

# FINANCING STATE AND LOCAL GOVERNMENTS

FOURTH EDITION

J. Richard Aronson and John L. Hilley



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# Financing State and Local Governments

*Fourth Edition*

J. RICHARD ARONSON  
JOHN L. HILLEY

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*To Judith Libby Aronson*

J.R.A.

*In honor of my mother, Dorothy Myers Hilley,  
and in memory of my father, William Allen Hilley*

J.H.

# Foreword

STATE AND LOCAL finances have expanded remarkably over the last forty years. The expenditures of state and local governments have increased at a higher average annual rate than either the gross national product or the expenditures of the federal government. The corresponding and necessary increases in state and local revenues have been made possible by higher property and sales taxes, greater reliance on income taxes, sharply increased debt, and federal grants-in-aid. Perhaps the most dramatic changes have occurred in the fiscal relations among the three levels of government.

This edition of *Financing State and Local Governments*, like its predecessors, examines the incidence of the major state and local taxes and assesses the capacity of state and local governments to carry their debt burdens. It documents recent trends and forces that have been influencing state and local governments. Expenditure growth of state and local governments has slowed; the federal government has cut back on the level of its grant-in-aid programs; and the tax limitation movement has nudged the local revenue structure toward increased reliance on fees and user charges. This edition also includes a new chapter on financing education and expanded analyses of debt finance, the financing of state and local pension plans, and the state corporate income tax.

The author of the first edition of *Financing State and Local Governments*, published in 1965, was James A. Maxwell of Clark University. Professor Maxwell revised the book in 1969 and, before he died in 1975, he and J. Richard Aronson of Lehigh University revised it again for an edition published in 1977. This fourth edition still bears the mark of Maxwell's remarkable understanding of government finance. Yet much has changed since 1975, and this revision contains a significant amount of new material.

This volume is the twenty-second in the Brookings Studies in Government Finance second series, which is devoted to examining issues in taxation and public expenditure policy. Work on the project as part of the



Brookings Economic Studies program was initiated under the guidance of Joseph A. Pechman and completed under Alice M. Rivlin. J. Richard Aronson is William L. Clayton Professor of Economics and director of the Fairchild-Martindale Center for the Study of Private Enterprise at Lehigh University, in Bethlehem, Pennsylvania. John Hilley is senior economist for fiscal and monetary affairs of the U.S. Senate Committee on the Budget.

The authors wish to thank several people who helped produce this volume. The editor was Alice M. Carroll, who also edited the second and third editions. Her understanding of the style and substance of the volume was a great help in preserving its original intent—to present a broad, factual overview of state and local finance. Asuman Baskan of Lehigh University provided excellent research assistance, and Carolyn A. Rutsch of Brookings checked the accuracy of the data. The manuscript was typed by Diane Steele at Lehigh University and by Anne Willis and Michelle Adams in Washington.

The views expressed here are the authors' alone and should not be ascribed to the persons whose assistance is acknowledged, to Lehigh University, to the Senate Budget Committee, or to the trustees, officers, or staff members of the Brookings Institution.

BRUCE K. MAC LAURY  
*President*

*April 1986*  
*Washington, D.C.*

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# Introduction

WHICH LEVEL of government, the federal or the state and local, bears major responsibility for providing civilian (nondefense) services in the United States? The answer is state and local, and by a considerable margin. In fact, when it comes to civilian services, state and local governments together spend more than two and one-half times as much as the federal government. Education, roads, welfare, public health, hospitals, police, sanitation are primarily state and local responsibilities, and their cost falls mainly on state and local sources of revenue.

A great surge of state and local activity began after World War II. Spending on their functions had been reduced or postponed during the war and the Great Depression that preceded it. With the end of war, both the need and the desire grew to expand and improve the nation's capital and social infrastructure. For many years the increase in state and local spending was unambiguous. Whether spending was measured in nominal terms or on an inflation-adjusted basis, in per capita terms or in relation to gross national product, the rising trend was clear. But between 1978 and 1982 per capita state-local spending in constant-dollar terms actually declined and, in 1984, real per capita expenditure had almost reached the level of 1978. Will state and local expenditures resume their upward trend or have new public priorities been established? This is one of the main concerns of this book.

What governmental functions are mainly state and local? Education is the single most important responsibility of state and local governments, but in recent years spending growth has slowed and education expenditure now claims a smaller share of the gross national product than in the 1970s. On the other hand, government spending on public welfare and health has exploded, growing more rapidly than either total state and local expenditures or the GNP. Also, the aged have become a larger proportion of the population and continuing advances in medicine have lengthened lives and enlarged the range of treatments. This has resulted in relatively large increases in expenditures on health and hospitals.