

CITIES AND STATE FISCAL STRUCTURE 2015:

A COMPARATIVE ASSESSMENT OF STATE AND LOCAL FISCAL SYSTEMS

The fiscal systems of cities are defined by the states in which they are located. These systems can create an environment that either allows municipalities to fund their share of resident needs and to thrive economically, or constrains the ability of cities to balance budgets and deliver basic services.

The latest *Cities and State Fiscal Structures* report, provided by the National League of Cities' Center for City Solutions and Applied Research, examines how the key components of these systems (fiscal authority, revenue reliance/capacity, state aid, and tax and expenditure limitations) are structured across states.

1. Fiscal Authority: Municipal fiscal authority is a city's access to general taxes on sales, income, and property. We rate municipalities as having authority if they have an option to levy the tax, local option to control the tax rate (within some increment; they have some ability to shift the rate), and if the revenues are for general use (e.g., not earmarked for specific uses). No state uniformly authorizes its municipalities to utilize all three tax sources.

2. Revenue Reliance and Capacity: Municipal revenue reliance is the proportion of revenues that a municipality generates from its own sources for general use. It determines whether a city's fiscal policy decisions

can impact its fiscal direction. We examine the share of general fund revenues derived from local sources, including major taxes (property, sales, income), fees and charges (since fees and charges are usually set locally). On average, U.S. municipalities derive approximately 71 percent of their general fund revenues from own-source revenues, including 24 percent from property taxes, 13 percent from sales taxes, 3 percent from income taxes and 32 percent from fees and charges.

3. State Aid: State aid is the share of general revenue from state sources. On average, state aid makes up 17 percent of city general fund revenues.

4. Tax And Expenditure Limits: Voter- or state-imposed (constitutional



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or statutory) tax and expenditure limitations (TEs) require that local governments tax or spend according to state regulations. There are two types of TEs that we examine those that constrain the property tax in particular and those that constrain overall revenue spending increases. Currently, 41 states impose some form of a TEL on their municipalities.

SUMMARY

With these criteria in mind, several states stand out as “ahead of the pack,” or provide their cities with a greater degree of local authority than other states.

Alabama and Missouri both provide some municipalities with a higher level of local authority, namely by allowing Alabama municipalities and Missouri’s two largest municipalities authorization to levy an income tax in addition to the local property and sales tax. More local authority is, however, offset by low levels of state aid relative to other states and, for Missouri, a potentially binding TEL also figures into the mix.

New York and Pennsylvania also appear to be ahead of the pack. Although New York has a potentially binding TEL, the state does provide additional local authority to a significant sector of the state’s population through granting New York City and Yonkers the authority to levy income taxes. Similarly, Pennsylvania provides some additional local authority through the sales tax provided to Philadelphia (no other municipality in the state is permitted to levy a sales tax), its state aid level is particularly high, but it has a potentially binding TEL.

Due to their broad-based tax bases, municipalities in Ohio, Kentucky, and Washington are placed in the “ahead of the pack” category as well. Moreover, even though all three operate under “potentially binding” property tax limitations, the effect is in large part mitigated by the broad tax base. In this regard, municipalities in these states are less likely to adjust tax or assessment issues because the tax bases are flexible and broad. Municipalities in states whose tax bases are narrow might be inclined to adjust their revenues by tinkering with the property tax system; the municipalities in these three states have more options. Hence, we place them in the “ahead of the pack” group.

Our assessment of “behind the pack” municipalities places considerable

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weight on local authority and reliance in combination with low ratings on one of the other factors. For example, a group of states are characterized by low authority and reliance in combination with a potentially binding TEL (Idaho, Maine, Massachusetts, New Jersey, and Rhode Island). Another set of states are characterized by low levels of authority, reliance, and state aid (North Carolina, Oregon), or low levels of authority, reliance, and capacity (Connecticut and New Hampshire). West Virginia perhaps has the most constrained combination, with low levels of authority, reliance, state aid, and the presence of a potentially binding TEL.

CONCLUSION

Compared with the 2008 analysis of cities and state fiscal structures, the lack of change in each of the four structure components is striking given radical economic shifts that have ensued, but not wholly unexpected. Local fiscal health remains below pre-recession levels despite burgeoning broader economic recovery in part because authorization of more local revenue authority and other enhanced capacity measures to allow cities to leverage local economic vitality are rare.

The full Cities and State Fiscal Structures report can be viewed at

file:///H:/Review,%20Misc,%20Board%20and%20Article-Photos/Misc/NLC_CSFS_Report_WEB.PDF.

The previous analysis conducted in 2008 can be viewed at <http://www.nlc.org/Documents/Find%20City%20Solutions/Research%20Innovation/Finance/cities-state-fiscal-structure-2008-rpt.pdf>. □

This summary article was reprinted from the National League of Cities' website at <http://www.nlc.org/find-city-solutions/city-solutions-and-applied-research/finance/cities-and-state-fiscal-structure>.