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Intergovernmental Fiscal Relations

PAD 642

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Concepts

- Intergovernmental fiscal relations: the way responsibilities and financial resources are divided and shared among federal, state, and local governments.
  - Who provides public services (e.g., education, transportation)
  - Who raises revenues (tax authority)
  - How funds are transferred across levels (grants and aid)
- Fiscal decentralization: the transfer of expenditure responsibilities, revenue authority, or both from higher to lower levels of government.
  - Aims to improve efficiency, responsiveness, and local accountability
  - May also create challenges such as inequality across jurisdictions and coordination issues
- US context: highly decentralized on spending (e.g. education, health, etc.), but less decentralized on revenue, which is why intergovernmental transfers (federal and state aid) are so important.

US context: three levels of governments

- Three levels of government:
  - Federal government (1)
  - State governments (50)
  - Local governments (tens of thousands: counties, cities, towns, villages, school districts, special districts)
- Federalism: In the U.S., governments operate within a federal system in which power is shared between the federal government and the 50 states. States have sovereign status and are constitutionally independent within the division of powers established by the U.S. Constitution.
- Division of powers: What powers belong to the federal government versus the states? What happens if the federal government overreaches its authority? Disputes are typically resolved through the courts (judicial review).
- Local governments: Local governments are “creatures of the state,” meaning they are created by state governments and receive their powers and responsibilities from state law.

Principles of intergovernmental fiscal relations (1)

- Principles of intergovernmental fiscal relations help determine which level of government should be responsible for providing services, raising revenues, and how fiscal transfers should be designed and allocated across levels of government.
- Efficiency
  - Economies of scale: Public services should be provided by the level of government that can deliver them most efficiently at the lowest cost
    - Example: public health surveillance, Medicaid administration
  - Coordination costs: Some functions require coordination across jurisdictions, which may justify involvement by higher levels of government or intergovernmental cooperation.
    - Example: transportation, environmental policy, economic development
  - Externalities (spillovers): When the benefits or costs of a service extend beyond one jurisdiction, higher-level governments may intervene to ensure appropriate provision and funding.
    - Example: federal funding for pollution control to address air or water pollution that crosses state boundaries

Principles of intergovernmental fiscal relations (2)

- Capacity: Refers to the ability of a level of government to effectively raise revenues, manage resources, and deliver public services.
  - Responsiveness to local preferences: Local governments are often better able to tailor services to reflect local needs and priorities.
    - Example: A city may adjust policing, parks, or zoning policies based on residents' preferences.
  - Accountability: Are there mechanisms (e.g., elections, audits, transparency requirements) to hold local governments accountable for their decisions and performance?
    - Example: Local school boards are accountable to voters for school budgets and performance.
  - Administrative capacity: Do local governments have sufficient management skills, staff, and technical expertise to effectively deliver services?
    - Example: A large county may have the staff capacity to administer public health programs, while a small town may not.

Principles of intergovernmental fiscal relations (3)

- Equity: Ensures that public services and fiscal resources are distributed fairly across jurisdictions, regardless of differences in income, wealth, or location.
  - Vertical fiscal imbalance: Refers to the mismatch between the revenue-raising capacity and expenditure responsibilities across levels of government.
    - Example: The federal government raises more revenue (e.g., income taxes), while states and localities bear significant spending responsibilities (e.g., education, infrastructure), requiring intergovernmental transfers.
  - Horizontal fiscal imbalance: Differences in income, wealth, and tax base lead to unequal fiscal capacity across state and local governments.
    - Example: Wealthier jurisdictions can raise more revenue from property taxes than poorer areas, leading to disparities in public services such as school funding.

Intergovernmental assistance

- Intergovernmental assistance refers to financial transfers from federal or state governments to lower levels of government to support service delivery, address fiscal imbalances, and achieve national or state policy goals.
- State aid to local governments
  - Education: especially K–12 school aid
  - Health and social services: including welfare, public assistance, and local service programs
  - Transportation and infrastructure: roads, bridges, transit, and local capital projects
- Federal aid to states and localities
  - Health: especially Medicaid
  - Income security: SNAP, TANF, housing assistance, unemployment-related programs
  - Education: special education, higher education support
  - Transportation and infrastructure: highways, transit, airports, water infrastructure

Patterns of interaction among levels of gGovernment

- Intergovernmental assistance
  - Funds are transferred to state or local governments, which then administer programs or provide services.
  - State aid to local governments: education, social services, transportation.
  - Federal aid to states and localities: Medicaid, education, transportation, income security programs.
- Direct expenditures and taxes
  - Federal and state governments directly tax and spend within state and local jurisdictions.
  - Funds go directly to individuals, businesses, employees, contractors, or projects.
  - Examples: Social Security payments, federal employee salaries, defense spending, infrastructure projects, contracts with private firms.
- Key distinction: Direct spending bypasses state/local governments; intergovernmental aid flows through them.

Grant characteristics

- Fiscal assistance or aid: general term for intergovernmental financial transfers
- Grants: structured programs within aid, with rules and conditions
- Varied purposes: Grants support a wide range of policy areas (e.g., education, health, infrastructure).
- Recipients: Can go to state and local governments, nonprofits, institutions, or individuals.
- Eligibility criteria: Recipients must meet specified requirements (e.g., income levels, population, program compliance).
- https://www.grants.gov/

Types of grants

- Formula grants: Funds allocated based on predetermined formulas (e.g., population, poverty rates); predictable and stable.
- Competitive (discretionary) grants: Awarded based on applications and evaluation; funding goes to proposals that best meet program goals.
- Matching grants: Require recipients to contribute their own funds to receive grant support, often to encourage local investment or shared responsibility.
- Grants with conditions: Require recipients to follow specific rules or policy requirements, such as reporting standards, eligibility rules, or maintenance-of-effort requirements.

Types of Fiscal Assistance

- Revenue sharing: Transfers from higher levels of government to lower levels with minimal restrictions on use.
  - Purpose: Supports general government functions and local priorities with high discretion (less common today in the U.S. federal system).
  - Examples: some state aid programs that provide unrestricted funds to local governments.
- Block grants: Provide broader funding for general policy areas (e.g., health, community development); offer greater flexibility to state/local governments.
  - Examples: Community Development Block Grant (CDBG), Social Services Block Grant (SSBG).
- Categorical grants: Funds must be used for specific, narrowly defined purposes; often include detailed federal requirements and oversight.
  - Examples: Medicaid, Title I education funding (for schools with disadvantaged students)

Types of Fiscal Assistance: Federal–State vs. State–Local

- From federal to state & local governments
  - Categorical grants (most common):Targeted funding with specific requirements (e.g., Medicaid, Title I education, transportation grants, SNAP administration)
  - Block grants (less common): Broader policy areas with more flexibility(e.g., CDBG, TANF, Social Services Block Grant)
  - Revenue sharing (rare today): largely discontinued at the federal level.
- From state to local governments
  - Categorical aid (very common): Restricted funding for specific services(e.g., K–12 education aid, transportation, public safety)
  - Formula-based aid (very common): Distributed based on factors like population, need, or fiscal capacity(e.g., school aid formulas based on enrollment, property wealth, poverty)
  - Flexible/block-type aid (less formal): Some programs allow broader local discretion
  - Revenue sharing / unrestricted aid (varies by state): General-purpose support for local governments, often smaller in scale

Restructuring Patterns of Intergovernmental Relations

- Restructuring tax laws: increasing tax authority or revenue-raising capacity of state and local.
- Reducing strings attached to federal grants: Shifting from highly restrictive categorical grants toward more flexible funding.
- Eliminating/reducing unfunded mandates: Limiting federal requirements imposed on states/localities without accompanying funding.
- Supreme Court decisions affecting intergovernmental relations: Court rulings shape the balance of power between federal and state governments.
- Reducing paperwork: Streamlining programs and reducing reporting requirements and paperwork burdens