Economic and Environmental Issues in Arkansas: A Policy Perspective

Looming County Government Fiscal Crisis

Executive Summary

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Introduction

Numerous Arkansas counties, particularly in the Delta and the Coastal Plains, are rapidly losing businesses, employment opportunities and population. These losses have created fiscal crises for several county governments in the state as revenues decline and costs increase. Meanwhile, some urban counties are growing rapidly, yet they are having difficulty generating enough revenue to pay for the additional infrastructure and services necessary for an increasing population. In 2007, the Arkansas state legislature recognized some of these difficulties and provided $16 million in supplemental funding to be divided amongst all counties over the next two fiscal years. However, this is a temporary fix to the current and future fiscal crises facing many county governments.

Without understanding the underlying causes and finding solutions to deal with the sources of the crises, many counties will be unable to provide the services needed to compete in global economy. These crises could lead to underinvestment in the infrastructure and services needed to support a viable and growing economy. This could result in the loss of more businesses, and the fiscal crises could become even more severe.

This research (1) identifies the counties in current fiscal crisis, (2) ascertains the long-term structural issues that affect the ability of county governments to provide required services, (3) estimates the effect of projected changes in employment opportunities and population on the ability of county governments to generate the necessary revenue to pay for these services, and (4) identifies options available to county governments to provide services while reducing costs.

By understanding the nature and extent of county governments' fiscal problems, solutions, which help counties provide the infrastructure and services needed to support viable communities, can be implemented.

Methodology

This study uses both primary and secondary data to better understand the fiscal crises affecting many Arkansas counties and to identify workable strategies to deal with the crises. Economic and fiscal impact models are used to estimate the change in the tax base due to projected population and economic activity changes in each county.

County income and expense statements for years 1999 through 2003 (most current available) from the Arkansas Bureau of Legislative Audit are used to determine the extent and magnitude of the fiscal crises facing Arkansas county governments. These statements are used to show trends in revenue and expenditures and to make comparisons among counties and regions of the state. These data are also used in conjunction with explanatory variables to explain changes in revenues and expenditures over time and differences among counties.

To estimate the ability of county governments to raise additional revenue from the existing tax base and current tax rates we classified counties according to their tax capacity and tax effort. Counties with low tax capacity and high effort are more likely to face serious fiscal problems. Tax capacity and effort are calculated for the two major sources of local revenue - property and sales taxes.

To identify alternative cost-effective strategies counties can use to provide the infrastructure and services needed, we collected in and out-of-state examples of ways county governments have dealt with budget deficits. A database of examples was developed, and case studies of a few Arkansas examples were undertaken.

The information and analysis generated from this study will be used to develop educational materials and training for county agents, county officials and the general public as requested. Different training venues will be used including workshops, the internet and media releases to work directly with selected audiences and to train the trainers.

Key Findings

There are growing disparities among counties in the state in their ability to generate revenue to pay for the increasing cost of infrastructure and services. Projections of declines in economic activity and population in many rural areas of the state suggest that many counties will find it increasingly difficult to pay for infrastructure and services using existing methods of providing and paying for these services. Cost-effective strategies for service delivery that have been adopted by a few local governments in Arkansas and elsewhere in the U.S. offer possibilities for fiscally-stressed counties.

Total county government and per capita revenue grew, but revenue per $1,000 of personal income declined over the four-year period from 1999 to 2003. While total revenue increased by 9%, the median county government revenue increase was only 5%, and the range was from a decline of 27% to an increase of 209%. Thirty-seven percent, or 38 of 75 counties, saw their total revenue decline from 1999 to 2003.

Intergovernmental revenue continues to be the major source of county government revenue, although the degree to which this revenue source contributes to county budgets varies greatly, from 13% to 67% in 2003. The fastest growing source of county revenue is from the sales tax which grew 21% from 1999 to 2003 and overtook the property tax as the major local source of county government revenue. Property tax revenue declined by 5% during this period and declined as a share of county revenue in 58 of 75 counties.

The rural counties of the state must generate much more revenue per person than the urban counties to pay for infrastructure and services and per capita costs. Revenue generated per person is increasing more rapidly in rural areas of the state due in part to declining populations. Rural areas, especially the Highlands, also generate more revenue per $1,000 of personal income than do urban areas, but the difference between rural and urban areas remained constant over the four-year period.

Sales tax revenues per person are much higher in rural counties and property tax revenues per person are somewhat higher in urban counties. Since urban counties have larger business and industrial tax bases than rural counties, rural residents have a larger local government tax burden than do urban residents.

Total county government expenditures grew more rapidly than revenues, growing 15% from 1999 to 2003. Even though total county expenditures grew during this period, 24 of the 75 counties had declining expenditures. This is in part due to the declining population and tax base in some rural areas, but also affected by the ability to generate revenue to pay for these expenses.

Expenditures per person are much higher and increased more rapidly in rural than in urban counties during this period. The higher per person cost of providing services in rural counties is likely to continue to grow faster in rural counties as people continue to move from rural to more urban areas of the state.

Law enforcement and public safety consumes the largest share (36%) of total county expenditures and these expenditures grew the most rapidly, by 24% during this period. Rural counties in general spend a smaller share of their budget for law enforcement and public safety. However, spending on law enforcement and public safety increased more rapidly in rural counties from 1999 to 2003, and by 2003, per capita spending in rural counties surpassed urban county spending for law enforcement.

Spending on highways and streets increased in both urban and rural counties, but not as rapidly as the increase in spending for law enforcement. The increase in spending for highways and streets is closely associated with increases in population.

While the cost of providing services is increasing, many rural counties in Arkansas have little capacity to generate additional local revenue from either the sales or the property tax. Fifty-six counties have little capacity (a small tax base) from which to generate revenue for county governments from either the sales or property taxes. About 30 of these counties are already taxing at very high rates which limit their ability to increase rates to generate additional revenue.

Projected declines in business activity, employment and population in many of the same counties that have low tax capacity and high tax effort will result in a further decline of the tax base and the ability to generate enough revenue to pay for needed infrastructure and services.

There are ways that local governments have adapted to changing fiscal conditions that have allowed them to continue providing needed infrastructure and services with declining tax bases and increasing costs. Larger communities are more likely to use public-private partnerships or contracting for services to reduce costs. Interlocal governmental agreements are another effective way for counties to work together with local towns and nearby counties to provide services at a minimal cost. Local governments in Arkansas have used interlocal agreements for all types of services including purchasing, library services, water quality management, solid waste management, law enforcement, fire and emergency services, education, road maintenance and others. While the type of interlocal governmental agreements in use is broad, the number of agreements in use is small relative to the potential for using interlocal agreements to reduce costs.

Conclusion

There is a significant growing disparity between the ability of county governments to raise enough revenue to pay for the increasing cost of providing services. While total county government revenue grew by 9% from 1999 to 2003, over one-third of Arkansas counties received less revenue in 2003 than in 1999. Many of these counties also experienced an increase in their total expenditures during this period. This combined with the fact that many of these counties have low tax capacity and high tax effort, suggests that there is little capacity to generate additional revenue to pay for increasing costs. The projections indicate additional declines in the ability to generate local revenue. This suggests a need to implement creative cost-effective methods of providing services to maintain the infrastructure and services required to compete in a global marketplace.