with a minimum level of fiscal support but could also distribute varying amounts of additional aid to poor districts. Unfortunately, most states, however, did very little through the years to correct the funding inequities—indeed, gross disparities--that developed from the onset of public education until the 1970s. As a consequence of the unwillingness of most states to take corrective action inevitably led to a number of legal challenges. In the landmark case of *Serrano* v. *Priest* (1971), the California Supreme Court ruled that inequities in school district spending resulting from variations in taxable wealth were unconstitutional. Following *Serrano*, successful lawsuits

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were filed in most other states by plaintiffs seeking to have their states' own property tax-based systems declared unconstitutional as violating "equal protection" guarantees found in their state constitutions that are analogous to the U.S. Constitution's 14th Amendment. Subsequently, many states by the late 1970s began to substantially increase their financial assistance to school districts.

But as seen in the analysis of state aid to the other four types of local governments, it is also apparent from Figure 2 that the Great Recession had a profound impact of states' ability to and willingness to continue the same level of financial assistance to school districts as they had done in previous years. Consequently, there was a noticeable drop in the state aid proportion of school district TR after 2002. Moreover, additional data indicate that there has also been a very visible decline in school district's share of total state aid to all local governments from 56 percent in 2007 to 48 percent in 2020. None of this bodes well for local school districts' finances going forward.

2. Federal Aid

While federal fiscal aid has never been a major source of revenue for local governments, generally, or for any particular local government, federal fiscal assistance is still important to these governments as they attempt to balance their budgets while providing staple services to their constituents. Obviously, federal money permits local (like state) governments to do things and provide services that these governments' limited resources would not allow. By contrast, federal aid has been a vital source of revenue for state governments in the Post-World War Era. In 2012, federal aid supplied over 27 percent of states' TR. However, the figure had jumped to 36 percent by 2020 as a result of the huge infusion of new federal aid money from the ARRA and the American Rescue Plan Act in 2021 (ARPA), while, at its height in the mid- to late 1970**s**, it accounted for approximately one-third of states' TR.

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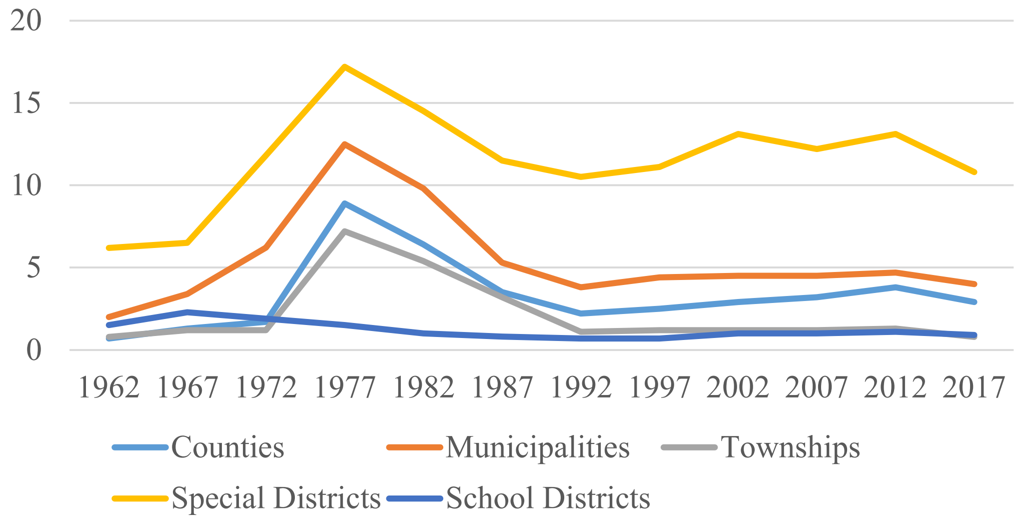
Ratification of the 16th Amendment in 1913 forever changed the face of fiscal federalism in the U.S. and resulted in the federal government being able to run a fairly hefty surplus which was used to create and expand a massive federal grant-in-aid system. As mentioned above, local governments, however, were not initial direct or major recipients of the federal government's newly-found largesse. Even 50 years after the creation of the first grant-in-aid programs, local governments still received only a small fraction of the amount of money available from the federal government. This small amount of direct federal aid money accounted for an average of around 2 percent of the TR of all local governments in the early 1960s.

Figure 3 breaks down the proportion of TR accounted for by federal aid by type of local government.

Figure 3: Federal Aid to Individual Local Governments as a Percentage of Total Revenue (TR), 1962-2017



The data located in the figure show a similar trends in the ups and downs of reliance on federal aid for the two general-purpose local governments (counties and municipalities) over, although the municipal proportion has always been higher. The federal aid proportion for both counties and municipalities grew rather slowly until the late 1960s (averaging around 1-2 percent for counties and about 3-4 percent for municipalities), until it shot upward as rapidly increasing amounts of federal grant money began to flow to state and local governments from the Johnson administration's Great Society programs and the Nixon's administration's general and specific revenue sharing initiative. But, by 1977 the federal proportion had risen to around 9 percent, while it had grown to nearly 13 percent for municipalities, only to begin declining steeply as the Reagan administration and Republicans sought deep cuts in federal aid. They were even joined by some Democrats in Congress when program evaluations of a number of grant-in-aid programs strongly suggested that there was a significant amount of waste and inefficiencies in the spending on federal money and little evidence that programs achieved their goals (i.e., programmatic effectiveness). In addition, many of the recipients of these programs were not effectively organized enough to maintain a consistent lobby presence in Washington. By the early part of the first decade of the 21st century, the federal aid proportion for counties had shrunk to around 3 percent for counties and 4 percent for municipalities. These proportions did rise only so slightly in the Great Recession to 4 and 5 percent, respectively, with the release of federal stimulus funding under the ARRA to counteract the significant downturn in the economy, only to drop to 3 percent for counties and 4 percent for municipalities by 2017. Chances are that these percentages continued to decline during the early days of the COVID-19 and even rise again by the later part of the health pandemic with the release of funds from federal ARPA. But we will have to wait to verify these assumptions until financial data from the 2022 Census of Government report become available.

Another look at Figure 3 reveals a somewhat similar pattern for limited general-purpose governments—townships--except the federal aid proportion of these governments' TR is lower and closer to that for county government and even "flat lines" after 1992. Moreover, it is evident from the trend line in Figure 3 that very little federal stimulus during the Great Recession was channeled to townships.

` It is also clear form Figure 3 that school districts have never counted on federal aid to supply more than a very tiny proportion of the their TR between 1962 and 2002. Since 1982, the federal aid proportion of school districts' TR has been no more than 1 percent and usually less. The only time over the last 50 years that the federal aid proportion rose even slight was in the aftermath of the Elementary and Secondary Education Act of 1962 and the beginning of federal funding for free lunch programs during the mid-1960s.

Perhaps the most intriguing finding to emerge from Figure 3 is the degree to which special districts depend on federal aid. Even as early as 1962, special districts were receiving a larger proportion of their TR from federal grants-in-aid than were even counties, municipalities, and townships, and, of course, school districts. Similar to what was detected for municipalities, the federal aid proportion of special districts' TR began to steadily increase by the mid-1960s and peaked around the mid-1970s at about 17 percent, thus coinciding with the proliferation of federal grants during the Johnson administration and the advent of revenue sharing during the Nixon administration.[3] But, with the approach of the end of the 1970s, this proportion began to decrease due to an economy rocked by double-digit inflation and the Reagan administration's concerted efforts to achieve significant cuts in both the number of and amount of money flowing through federal grants-in-aid. Moreover, revenue sharing came to an end in 1988. By

1992, the federal aid proportion had dropped to close to 10 percent. Nonetheless, the federal aid proportion began to rise again during the George W. Bush administration, and Bush himself has been portrayed as an "uncharacteristic Republican" and "a big spending conservative" (Benton 2007). Finally, it can be seen that there was another slight increase in the federal aid proportion after 2007 which resulted from the ARRA during the Great Recession.

Given the programmatic purposes for which federal aid usually has been spent by special districts, it is important to take a closer look at the kinds of special districts that receive this money and the circumstances under which these governments were created. The fact of the matter is that quite a number of special districts have been established by states upon the urging of general purpose local governments—that is, counties and municipalities—and their residents. Why do these counties and municipalities want and/or need special districts? Simply stated, municipalities and counties have been greatly challenged in efforts to deal with increasing poverty, an aging and inadequate housing stock, deteriorating infrastructure and neighborhoods, unavailability of a potable water supply and safe sewage disposal, and traffic gridlock, among other things. Yet, these governments' needs are greatly surpassed by their monetary resources at their disposal, while their state legislatures historically have not empathized with their sometimes dire situations and therefore have not been willing to provide sufficient amounts of state aid.

From this perspective, it is reasonable to conclude that much of the federal money that flows to special districts eventually ends up being "additional" federal aid for local governments albeit somewhat through a proverbial "backdoor." It is almost like a "bonus" kind of federal aid to cities and counties. That is, the federal money helps to finance the provision of services for which residents of counties and municipalities receive (for example, public

housing, urban renewal and redevelopment, replacement of decaying infrastructure, mass transit, safe water supply and sewage disposal, anti-poverty programs, etc.) but for which these governments do not have the resources to directly pay for. In short, the receipt of federal fiscal assistance can be viewed as an indirect type of federal aid to the nation's two types of general-purpose local governments.

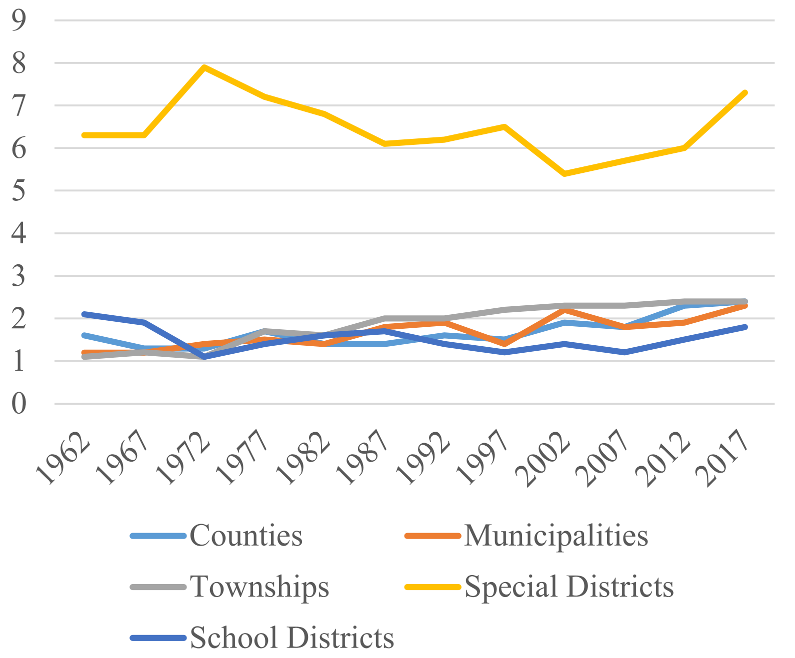
It addition to entertaining the possibility that an indefinite amount of federal aid allotted to special districts is just an indirect form of aid to county and municipal governments, it is also important to keep in mind that an undetermined amount of federal aid received by the states eventually finds its way to local government, as a result of congressional language that stipulates that some of this money must be "passed-through" to the local level.

3. Revenue from Other Local Governments

Strickly speaking, of course, revenue received by one local government from another local governments is not the same as a grant-in-aid, whereby one government (usually higher level) is providing financial assistance to another government (usually lower level). Whenever a government reports the receipt of revenue from another local government, it is usually a payment of sorts for the rendering of services by the former to the latter. For instance, it is not uncommon for local governments (but especially, municipalities) to provide water and sewer service, police or fire protection, solid waste collection and disposal, parks and recreation services, maintenance of vehicles, buildings, and other facilities, planning and zoning expertise, payroll and other administrative functions, libraries, just to mention a few. Simply put, the revenue that one local government derives from another local government serves to augment the fiscal resources of the providing government so that it may become less dependent on revenue received from one's own sources as well as federal and state aid.

Figure 4 displays data on the degree to which various local governments take advantage of this alternative source of revenue that can be best describe as being entrepreneurial. These data show that this form of intergovernmental revenue supplies, at best, a very small proportion of local governments' TR. This is especially true for four of the five types of local governments (the exception being special districts).

Figure 4: Revenue from Other Local Governments for Individual Local Governments as a Percentage of Total Revenue (TR), 1962-2017



Although varying somewhat, revenue proceeds from other local governments provided anywhere from 1 to 2.5 percent of the TR for counties, municipalities, townships, and school districts between 1962 and 2017. In most cases, the revenue from other local governments was comparable

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to the proportion that these local governments received in the form of federal aid. Upon closer examination, the other local government revenue proportion was slightly higher for counties and municipalities

Again, it was somewhat interesting to find that special districts were receiving a larger proportion of their TR from other local governments. Over time, revenue received from other local governments has constituted around 6 percent of these governments' TR, although this proportion ranged upward to around 8 percent during the late 1960s and early 1970s. Given that counties and especially municipalities have a long history of providing services such as water supply, sewer disposal, fire suppression, police protection, parks and recreation, protective inspections, and various financial and administrations functions, one would think that they would derive a larger proportion of their TR from other local governments. One possible explanation for special districts being more successful in collecting a larger proportion of their TR from revenue from other local governments is that they may possess the expertise or experience to provide a service that a city or county views as a burdensome albeit mandated functional responsibility. Good examples could include: managing public housing projects, overseeing urban renewal and redevelopment projects, having responsibility for anti-poverty programs, operating airports, transit systems, marinas, and sports facilities, running hospitals and out-patient medical facilities, among others.

One would think that during times of a troubled economy or dwindling revenue due to purely indigenous factors (depressed local economy, increasing levels of poverty, exodus of more affluent and educated residents and businesses, rising crime rates, undesirable place to live, climate, etc.) local governments would take advantage of any existing opportunities to bring in additional revenue to replace lost dollars from previously reliable revenue sources or even

become creative in developing and nurturing money-making opportunities. But, maybe those opportunities do not exist in some areas and therefore is not necessarily a situation of "missing the boat." Or, it may be the case that opportunities are available to contract with other local governments to provide services, but the ability to make a reasonable profit is not feasible or worth the administrative effort or may pose the possibility of opening up the government to civil liability.

V. IMPLICATIONS AND DISCUSSION

Based on the trends and patterns in fiscal federalism reported in this paper, what does the future portend for local governments or what should they be doing differently? In a nutshell, it would appear that the future for state aid is problematic, while the future for federal aid appears less problematic but will always be subject to a degree of uncertainty given the ever-changing political winds in Washington. As for local governments tapping the potential for deriving more revenue from other local governments, it would seem that this alternative source of revenue is yet to gain much momentum in spite of its potential to produce much-needed additional revenue.

1. Federal Aid

While time seems to have confirmed that some kind of federal aid has become a semi-guaranteed fixture or institutionalized feature of fiscal federalism, it will likely be a source of revenue for both local government and their states for the foreseeable future. However, with that said, itis reasonable to speculate that federal aid will continue to constitute only a small proportion of most local governments' TR—probably somewhere in the 2-3 percent range for counties, municipalities, and townships; somewhat more (5-6 percent) for special districts; and 1 percent or less for school districts. While it would be very far-fetched to think that the federal government would

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completely terminate fiscal assistance to state and local governments, it is certainly possible that there could be future reductions in the number of grant programs or a consolidation of some grants into block grants and even overall cuts in monetary allocations such as occurred during the Reagan administration. Early on, the Trump administration indicated a desire to cut funding for some grant programs (e.g., Community Development Block Grants), as well as for several long-standing anti-poverty programs.

If history gives us a glimpse into the future as it usually does, then two things seems relatively certain and easy to predict about federal aid. First, support for federal fiscal assistance to sub-national governments is likely to vacillate depending on the philosophical, ideological, and political temperament in Washington. In other words, there will always be debates over the merits and drawbacks of federal grants-in-aid, in general, and support or opposition to certain grants, in particular. Second, the federal government can probably be counted on to do what it has typically done over the years during significant downturns in the economy regardless as to which political parties controls the White House and Congress. That is, temporary, emergency money is likely to be appropriated and dispersed to state and local government, as has been the case in the past on a number of occasions (most recently with ARRA funding during the Obama administration), to assist these governments.

2. State Aid

Given a preliminary assessment of state aid revenue receipts for the period of time that coincides with the Great Recession and its aftermath, there is ample reason for local government officials to be concerned about the future of fiscal assistance obtained from their parent governments going forward. In fact, some scholars (Benton 2018, 2019, 2024; Fisher and Bristle 2012) envision a very troublesome

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scenario where local governments could see some permanent or near-permanent reductions in state aid in both the near and far future. As was visible from the earlier analysis of trends and patterns in state aid, the Great Recession was a period of decline in the largest source of intergovernmental revenue for all five local governments, but particularly for counties, municipalities, townships, and school districts. Drops in state aid were noticeable at the very outset of the Great Recession (2007) for four of five types of local governments and continued through 2017 (the exception being special service districts. Data for 2022, which are not yet available, will be vital in determining if the negative impact of the Great Recession combine with the recession caused by COVID-19 and spiraling inflation in 2022-2024 had on state aid on local governments. However, there is some credible anecdotal evidence to suggest that state aid is still lagging behind pre-recessionary levels in a number of states for a large number of local governments (see Fisher and Wassmer 2012, Gordon 2012a, 2012b, Benton 2024).

If the trends and patterns seen in the earlier analysis become permanent fixtures and/or become an integral part of what some scholars (Martin, Levey, and Cawley 2012) have referred to as the "New Normal," this could foreshadow a bleak future for state aid to local governments. What the Great Recession and the COVID-19-induced recession vividly taught—if not, reminded us of—is that state governments, like their local governments are also experiencing several fiscal dislocation and stress and find out very quickly that they do not have enough money to fund their programs and balance their budgets. Consequently, their first reaction is to find ways to reduce their own expenditures, but usually at the top of the list is to cut financial assistance to the states.[4] A good example of this was when a fiscally-conservative and Republican-controlled Florida state legislature and Republican Governor Rick Scott in 2018 cut state aid in the wake of the

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dire need for more resources for[1] county government clerks of the circuit and county courts to handle additional state-related functions and[2] school districts that have been mandated to have a police officer in every K-12 classroom. Adding to the financial problems of state governments is the reality that they will have to significant increase their portion of funding for Medicaid. All of this makes for a bleaker picture for a return to pre-Great Recession era levels of state aid.

If this scenario persists well beyond the end of the Great Recession and the recession that accompanied the health pandemic, then there is a very real possibility for a permanent or near-permanent realization of what Shannon (1987) and others (Pagano and Hoene, 2003; Benton 2018a, 2024) labeled "fend-for-yourself federalism" and none of this bodes well for the finances of local governments and their ability to stay afloat financially without significant cuts in programs and services and/or

[1] Another way to conceptualize the importance of state aid to local governments is to calculate the proportion of IR that is accounted for by revenue received from one's state government. In 1962, state aid amounted to 94 percent of local governments' IR but declined steadily until the early 1980s (it was 81 percent in 1982) perhaps due to the greater availability of federal aid during this period (see Figure A1 in the Appendix). By 1982, the state aid proportion of IR had begun to climb again until the early part of the 21st century (when it reached a high of 89 percent) and likely the result of a robust economy for most of this time. By 2007, there were clear signs of a faltering economy (Great Recession), as the state aid percentage of IR dropped to 86 percent and declined even further to 83 percent by 2012 and dropped further to 82 percent by 2017. It will be interesting to see what the state proportion was in 2022 when these data become available.

[2] Illinois is a good example of this influence (see Banowitz and Kelty 1983; Banowitz 2002; Benton 2018c).

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increases in taxes (primarily property) or charges for services/user fees.

3. Revenue from Other Local Governments

Based on past and current trends and patterns for local governments' efforts and success to obtain additional revenue by providing services to other local governments, this possibility for bringing in more money to supplement local government coffers does not appear promising going forward. This is spite of anecdotal reports during the Great Recession and even during earlier recessionary periods that local governments had explored opportunities to bring in extra money so as to be able to stretch their budget and do more in the way of service provision[3]. However, as speculated earlier, it may be the case that in the final analysis such efforts do not result an appreciate amount of revenue when taking into consideration the "overhead" cost of contracting with other local governments for the provision of services. In other words, the "bottom line" or "profit margin" may not be lucrative enough to warrant such efforts, although intuitively it may seem like a good idea for bringing in supplemental funding to support the government's operations.

[3] This period marked the only time that the national government engaged in a conscious effect to specifically target local governments for federal monetary assistance as contrasted with the usual pattern of providing most federal aid to the states, with the expectation that they would or could share some of it with their local governments. However, the effort to circumvent states that were not attentive to their local governments' was short-lived, as state interests lobbied Congress successfully to resume the old pattern by stressing local governments were more likely to waste or mismanage the money they received from the federal government.

VI. CONCLUSIONS AND FUTURE RESEARCH

Understanding and explaining the underlying reasons for the evolving patterns and trends in intergovernmental fiscal relations is of continuing interest and importance to scholars for theory building purposes and to practitioners for helping in making policy decisions. The citizenry could benefit from knowing how their local governments raise and spend the large sums of money required to provide a large menu of services as well as understanding the advantages and disadvantages of receiving IGR. Therefore, where does this line of research go from here?

First, it would be instructive to identify state and federal aid patterns as well as trends in revenue received from other local governments for counties, municipalities, townships, special districts, and school districts on a state-by-state basis. Better stated, attention should be devoted to pinpointing local governments that differ markedly from the mean with respect to dependency on state and federal aid and as well as to the ability (success or failure) to amass additional revenue from other local governments. It would also be useful to know if the larger jurisdictions collect more revenue from other local government, thus suggesting that larger governments are better equipped and have the capacity to provide contracted kinds of services.

Second, and as a follow-up to the first task, it would be helpful to theorize about what factors might explain variability among local governments with respect to the receipt of state and federal aid and revenue from other local governments. This would produce a regression model suitable for testing. Two logical dependent variables would be operationalized as the incidence of and change in the proportion of a local government's total revenue (TR) that is attributable to state and federal aid and revenue derived from other local governments between 1962 and 2017 and beyond whenever additional data become available. Based on our theorizing about plausible causes of change, the

time frame of the dependent may look at shorter intervals of time. Possible independent variables would include but not limited to: state-level partisanship and ideology; political culture; personal income, education, and ethnicity of the citizenry; degree of centralization/decentralization of state administration; historical partisanship of the legislature; GINI Index, percent of local government budget spent on mandated services versus optional services; degree of home rule permitted by the state; and percent of local government revenue received from the federal government. Separate regression models would be constructed for each of the five types of local government.

Finally, it would be critical to make sure that any findings be evaluated in the context of the possible impact of the Great Recession and the COVID-19-induced recession in both the short- and long-term to determine if a New Normal has resulted, thus portending a permanently altered trend in revenue expectations for all five types of local governments[4].

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[4] In addition, states may even mandate local government to perform functions previously performed by the state and also pay for the cost of doing so.

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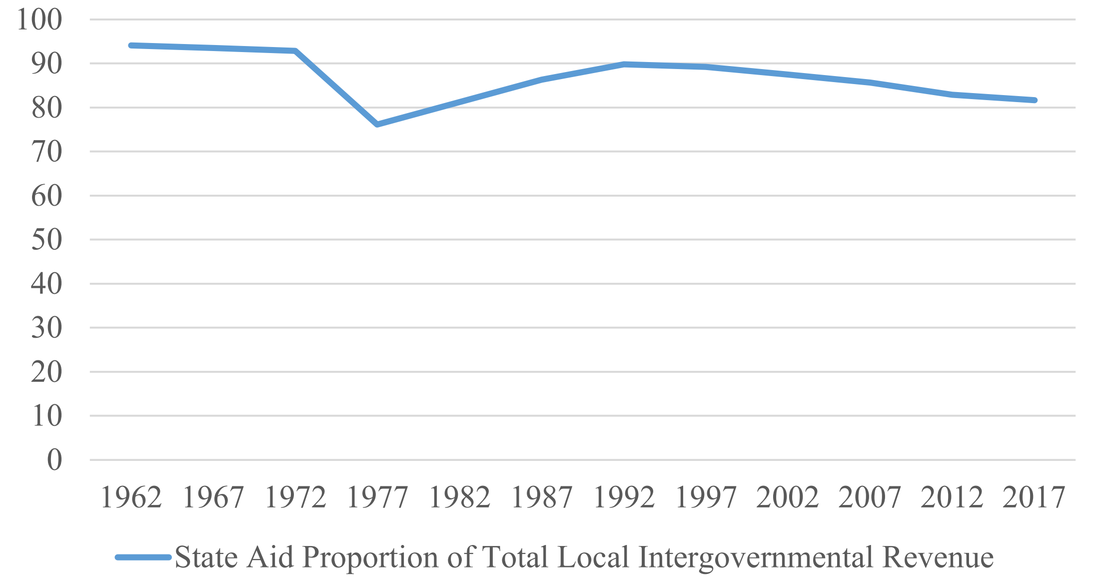
Appendix

Figure A1: State Aid as a Percentage of Total Local Intergovernmental Revenue

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