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Formulating Optimal Tax Reform for an Underdeveloped State: The West Virginia Case

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By

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Introduction

Even with a voluminous and growing literature on state-local taxation, the formulation of an optimal tax policy for a state government remains a relatively virgin subject. And the more specific question of a desirable fiscal strategy for an underdeveloped state is virtually untouched. Nevertheless, state budgets continue to grow at astonishing rates—and tax reforms continue to be made, sometimes on rational bases and sometimes on no basis at all. The final shape of these reforms are determined by a number of factors ranging from legislative self-interest to the effectiveness of pressure groups to perhaps the personal bias of a consulting tax economist. If such a concoction of influences results in tax structure changes which conform to the economic norms of effective fiscal action, it surely must be happenstance.

Basically, the objective of this paper is to define certain norms for optimal tax reform in an underdeveloped state, and to use these benchmarks to evaluate West Virginia's fisc and to suggest what might be a program of effective tax reform planning. Accordingly, what follows is trisected into (a) a very brief overview of the considerations seemingly relevant in planning state government fiscal activity, (b) an evaluation of West Virginia's recent historical fiscal behavior, and (c) a suggested

*The views expressed here are my own.

program of action designed to move the state fisc in the direction of conformity with specified fiscal norms. The particular concern in the final section is with the local government sector; but since the conclusion here is that the salvation of West Virginia's local governments is bound up in a program of intergovernmental relations, we never depart from a close scrutiny of the fiscal role of the state government.

Norms for Tax Reform Planning

Professor Musgrave neatly divides the federal budgetary decision with allocation, redistribution, and stabilization considerations.[1] Our own breakdown of the considerations relevant in planning the state fisc are neither so neat, in the sense of their interrelationships, nor so general. We will consider the allocation and redistribution objectives in terms of the standard maxims of tax analysis, and will separately examine the more specific question of the role of state and local government in the longer run development plan. Note that stabilization is not included here as a relevant consideration in formulating state government fiscal policy, primarily because of the relative size of the state-local budget and the openness of the state's economy.

An Appropriate Size Public Sector

A first prerequisite in tax reform planning is some target figure for the size of the public sector, i.e., what fraction of state gross domestic product is to be extracted in the form of taxes. Since in the United States the direction of causation typically runs from expenditures to revenues, the question might be more appropriately put as what determines the best division of spending between the private and public sectors.

The agent of economic growth is capital formation and productivity and not government expenditures, hence, the argument for a larger or smaller size public sector turns on the marginal contribution of state fiscal action to the conditions necessary for economic growth—infrastructure and human resource development. To make a first approximation of how much in public funds this might mean for a particular state, we will assume that states compete for both industry and hu-

[1]Richard A. Musgrave, *The Theory of Public Finance* (New York: McGraw-Hill, 1959) chapter 1.

man resources, and public sector activity is the vehicle through which they compete. Theoretically, the public sector effort will be too low if the opportunity cost of an additional block of spending is less than or equal to the value of the resources it would allow the state to retain or attract. In practice, probably the best guide as to whether the public sector in the state is large enough is a comparison with other states.

A second question about the optimal size public sector regards adequacy, i.e., if the public sphere **should** constitute 13 percent of state personal income this year and 15 percent in 1973, the tax structure should automatically provide this growth. Then by revenue adequacy we mean a revenue system which will grow adequately without the need for frequent discretionary rate or base adjustments.

Equity and Neutrality

Even an underdeveloped state in the United States can afford the luxury of considering the equity of its tax structure. A first point to be made is that the equity of a system is a function of some value judgment as to the basis for equal treatment, e.g., the same tax could be judged horizontally equal in a benefits sense but regressive in an ability-to-pay sense. The important consideration is that there be some value judgment about equity.

We opt to use the term neutrality primarily to describe the effect of the state tax structure on business activity—on both methods of doing business and of pricing output and input decisions. A neutral tax is one which has no effect on either.

Evaluation: The West Virginia Case

Given this brief setting for state tax structure evaluation, consider the fiscal experience in West Virginia. In the following sections we consider both the level and adequacy features of the revenue structure, the degree to which it conforms to some norm of equity and neutrality, and the extent to which it is harmonized with long-run development objectives of the state.

Comparative Public Sector Size

In attempting to empirically assess the size of West Virginia's public sector, one is immediately confronted with the

dilemma of the underdeveloped state. In Table 1 is shown a comparison of the relative size of government, i.e., these data describe fiscal activity per dollar of personal income. The result of this computation is that West Virginia's state and local governments extract 12.7 cents in taxes per dollar of personal income earned. The federal government matches this 13 cents with approximately 5 cents, with a result that of every one dollar (of personal income) earned in the state 17.4 cents of public goods are purchased. By comparison with surrounding states and with the U.S. median, this share for public consumption is high, but primarily because of the heavy inflow of federal money (see Table 1). If or when the well of federal funds for nonurban states dries up, West Virginia's public share will fall below the national average.

If instead of the relative size of the public (vs. private) sector we consider the absolute or per capita size, the state's comparative position is even worse. The data in Table 2 shows that even with the relatively heavy inflow of federal aid, West Virginia state and local governments spend about $60 less per person than does the median state. If public dollar expenditure differentials are even roughly indicative of public service quality differentials, West Virginia's public sector size is woefully small.

Revenue Adequacy

If West Virginia's revenue structure were adequate, it would expand automatically in some proportion to expenditure needs; and if we assume changes in income to be a reasonable proxy for changes in the demand for public services, we would be led naturally to argue that revenue adequacy may be gauged best by the income elasticity of the revenue structure. Further, we might speculate on three reasons why the revenue response to income should be more than proportional. First, we might argue that over a given income range the preference for public vis-a-vis private consumption will rise. Second, the demand for higher wages may bid up government costs quite independent of any change in overall personal income. Third, the productivity imbalance between a relatively labor intensive public sector and a capital intensive private sector will require government to divert an increasing share of income just to keep up. If these arguments can be accepted as indicating a

need for an income-elastic revenue structure, we should now turn to an examination of West Virginia's revenue structure to ascertain whether such an elasticity does exist.

There is not an extensive literature comparing the income-elasticity of state revenue structures, but what does exist in-

TABLE 1

RELATIVE SIZE AND COMPOSITION OF THE PUBLIC SECTOR: WEST VIRGINIA AND SELECTED STATES (IN 1965-66)

State	General Revenue from own Sources per $1,000 of Personal Income	Federal Assistance per $1,000 of Personal Income	Percentage Importance of Federal Assistance	Total Expenditure per $1,000 of Personal Income
West Virginia	$127.45	$47.33	37.14	$174.32
Kentucky	122.59	39.05	31.85	167.51
Maryland	119.21	17.00	14.26	141.12
North Carolina	127.30	27.31	21.45	149.32
Ohio	108.57	18.61	17.14	130.10
Pennsylvania	113.26	18.20	16.07	131.29
Tennessee	122.23	36.17	29.59	167.88
Virginia	112.58	26.73	23.74	146.37
Louisana	163.91	45.38	27.68	203.61
U.S. Merian	132.43	30.22	22.82	167.88

Source: U.S. Bureau of the Census, Governmental Finances in 1965-66, Series GF—No. 13 U.S. Government Printing Office, Washington, D.C. 1967, Table 24.

TABLE 2

ABSOLUTE SIZE AND COMPOSITION OF THE PUBLIC SECTOR WEST VIRGINIA AND SELECTED STATES (FOR 1956-66)

State	Per Capita General Revenue from own Sources	Per Capita Federal Assistance	Per Capita Total Expenditure
West Virginia	261.37	97.08	357.50
Kentucky	249.93	79.62	341.49
Maryland	349.88	49.91	414.20
North Carolina	256.38	55.01	300.74
Ohio	305.25	52.34	365.78
Pennsylvania	311.13	50.00	360.65
Tennessee	243.93	72.19	335.03
Virginia	267.07	63.42	347.22
Louisiana	334.77	92.69	415.88
U.S. Median	349.88	76.42	422.15

Source: U.S. Bureau of the Census, Governmental Finances in 1965-66, Series GF—No. 13 U.S. Government Printing Office, Washington, D.C. 1967, Table 24.

dicates that the West Virginia system is income inelastic. A recent report by the Advisory Commission on Intergovernmental Relations finds West Virginia to be one of 11 states where tax revenues do not grow at least proportionately with personal income.[2] The coefficient derived—0.89—may be interpreted as showing that a 1 percent increase in West Virginia incomes will call forth only a 0.89 percent increment in state-local revenues. In turn, this means that in the absence of discretionary action, the public sector share in West Virginia will decline secularly. Alternatively, the state legislature could (as they have in the past) take discretionary action to bolster the public sector share.

But the use of periodic legal rate and base changes to maintain an adequate level of state-local government services is an inefficient if not dangerous process for several reasons: (a) state legislatures move slowly, a truth which is certain to result in a lagging level of public services, (b) the uncertainty associated with frequent tax changes is anything but an inducement for industry, (c) periodic discretionary changes represent a piecemeal approach to revenue structure formation, a process which over the long-run is unlikely to generate an integrated approach to state economic development, and (d) a management by crisis approach is most likely to be unplanned, and fraught with undesirable features.

Equity and Neutrality

One set of estimated comparisons of interpersonal effective tax rates is shown in Table 3. These estimates suggest that the burden of state-local taxes is considerably greater on the lower income classes, i.e., that the net effect of the sum of all state and local taxes is regressive in effective rate. The data in Table 3 would indicate that the consumer sales, cigarette, beer, capitation, soft drink, property, and gross sales taxes show a regressiveness in effective rates, while the personal income tax, insurance tax, inheritance tax, pari-mutuel tax, and corporation charter tax are generally progressive. But the overall effect of this package of state-local taxes is to command 14 cents per dollar of income from the average family earning less than $2,000, 11.7 cents per dollar from the average family earning

[2]Advisory Commission of Intergovernmental Relations, *Sources of Increased State Tax Collections: Economic Growth vs. Political Choice,* GPO, Washington, 1968.

TABLE 3

EFFECTIVE RATES OF WEST VIRGINIA STATE-LOCAL TAX PAYMENTS IN TOTAL AND BY TYPE OF TAX FOR 1965

West Virginia State and Local Taxes	Tax Payment as Percentage of Income							
	0-$2,000	$2,000-$3,000	$3,000-$4,000	$4,000-$5,000	$5,000-$7,500	$ 7,500-$10,000	Over $10,000	TOTAL
1) Consumer Sales Tax	2.9	1.7	1.4	1.2	1.1	.8	.5	1.4
2) Personal Income Tax	.3	.3	.4	.4	.6	.6	.6	.6
3) Cigarette Tax	.5	.4	.4	.3	.3	.2	.2	.4
4) Beer Tax & Liquor Revenues	.8	.9	.6	.5	.5	.4	.4	.5
5) Capitation Tax	.3	.1	.1	.1	(a)	(a)	(a)	(a)
6) Insurance Tax	.1	1.0	1.2	1.4	1.7	1.6	1.4	.3
7) Inheritance Tax	-	-	-	-	-	-	.6	.1
8) Soft Drink Tax	.3	.2	.2	.1	.1	.1	.1	.1
9) Pari-mutuel and Racing Tax	.2	.1	.1	.2	.2	.3	.3	.2
10) Real & Personal Property Tax	4.6	4.3	4.1	3.3	2.4	1.5	1.5	3.3
11) Gross Sales Tax	4.0	2.7	2.5	2.3	2.3	1.9	1.6	2.2
12) Corporation Charter Tax	(a)	(a)	(a)	(a)	(a)	(a)	.1	(a)
13) Total	14.0	11.7	11.0	9.8	9.3	7.4	7.3	9.1

Source: Report submitted to West Virginia Joint Committee on Government and Finance by James A. Papke, August 8, 1966.

[a]Less than one-tenth of one percent.

between $2,000 and $3,000, but only 7.3 cents per dollar from the average family earning in excess of $10,000.

Hence, when tax burdens are compared among income classes in West Virginia, there is some empirical support for the contention that the system is highly regressive. If this is taken to be an undesirable situation, any attempts to resolve the local revenue problem in West Virginia should focus on the dual objectives of providing adequate funds to upgrade local public facilities and reducing (or at least not increasing) the overall regressivity of the state's tax system.

Aside from questions of interpersonal equity, the state's major business tax, the gross sales tax, suffers from two basic defects. First as to industrial equity, the fact that the tax rate differs among industries would at first glance imply that industrial classification is a "relevant difference" for taxation purposes. Certainly it could be argued that these **differentials** (e.g. $1.35 per $100 of sales or coal $2.00 on contracting, $5.20 on electric light and power, and $0.40 on manufacturing) cannot be justified on grounds of either benefits received or ability-to-pay. Though there is some merit to the argument that gross sales tax rates should be lower for firms with higher turnovers and lower profit margins, the question of how one arrives at the exact rates goes unanswered.

Further the gross sales tax is nonneutral in two important respects. Because it is levied at each level in the production process, it is pyramided forward to distort relative prices.[3] The output and employment effects of pyramiding are well documented. Moreover, this same feature results in an effective subsidy to the vertically integrated firm which is able to avoid the tax at n-1 stages in the production process.

In 1969, all of these undesirable features were incorporated into a piecemeal tax reform which exempts capital purchases from the state's consumer sales tax. This alleged one-year stopgap measure is a timely example of poorly planned fiscal action.

Tax Level, Tax structure, and Development Potential

Overlapping evaluation of the state's revenue structure in terms of allocation and redistribution considerations is the

[3]For an estimate of this pyramiding, see Roy W. Bahl and Kenneth L. Shellhammer, "Evaluating the State Business Tax Structure: An Application of Input-Output Analysis," *National Tax Journal* (forthcoming).

relatively complicated and surely moot question of how the public sector affects industry location choices. The issue of the importance of tax levels as an influence on industry location has been paid no small amount of attention in the literature, but almost always with the same result—taxes are but marginally important. A questionnaire type study in West Virginia yielded these same results.[4] But the conclusiveness of this research notwithstanding, state legislators in West Virginia and almost everywhere else believe steadfastly in the powerful attractive and detractive potential of taxes—this belief being periodically honed by the business community. The influence of this "illusion" on state tax structures is profound.

The intent here is not to dredge up the old arguments but rather to explore, in a West Virginia context, the possible effects of tax-expenditure policy on the potential for attracting industry, i.e., the direction of the effect of alternative fiscal strategies. First on the tax side, two considerations would seem relevant. If there is a marginal importance to tax considerations, a tax burden which varies with methods of doing business could act as a locational deterrent to adversely affected firms. But probably more important is the general tax atmosphere i.e., is there a general dissatisfaction with the current revenue structure and is there about to be wholesale revision. Surely, West Virginia is a case in point of tax uncertainty over the past five years.

The view taken here is that if West Virginia's fiscal activity affects industry location choices it is because taxes are too low, and not too high. Again, if we might use dollars spent to proxy for public service levels, the comparative position of West Virginia is dismal (see Table 4). For the federally aided welfare and highway functions spending is relatively high as might be expected, in both cases West Virginia being above the national median. However, in no other case is West Virginia above the national midpoint (the actual position of the state is 39 in total education, 39 for local schools, 33 for institutions of higher learning, 46 for health and hospitals, 49 for police, 45 for fire, 45 for sewerage, 44 for sanitation, and 42 for local parks and recreation). Though certain of these dificiencies may over-state the case because of West Virginia's low level of ur-

[4]James H. Thompson and Thomas S. Isaack, *Factors Influencing Plant Location in West Virginia,* West Virginia University, Business & Ecomonic Studies, 1956.

TABLE 4

PER CAPITA EXPENDITURES FOR SELECTED FUNCTIONS: WEST VIRGINIA AND SELECTED STATES, 1965-1966

State	Total Education	Local Schools	Institutions of Higher Education	High-ways	Pulic Welfare	Health and Hospitals	Police	Fire	Sewerage	Sanita-tion	Local Park and Recreation
West Virginia	138.83	100.86	32.81	93.47	36.17	18.18	6.50	3.00	4.05	1.67	2.35
Kentucky	129.85	84.26	35.47	70.42	33.86	21.23	8.15	3.48	8.17	2.66	1.54
Maryland	172.78	138.85	31.37	54.73	21.06	36.67	17.07	7.73	12.70	5.01	7.46
North Carolina	137.12	97.05	35.61	45.28	23.38	22.65	8.42	3.64	5.20	3.06	1.80
Ohio	156.59	122.85	32.30	65.61	26.77	21.50	10.92	5.96	9.58	3.84	4.17
Pennsylvania	151.15	124.58	16.64	53.88	28.68	20.96	11.94	4.15	10.05	3.69	4.26
Tennessee	121.59	87.75	29.01	74.63	23.03	29.11	8.52	4.90	7.54	3.52	3.43
Virginia	146.50	115.05	26.18	79.91	13.82	20.89	10.52	4.65	7.00	3.71	3.28
Louisiana	148.75	107.72	34.76	73.99	57.85	24.57	12.14	4.64	8.34	3.93	4.80
U.S. Median	165.43	123.25	35.82	73.99	29.86	25.52	14.17	7.02	8.71	4.41	4.35

Source: U.S. Bureau of the Census, Governmental Finances in 1965-66 Series GF-No. 13. U.S. Government Printing Office, Washington D. C. 1967, Table 24.

banization, the level of public spending, particularly on local types of services, is extremely low.

A low level of public services makes the state a loser in many ways. First, an inadequate development of the West Virginia's human resources discourages industry in search of suitable labor markets as well as a suitable home for its managerial personnel. An inadequately developed infrastructure is apt to have a similar effect. And the effects are cumulative. As the state is unable to attract industry, it will experience a net outflow of human resources as its younger residents go out of state in search of career and job opportunities. It has been estimated that between 1950 and 1959, each of the over 1 1/2 million out-migrants from Appalachia carried with him a total public and private "rearing cost" of over $1,000, most of which was derived from regional sources. West Virginia is an underdeveloped state precisely because its human resources are underdeveloped and until this deficiency is remedied—at the initiative of the government sector—there is little hope for great progress.

Deficiencies in Intergovernmental Relations

Finally, the historical evolvement of West Virginia's fisc has resulted in a legal division of tax capacity which may not be commensurate with the existing division of program responsibility. The result of this imbalance is the low level of local public services (e.g., police, fire) described above. Certain public functions in West Virginia, as in most other states, are wholly or substantially a local responsibility—police, fire, sewage, sanitation, public redevelopment and housing programs, etc. But in West Virginia, and not like in many other states, local governments are denied the use of the income tax and a general purpose grants program does not exist. Compounding this fiscal difficulty are county-coterminous school districts which compete with cities for the property tax base.

The crux of the issue is that the level of locally raised revenue is a function of a tax base which may be less than income elastic, and that the potential for discretionary expansion is limited. The primary sources of local tax receipts are the property tax and a local surcharge on the gross sales tax. Though empirical analyses have not been consistent in estimates of the income elasticity of the property tax, at least the nature of the

assessment procedure, i.e., periodic reassessment and fractional valuation, may result in an erratic secular relationship between assessed value and income. But more important are the constraints which have been placed by the state on local property tax rates—thereby removing the conditions necessary to guarantee the possibility of increasing the level of revenues to meet needs. Moreover, the property tax is subject to equity questions of two kinds. First, if property values represent a declining proportion of income as income level rises, and since the property tax rate is the same for all taxpayers within a jurisdiction, the tax is regressive in effective rate. That is, it bears more heavily on the lower income families. Second, assessment practices are far from uniform, varying widely across counties, thereby interjecting an element of spatial-governmental inequality.

The second major source of local governmental tax revenue is the business and occupational license, or gross receipts tax. It accounts for over 40 percent of general revenues of the larger cities, being levied on total sales of firms according to one of some 30 different industry rates. Cities are authorized to levy a rate as high as, but not exceeding, the state rate for any given industry. One could level a number of criticisms at any argument to expand this source of local revenue. First, it is in effect a shared revenue source with the state and consequently its fortunes are closely tied to state actions. There is historical evidence in West Virginia that the gross sales tax is inadequate, inflexible, and inequitable—to the extent that the state has been willing to seriously consider repeal. There is a second argument against a local gross receipts tax. Since local units must take the initiative in levying the tax against local firms, the yield depends on the willingness of local public officials to take tax actions which may be unpopular with the business community. Indeed, there is evidence that they might not. Specifically Wheeling and Weirton are examples of cities which, though heavily industrialized, do not rely heavily on the gross sales tax. Yet another problem with the gross sales tax as a solution to local revenue problems is that of equity. In order to match the per capita yield of Charleston with its heavy industry and relatively low gross sales rates, Morgantown would have to levy exorbitant rates on what industry it has. If that were done, it is conceivable that a wholesaler in Morgantown, for example,

would pay a higher rate (state and local) than he would if located in Kanawha County and still not benefit from a greater level of public services. Finally, because of the relatively small population size of most of the 10 or 20 largest cities in the state and their lack of industrial diversification, the enactment of a heavy local gross sales tax would seem an invitation to revenue instability. The basic industry of the community may reflect cyclical instability in gross sales tax payments, leaving the community in a position of having to base public expenditure planning at least partially on anticipated swings in business activity.

A second deficiency in West Virginia state intergovernmental fiscal activity relates to the distribution of state funds among counties.[5] Presently, the distribution of the total of state grants and expenditures is income equalizing among the state's counties. In fact, an analysis of 1962 shows per capita state and local spending to be **greater** in lower income counties. A critique of this distribution requires first the assumption that social overhead capital should be developed within the state so as to maximize economic growth potential, and second the assumption that the development process must "takeoff" before the diffusion of social overhead capital can influence the rate of growth. Advocates of this theory argue that given the limited resources available in the state, it is not possible to simultaneously equalize public service activity within the state and reduce the disparity in public service levels between urban (growth) areas in West Virginia and those in the region or the United States as a whole. If this premise is accepted, it leads to the conclusion that state equalization policies in West Virginia are not compatible with the objectives of long-run economic growth. Consider, for example, the case of the education function in West Virginia. If teachers salaries in West Virginia urban areas are not presently at high levels, it seems improbable that West Virginia school districts will be able to bid quality resources away from other potential employment. In fact, it is probable that relatively low salaries in West Virginia may contribute to a net outflow of quality teachers. Consequent-

[5]See Ray W. Bahl and Robert J. Saunders, *Intercounty Differences in West Virginia Government Expenditures* (Office of Research and Development, West Virginia University, 1967), and Roy W. Bahl and Robert J. Saunders, "The Role of State and Local Government in the Economic Development of Appalachia," *Land Economics,* May 1968.

ly, the real effect of state equalization policy in regard to education, is to enable the state's low income counties to compete with their higher income counterparts in terms of teachers' salaries. Meanwhile, West Virginia urban areas fall further behind competitors in the stockpiling of human resources.

There is another ramification of the current spatial-fiscal equalization process. Historically, the state government of West Virginia has made extensive direct expenditures and provided grants-in-aid for the education, highway, and welfare functions. It has not assisted county and city governments in the provision of such services as police, fire, refuse collection, sewerage disposal and local park and recreational facilities. One could make the argument, however, that general purpose aid exists indirectly if higher levels of state financial participation in education and welfare free locally raised funds for other public services. But since aids for education are distributed among counties on an income-equalizing basis, a displacement effect (to the extent it exists) is most pronounced in the lower income counties, which by virtue of their rural nature may be least in need of higher levels of local public services.

Evaluation: Summary

West Virginia's public sector by U.S. standards is small both in the absolute and relative to personal income. Moreover, it is top heavy in terms of dependence on federal assistance—possibly an uncertain source of funds in the future. There is evidence that the revenue structure is income inelastic; hence, the potential for expansion more than in proportion to income is a function of the degree to which discretionary charges may be made. In an ability to pay sense, the overall revenue structure is inequitable as indicated by estimates of interpersonal differences in effective tax rates. The existing levels of local-type public services is especially deficient with the potential for raising these levels severely limited by restrictions on local government fiscal choices and the absence of a general purpose state grants system.

A Tax Reform Plan for West Virginia

Tax reform planning for West Virginia must necessarily focus on the above issues. A first basic question to be answered is what is the potential for a tax increase. Then, separately, the

otential for reforming the state and the local revenue structures must be considered. The following subsections are divided ccordingly. But since our primary interest here is with the ocal fiscal problem, the remarks on possibilities for state government reform are rudely brief and the supporting detail curory.

evenue Needs in West Virginia

One approach to estimating a "desirable" level of revenue or West Virginia is to assume an annual per capita increase in eneral revenues which is equal to the national average. Assume hat national average per capita revenues increase at the same ate as between 1963-1966, as will national average per capita ncome and West Virginia per capita income. The data in the rude estimates in Table 5 show that without reform, 1973 general revenues will reach $304 million, whereas a revenue growth t the assumed national average rate would require a level of 365 million. Then under these assumed conditions a revenue ap of $61 million will arise. If via tax reform West Virginia overnments did generate a revenue of $365 million, a tax ffort of $151 per $1,000 of personal income would result—as ompared with the (projected) national mean of $140. From his crude calculation, we may glean two unavoidable facts: (a) ertainly a substantial tax reform will be necessary, and (b) y comparison with the national average, an increase in the eighborhood of $60 million would certainly be feasible.

tate Government Reform

The policy focus of this paper is on the local government ather than the state government fiscal structure, hence

TABLE 5

A Revenue Gap for West Virginia State and Local Governments
(In millions)

	Predicted Actual	Expected at National Average	National Average
966	261	261	350
973	304	365	492
rojected 1973 revenues per $1,000 of personal income	122	151	140
evenue gap	61		

potential remedial action will only be glossed over. In general, the state tax system must be made both more elastic and more equitable. A first necessary step is repeal of the gross sales tax. Second, greater reliance should be placed on the personal income tax; there is evidence that a tripling of the yield would not place West Virginia out of step with the other states in personal income taxation. Third, food should be exempted from the consumer sales tax.

Reforming the Local Revenue System[6]

One could offer seven alternatives to strengthening the fiscal resources of West Virginia's local government:

1. A local income tax;
2. A local sales tax;
3. Increased local business taxes;
4. Increased local property taxes;
5. A program of unconditional state grants;
6. Transfer of function from local to state governments;
7. Increased user charges.

The first two, local sales and income taxes, and the fifth, an unconditional grants program, are considered in some detail in the following sections. The others are dealth with here in more summary fashion.

There has long been an effort in West Virginia to strengthen the local property tax by establishing uniform assessment procedures. But even so, the continuing reassessment needs of growing communities cast must doubt on the possibility of reliance on the property tax as a flexible source of revenues for West Virginia's local governments. In addition, the very serious problem of stringent rate limits eliminates the possibilities that discretionary action can render the yield adequate over the long-run. Finally, the property tax is regressive in its impact; therefore, increased use of it would place the burden of payment for increased local service levels most heavily on the lower income groups.

In West Virginia, the most feasible possibility for increased usage of business taxation by local governments would be increased sharing of the gross receipts tax base with the state,

[6]These recommendations are outlined in more detail in my forthcoming report, *West Virginia Local Government Finance* (Office of Research and Development, West Virginia University, Morgantown).

n alternative which does not necessarily offer the local unit dequacy or stability in yield, may not be politically desirable, ay not fit into the industrial development plans of the com-unity, and is not consistent with interindustry equity in tax reatment.

The transfer of financial responsibility from local to state overnments has been a partial solution to local fiscal ills in any states. But this transfer usually involves the welfare and ducation functions, both of which presently are highly cen-ralized in West Virginia. In fact, West Virginia is exceeded by nly two states in the over-all degree of governmental financial entralization. Since the functions in question here are es-entially local direct benefit services such as police, fire, parks, tc., there seems to be little possibility of further transfer of unctions to the state.

User charges, fees, and permits may be desirable and sub-tantial sources of additional revenue when public services may e priced. But the possibility for pricing these services varies idely among communities, and, in any case, the resultant ields probably would not be large enough to cope with the xpanding needs of West Virginia's local governments.

Local Income Taxes

One solution to the local fiscal problem would be to allow ocal units to levy an income tax. There is much to recommend his alternative. First, local revenues would rise secularly in ome proportion to income, hence some balance would be estab-ished between the increment in local resources and that in he demand for public services. Second, the income tax fits well he ability-to-pay notion of justice in taxation—tax rates can e made directly proportional to income. This feature would lso reduce the present high degree of regressivity in the over-ll state tax system. A third advantage would be ease in com-liance and computation, since the state adjusted income base ould be used.

On the other hand, use of local income tax would cause ome problems. The biggest would seem to be allocating the tax among local governments. There would seem to be very little to recommend a scheme by which city governments would im-pose and collect the tax. First, there is the inevitable place of work-place of residence problem in deciding on which indi-

viduals should be taxed. The Michigan local income tax statute deals with the problems by dividing the commuter's tax payment between city of work and city of residence. That is, the individual pays one half of his income tax bill to the city in which he works and the full tax bill to his home city, receiving a credit against the latter for nonresident taxes paid. But many problems remain even with this kind of division.

First, if the home city chooses **not** to levy an income tax, but the city of employment does opt to tax income, the taxpayer bears a greater tax burden than he would if both levied an income tax. Moreover the Michigan half-and-half distribution between city of work and city of residence is arbitrary in that it does not necessarily reflect the actual division of the costs imposed by the taxpayer on the two cities. Finally, the appropriateness of the city government as the taxing unit in the West Virginia case may be questioned. The structure of local government in most of the growth areas is a central city, which provides the great bulk of local services, ringed by a number of smaller communities. The **1962 Census of Governments** shows that the population size distribution of West Virginia municipalities is heavily skewed toward the low end of the population distribution.

A distribution plan such as that adopted in Michigan may have the effect of strengthening the smallest of the cities to a much greater extent than the larger cities. Moreover, this plan would leave the central cities—e.g., Charleston, Clarksburg, Wheeling, Morgantown—in the position of having to cope with a secular revenue decline, if residents and/or firms look to more spacious outlying areas as new home and plant sites. Finally, since less than 45 percent of West Virginia's population resides in cities, any city government levy per se will miss a large number of the local population and, therefore, generate a sizable local inequity in tax treatment. The argument could be made that a city income tax would eventually have an unfavorable impact on the development and growth of the cities, i.e., that, **ceteris paribus**, prospective residents would choose outlying sites to avoid the tax.

These adverse considerations lead naturally to an alternative—that the tax should not be levied within city limits but within an area large enough to encompass all local residents. A county area would seem to be the most feasible spatial unit.

At least one possibility would be a county-wide income tax with the receipts distributed among the cities and county government on some combined basis of population and employment.

But this proposal raises the additional question of how efficiently local units could handle the collection and distribution of such a tax. At any rate, one might ask the question of why should the tax be collected locally when the state government already assesses the same base? A natural answer to this is that this should be a surcharge on the state income tax to be returned to the local units. The state could collect the tax along with state income tax payments, deduct a collection charge from each county's receipts, and return the balance to the county of location. This amount could then be distributed within the county, among cities and county government, on the employment-population basis suggested above.

To illustrate the effects of a shared income tax, consider what would have been the result of a one percent surcharge on adjusted gross income in 1964.[7] The yields are shown in column (2) of Table 6. These yields are computed as one percent of adjusted gross income in each county, which would seem an appropriate method of estimating county collections since adjusted gross income is the state income tax base. Among counties it is apparent that the distribution of that tax will favor the higher income areas, though within any given county the burden will fall relatively heavier on higher income residents. This solution seems to fit the general requirement of ability-to-pay among individuals, while the distribution of receipts among counties fits some notions of the relative needs of higher income and more populous areas. Further, if the public service demands of residents of a county do in fact expand with income, revenues will expand in some proportion to these requirements. However, it must be emphasized that the ultimate effectiveness of this shared tax in meeting local revenue needs depends on the legislative decision about the proper among-county distribution.

An alternative to the piggyback income tax is an income tax credit plan, whereby the local unit could choose to levy an income tax and the taxpayer would be able to deduct some pro-

[7]Unfortunately, 1964 was the most recent data available at the time of this compilation. Naturally for projection purposes an updated analysis would be mandatory. Nevertheless. these data do present a clear pattern for purposes of intercounty comparison.

TABLE 6

INTERCOUNTY DISTRIBUTION OF COLLECTION AND BURDEN OF A ONE PERCENT SHARED INCOME TAX (IN DOLLARS)

	Income Taxes At 1 Percent Of 1964 Adjusted Gross Income	Percent Of Total Yield	Per Capita Income Tax Revenue	Income Tax Revenues Per $1,000 Of Income
Barbour	123,250	.48	8.11	6.78
Berkeley	500,286	1.95	14.46	8.73
Boone	249,111	.97	9.23	6.64
Braxton	100,680	.39	6.80	7.16
Brooke	510,781	1.99	17.74	7.22
Cabell	1,952,965	7.61	17.95	7.54
Calhoun	57,681	.22	7.03	7.82
Clay	58,232	.22	5.06	5.34
Doddridge	61,540	.23	8.10	7.41
Fayette	568,288	2.21	9.62	6.82
Gilmer	68,975	.26	7.93	6.84
Grant	72,284	.28	8.50	4.62
Greenbrier	358,027	1.39	10.50	7.76
Hampshire	97,621	.38	8.27	7.80
Hancock	854,813	3.33	21.37	7.43
Hardy	70,091	.27	7.38	7.20
Harrison	1,215,787	4.73	16.25	7.67
Jackson	274,890	1.07	13.68	7.27
Jefferson	228,246	.88	11.89	6.82
Kanawha	4,364,825	17.01	17.38	7.21
Lewis	199,401	.77	9.92	7.84
Lincoln	146,029	.56	7.05	7.37
Logan	585,351	2.28	10.38	6.31
Marion	1,011,392	3.94	16.69	7.92
Marshall	541,748	2.11	14.49	6.92
Mason	274,407	1.06	11.20	8.33
Mercer	804,853	3.13	11.99	7.07
Mineral	319,540	1.24	13.37	6.86
Mingo	272,497	1.06	6.86	5.63
Monongalia	768,895	2.99	14.16	8.61
Monroe	82,610	.32	7.25	6.57
Morgan	94,171	.36	11.08	9.18
McDowell	494,996	1.92	7.03	5.49
Nicholas	254,873	.99	$10.53	$6.21
Ohio	1,284,931	5.01	19.89	8.18
Pendleton	46,144	.17	5.92	6.06
Pleasants	87,818	.34	11.71	8.49
Pocahontas	80,709	.31	7.99	7.20
Preston	241,150	.94	9.10	6.98
Putnam	325,624	1.26	13.51	3.25
Raleigh	775,607	3.02	10.79	6.90
Randolph	256,107	.99	9.42	7.72
Ritchie	102,634	.40	9.96	6.51
Roane	134,471	.52	8.57	7.51
Summers	121,781	.47	8.17	6.83
Taylor	171,356	66	11.98	9.11
Tucker	71,252	.27	9.63	7.20
Tyler	24,513	.48	12.71	9.50
Upshur	165,578	.64	9.20	8.03
Wayne	378,013	1.47	9.40	7.14

TABLE 6 (Continued)

INTERCOUNTY DISTRIBUTION OF COLLECTION AND BURDEN OF A ONE PERCENT SHARED INCOME TAX (IN DOLLARS)

	Income Taxes At 1 Percent Of 1964 Adjusted Gross Income	Percent Of Total Yield	Per Capita Income Tax Revenue	Income Tax Revenues Per $1,000 Of Income
Webster	88,724	.34	6.99	6.52
Wetzel	356,645	1.39	18.48	12.18
Wirt	36,023	.14	8.19	8.23
Wood	1,376,999	5.36	17.70	7.67
Wyoming	322,455	1.25	9.71	6.61

portion of the amount paid to the local unit from his state income tax liability. For example, assume the local government chose to levy a flat rate 2 percent income tax and the legislature provides for a 50 percent credit on state income taxes. Then a taxpayer who pays $100 in **local** income tax and owes $200 in **state** income taxes, credits $50 to his state tax bill—hence his total state and local income tax payment is $250 ($100 local and $150 state). Therefore, the total taxpayer burden would rise by only some fraction (50 percent in the example used here) of the total levy. Collections under this system would be returned to the county of payment with a division between the county government and among cities in the county area on some combined employment-population formula.

While the tax credit plan would have the effect of reducing state government income tax revenues, the state government would control the magnitude (percent) of the credit, and could adjust state tax rates depending partially on the level of assistance provided by the federal government and partially on projected expenditures. The chief merit of the tax credit method is that it offers a solution to the "pass-through" problem which would have to be dealt with if the Heller-Pechman Plan or some other form of revenue sharing is instituted and is structured so that the state is responsible for allocating the funds to local units. This plan would provide a mechanism by which the state could release general purpose funds to local governments.

The Local Sales Tax

An alternative solution, in use in many states, would use retail sales rather than local income as the tax base. Since the

TABLE 7

INTERCOUNTY REVENUE DISTRIBUTION AND BURDEN OF A 1 PERCENT SURTAX ON THE STATE CONSUMER SALES TAX (IN DOLLARS)

	Total Retail Sales (Thousands Of Dollars)	Local Sales Tax Revenue	Percent Of Total Yield	Per Capita Sales Taxes Revenue	Sales Taxes Per $1000 Of Income
Barbour	10,846	140,239	.58	9.23	8.40
Berkeley	36,465	471,492	1.94	13.63	9.28
Boone	20,009	258,716	1.06	9.58	7.09
Braxton	10,846	140,239	.58	9.48	9.82
Brooke	23,375	302,238	1.24	10.49	6.45
Cabell	178,959	2,313,940	9.52	21.27	6.68
Calhoun	4,488	58,029	.24	7.08	10.02
Clay	4,301	55,612	.23	4.84	8.17
Doddridge	6,545	84,627	.35	11.13	9.66
Fayette	49,742	643,164	2.65	10.88	7.45
Gilmer	4,488	58,030	.24	6.67	8.47
Grant	11,594	149,910	.62	17.64	5.34
Greenbrier	37,587	480,000	2.00	14.25	8.46
Hampshire	12,155	157,164	.65	13.32	10.72
Hancock	37,026	478,746	1.97	11.97	6.49
Hardy	10,285	132,985	.55	14.00	8.51
Harrison	96,492	1,247,642	5.13	16.88	7.22
Jackson	14,773	191,015	.79	9.50	7.33
Jefferson	22,814	294,985	1.21	15.36	7.70
Kanawha	331,177	4,282,119	17.61	17.05	6.66
Lewis	17,765	229,701	.94	11.43	9.59
Lincoln	8,415	108,806	.45	5.26	8.63
Logan	43,758	565,791	2.33	10.03	5.94
Marion	68,068	880,119	3.62	14.52	7.34
Marshall	28,237	365,104	1.50	9.76	6.95
Mason	13,651	176,507	.73	7.20	8.99
Mercer	65,824	851,104	3.50	12.68	6.85
Mineral	17,391	224,866	1.34	9.41	7.15
Mingo	35,530	459,403	1.89	11.57	7.02
Monongalia	60,401	780,985	3.21	14.38	8.78
Monroe	5,236	67,701	.28	5.94	8.92
Morgan	5,797	74,955	.31	8.82	9.77
McDowell	41,888	541,612	2.22	8.46	6.28
Nicholas	21,879	282,895	1.16	11.69	5.96
Ohio	113,322	1,464,253	6.03	22.68	6.58
Pendleton	4,114	53,194	.22	6.82	9.14
Pleasants	7,293	94,298	.39	12.57	9.82
Pocahontas	7,293	94,298	.39	9.34	9.67
Preston	16,830	217,612	.90	8.21	8.04
Putnam	10,659	137,821	.57	5.72	8.14
Raleigh	71,247	921,224	3.79	12.81	6.85
Randolph	24,123	311,910	1.28	11.47	9.35
Ritchie	7,854	101,552	.42	9.86	7.52
Roane	11,033	142,657	.59	9.09	9.44
Summers	12,155	157,164	.65	10.55	9.13
Taylor	11,968	154,746	.64	10.82	9.48
Tucker	6,358	82,209	.34	11.10	8.87
Tyler	8,228	106,388	.44	10.86	9.36
Upshur	17,391	224,866	.92	12.49	10.07
Wayne	19,074	246,627	1.01	6.13	8.96
Webster	9,163	118,478	.49	9.33	7.46
Wetzel	20,570	265,970	1.09	13.78	10.11
Wirt	1,683	21,762	.09	4.95	10.55
Wood	106,029	1,370,955	5.64	17.62	7.11
Wyoming	25,806	33,672	1.37	10.50	6.51

state government presently levies a consumer sales tax, this could also be treated as a shared tax. Again, the distribution method would be to return proceeds to the county of collection and allocate among governments therein on a combined population-employment basis. In absolute terms, the advantages of a retail sales surcharge are (a) that receipts would expand with economic activity creating a revenue base which may hold resources and requirements in balance, (b) the collection process would not involve great difficulties, and (c) those counties experiencing the most rapid growth would benefit according to that expansion. The data in Table 7 show the distribution of collection and burden among counties in the event of a 1 percent surcharge on state retail sales taxes. As expected, the higher income counties show markedly greater revenues.

On the negative side, the distribution of tax burden among income classes is highly regressive, primarily because food is not exempt under West Virginia's consumer sales tax. As expected, sales tax payments per dollar of income are substantially higher in the low income counties.

Local Sales Tax Vs. Local Income Tax Alternatives

Given the similar advantages of a local sales and a local income tax, it remains to compare them by some relevant criteria, thereby formulating a rational basis for choice. The most relevant criteria would seem to be adequacy and flexibility, interpersonal equity, and statewide intergovernmental equity.

The data in Tables 6 and 7 show county-by-county per capita amounts of income tax (at 1 percent) and an approximately equal yield state sales tax. In each case it may be seen that per person receipts are higher in the high income counties, and that the distribution among counties is quite similar for the two alternatives. The sales and income taxes would seem equally desirable on the basis of flexibility, since it is reasonable to assume that retail activity and income will expand and contract in a similar fashion over the cycle, and the long-term drift in each will be about the same.

A major problem in each case is that of intercounty leakages. For the income tax, the levy is at the county of residence. Hence a person living in county A but working in B pays only in A. But via the trip to work, county B provides certain public services to the individual and is uncompensated for these ser-

TABLE 8

Changes in Local Tax Effort Resulting from the Adoption of Alternative Equal Yield Taxes, Taxes Per 1000 Dollars of Income (In Dollars)

	Local Government Revenue Effort	Incremental Local Effort Under Adoption of Equal Yield		Resulting Effort Under Adoption of	
		Income Tax	Sales Tax	Income Tax	Sales Tax
Barbour	22.89	6.78	8.40	29.67	31.29
Berkeley	31.68	8.73	9.28	40.41	40.96
Boone	35.74	6.64	7.09	42.38	42.83
Braxton	29.61	7.16	9.82	36.77	39.43
Brooke	30.58	7.22	6.45	37.80	37.03
Cabell	32.77	7.54	6.68	40.31	39.45
Calhoun	35.67	7.82	10.02	43.49	45.69
Clay	27.58	5.34	8.17	32.92	35.75
Doddridge	57.97	7.41	9.66	65.38	67.63
Fayette	31.70	6.82	7.45	39.52	39.15
Gilmer	37.42	6.84	8.47	44.26	45.89
Grant	16.45	4.62	5.34	21.07	21.79
Greenbrier	25.12	7.76	8.46	32.88	33.58
Hampshire	34.37	7.80	10.72	42.17	45.09
Hancock	29.15	7.43	6.49	36.58	35.64
Hardy	32.09	7.20	8.51	39.29	40.60
Harrison	26.57	7.67	7.22	34.24	33.79
Jackson	27.08	7.27	7.33	34.35	34.41
Jefferson	33.10	6.82	7.70	39.92	40.80
Kanawha	36.09	7.21	6.65	43.30	42.74
Lewis	38.24	7.84	9.59	46.18	47.93
Lincoln	54.94	7.37	8.63	62.31	63.57
Logan	28.71	6.31	5.94	35.02	34.65
Marion	28.18	7.92	7.34	36.10	35.52
Marshall	38.25	6.92	6.95	45.17	45.20
Mason	45.00	8.33	8.99	53.33	53.99
Mercer	35.39	7.07	6.85	42.46	42.24
Mineral	20.47	6.86	7.15	27.33	27.62
Mingo	40.67	5.63	7.02	46.30	47.69
Monongalia	35.13	8.61	8.78	43.74	43.91
Monroe	27.72	6.57	8.92	34.29	36.64
Morgan	51.82	9.18	9.77	61.00	61.59
McDowell	29.65	5.49	6.28	35.14	35.93
Nicholas	17.06	6.21	5.96	23.27	23.02
Ohio	31.80	8.18	6.58	39.98	38.38
Pendleton	20.84	6.06	9.14	26.90	29.98
Pleasants	48.43	8.49	9.82	56.92	58.25
Pocahontas	25.36	7.20	9.67	32.56	35.03
Preston	32.38	6.98	8.04	39.36	40.42
Putnam	43.72	8.25	8.14	51.97	51.86
Raleigh	32.22	6.90	6.85	39.12	39.07
Randolph	23.68	7.72	9.35	31.40	33.03
Ritchie	40.17	6.51	7.52	46.68	47.69
Roane	28.83	7.51	9.44	36.34	38.27
Summers	32.11	6.83	9.13	38.94	41.24
Taylor	36.54	9.11	9.48	45.67	46.02
Tucker	36.23	7.20	8.87	43.43	45.10
Tyler	39.12	9.50	9.39	48.62	48.51

TABLE 8 (Continued)

CHANGES IN LOCAL TAX EFFORT RESULTING FROM THE ADOPTION OF ALTERNATIVE EQUAL YIELD TAXES, TAXES PER 1000 DOLLARS OF INCOME (IN DOLLARS)

	Local Government Revenue Effort	Incremental Local Effort Under Adoption of Equal Yield		Resulting Effort Under Adoption of	
		Income Tax	Sales Tax	Income Tax	Sales Tax
Upshur	27.23	8.03	10.07	35.26	37.20
Wayne	33.73	7.14	8.96	40.87	42.69
Webster	27.99	6.52	7.48	34.51	35.47
Wetzel	53.74	12.18	10.11	65.92	63.85
Wirt	53.10	8.23	10.55	61.33	63.65
Wood	28.76	7.67	7.11	36.43	35.87
Wyoming	41.52	6.61	6.51	48.13	48.03

vices. This weakness may be corrected **within** a county by a distribution formula stated in terms of both population and employment. But some other method, perhaps the Michigan requirement of payment at both place of work and place of residence with commensurate credit, would be necessary.

Conversely, sales tax receipts are determined by the level of retail activity in a county, and if residents of county A shop in county B, county A's share of the local sales tax is smaller by the amount of the leakage. Then, without some adjustment for cross-county leakages, an income tax would be less beneficial to larger employment and trading centers than would a local sales tax. (Note by comparison of Tables 6 and 7 that the per capita sales tax exceeds the per capita income tax by the greatest amounts in the major trading and employment centers, e.g., Cabell and Ohio Counties).

A significant difference between the income and sales taxes is the degree of regressivity. Consider first the relation between county income level and county tax collections under each plan. The data in columns (2) and (3) of Table 8 show personal income taxes and consumer sales taxes per $1,000 of income, based on equal yield ($25,310,000) taxes. Column (1) of Table 8 shows this effective tax rate for all local government revenues. In columns (4) and (5) the effective total state-local tax rates which would result in the event of adoption of equal yield income and sales taxes are shown.

In addition to spatial equity interpersonal equity is also a concern, since it is not only important to consider the distri-

bution of tax burden across counties but also across income classes. Effective tax rates of West Virginia residents in each of nine income classes are shown in column (1) of Table 9. In columns (2) and (3) are shown the effective tax rates resulting directly from the levy of the equal yield income or sales tax. Then in columns (4) and (5) the overall burden pattern which would result in the event of the adoption of the income and sales respectively is shown. A comparison of column (1) with (4) and (5) indicates that the income tax would substantially reduce the regressivity of the state's revenue system, whereas the sales tax would increase the overall pattern of regressivity.

TABLE 9

EFFECTIVE TAX RATES BY INCOME CLASS FOR 1964, CENTS PER DOLLAR OF INCOME (IN DOLLARS)

	Current Total Taxes Paid	Tax Proposals: Local Income Taxes	Tax Proposals: Local Sales Taxes	Resulting Taxes Paid: Local Income Taxes	Resulting Taxes Paid: Local Sales Taxes
Under $2000	23.47	0.10	1.34	23.57	24.81
2000-2999	21.83	0.28	1.23	22.11	23.06
3000-3999	22.16	0.45	1.22	22.61	23.38
4000-4999	20.10	0.74	1.10	20.84	21.10
5000-5999	20.03	0.88	1.09	20.91	21.12
6000-7499	19.39	1.09	1.04	20.48	20.43
7500-9999	18.50	1.28	0.99	19.78	19.49
10000-14999	17.45	1.49	0.94	18.94	18.39
15000 and Over	15.65	2.33	0.71	17.98	16.36

Source: Roy Bahl, Seymour Sacks, and Donald Phares *Interstate Differences in the Incidence of State and Local Taxes,* Unpublished manuscript, Syracuse University, 1968.

General Purpose State Grants

An alternative version of the state's role in assisting local government in meeting public service needs is the institution of a system of general purpose grants to cities—defined either as unconditional or inclusive of a wide range of services. This proposal is identical to the shared tax in that it would bring the broader tax base of the state to bear on local fiscal needs while not reducing local autonomy as would the transfer of functions to the state.

Aside from questions of legality, the biggest problems associated with establishing a grants program involve decisions about (a) the method by which funds will be distributed among

local units, and (b) the method by which the state will raise the additional funds. For the existing assistance programs (which are actually direct expenditure programs) funds are distributed on a project (highways), on an individual needs basis (welfare), or on an equalizing basis (education). It has been shown that the overall effect of these three programs is strongly equalizing. In fact, it is overequalizing in that the per capita level of public spending in counties is significant and negatively related to per capita county income.[8] For a program of unconditional grants, it was argued above that an equalizing distribution would not be compatible with the objective of upgrading the level of local public services in the more highly urbanized areas of the state. The communities experiencing growth and, consequently, the greatest need to expand local nonaided public facilities and service levels are the higher income communities, and an equalizing distribution of state aids would tend to divert funds from these local units. For this reason it could be suggested that population alone be the sole allocator in distributing these funds. Table 10 indicates the intercounty distribution of funds which would result under such a plan. A state grant fund of $24,310,000 would amount to $13.13 per capita to each of the 55 counties.

But as with any nonmatching intergovernmental aid program, there is the possibility that local governments will **substitute** state government funds for what otherwise might be higher local government taxes. To prevent this, some effort requirement could be built into the distribution method to penalize those counties exerting a below-average willingness to finance public services. So at once the level of local public facilities could be raised and county fiscal effort moved toward greater uniformity.

To illustrate the effects of imposing an effort requirement, consider the results of a recent study of intercounty local government fiscal effort differentials.[9] It was concluded that the effort exerted by local governments within a county is random, that is, there is not an observably consistent pattern of relationship between local government taxes per dollar of income and either population size or income level. Nevertheless, wide variations in effort do exist. By tying a "minimum effort"

[8]Bahl and Saunders, *Intercounty Differences, op. cit.*
[9]*Ibid.*

TABLE 10

INTERCOUNTY DISTRIBUTION OF STATE AIDS UNDER POPULATION AND POPULATION-EFFORT ALLOCATION METHODS (IN DOLLARS)

	Under An Equal Per Capita Distribution		1964 Actual Per Capita General Revenues	1964 Per Capita Revenues If Median State Effort Had Been Exerted	State Aids Per Capita		Available Aids Per Dollar Of Per Capita Revenue Increase
	Total	Per Capita				Total	
Barbour	199,576	13.13	26.98	38.70	9.15	139,098	0.34
Berkeley	454,298	13.13	53.48	55.15	12.73	440,458	0.24
Boone	354,510	13.13	45.74	45.74	13.13	354,510	-
Braxton	194,324	13.13	26.00	28.60	11.82	176,712	0.46
Brooke	378,144	13.13	61.55	65.52	12.33	355,104	0.20
Cabell	1,428,544	13.13	87.81	87.81	13.13	1,428,544	-
Calhoun	107,666	13.13	32.05	32.05	13.13	107,666	-
Clay	150,995	13.13	23.22	27.36	11.14	128,110	0.48
Doddridge	99,788	13.13	50.89	50.89	13.13	99,788	-
Fayette	775,983	13.13	45.12	46.53	12.73	752,343	0.28
Gilmer	114,231	13.13	40.80	40.80	13.13	114,231	-
Grant	111,605	13.13	33.95	65.90	6.76	57,460	0.20
Greenbrier	447,733	13.13	33.68	44.46	9.94	338,954	0.30
Hampshire	154,934	13.13	30.90	35.16	11.54	136,172	0.37
Hancock	525,200	13.13	113.25	113.25	13.13	525,200	-
Hardy	124,735	13.13	34.45	35.52	12.73	120,935	0.37
Harrison	982,124	13.13	57.80	70.64	10.74	803,352	0.19
Jackson	253,913	13.13	54.94	67.15	10.74	215,874	0.20
Jefferson	252,096	13.13	49.20	49.20	13.13	252,096	-
Kanawha	3,298,256	13.13	89.90	89.90	13.13	3,298,256	-
Lewis	263,913	13.13	49.46	49.46	13.13	263,913	-
Lincoln	271,791	13.13	38.35	43.64	11.53	238,671	0.30

Logan	740,532	13.13	48.94	57.68	11.14	628,296	0.23
Marion	795,678	13.13	60.39	60.39	13.13	795,678	-
Marshall	491,062	13.13	80.20	80.20	13.13	491,062	-
Mason	321,685	13.13	57.14	57.14	13.13	321,685	-
Mercer	881,023	13.13	59.24	59.24	13.13	881,023	-
Mineral	313,807	13.13	38.91	64.20	7.96	190,244	0.20
Mingo	521,261	13.13	53.98	53.98	13.13	521,261	-
Monongalia	712,959	13.13	56.95	56.95	13.13	712,959	-
Monroe	149,682	13.13	20.70	25.30	10.74	122,436	0.52
Morgan	111,605	13.13	55.22	55.22	13.13	111,605	-
McDowell	840,320	13.13	45.13	49.64	11.94	764,160	0.26
Nicholas	317,746	13.13	30.45	59.11	6.76	163,592	0.22
Ohio	848,198	13.13	87.25	113.09	8.75	565,250	0.17
Pendleton	102,414	13.13	20.63	32.42	8.35	65,130	0.41
Pleasants	98,475	13.13	80.56	80.56	13.13	98,475	-
Pocahontas	132,613	13.13	28.26	37.30	9.94	100,394	0.35
Preston	347,945	13.13	40.61	40.61	13.13	347,945	-
Putnam	316,433	13.13	55.98	57.73	12.73	306,793	0.23
Raleigh	944,047	13.13	48.64	50.16	12.73	915,287	0.26
Randolph	357,136	13.13	29.32	40.32	9.54	259,488	0.33
Ritchie	135,239	13.13	55.16	55.16	13.13	135,239	-
Roane	206,141	13.13	29.35	34.59	11.14	174,898	0.38
Summers	195,637	13.13	37.27	38.43	12.73	189,677	0.35
Taylor	187,759	13.13	41.32	41.32	13.13	187,759	-
Tucker	97,162	13.13	46.78	46.78	13.13	97,162	-
Tyler	128,674	13.13	47.25	47.25	13.13	128,674	-
Upshur	236,340	13.13	33.91	41.44	10.74	193,320	0.32
Wayne	527,826	13.13	29.62	29.62	13.13	527,826	-
Webster	166,751	13.13	27.28	32.15	11.14	141,478	-
Wetzel	253,409	13.13	68.78	68.78	13.13	253,409	-
Wirt	57,772	13.13	33.67	33.67	13.13	57,772	-
Wood	1,021,514	13.13	67.10	76.35	11.53	897,034	0.17
Wyoming	435,916	13.13	67.77	67.77	13.13	435,916	-

requirement to a straight per capita distribution of general purpose aids, the state government could simultaneously effect a reduction in the intercounty variance in local effort and provide a substantial measure of fiscal assistance to local units within the state.

Consider a state assistance plan which could accomplish this. The amount of assistance is assumed at approximately 25 million, which is the amount used in the evaluation of the local income and sales tax surcharges above. First, on a straight per capita basis each county would be entitled to $13.13, with the total amount going to each county shown in column (1) of Table 10. Column (3) shows actual per capita local government general revenues from local sources in 1964. Column (4) shows the per capita amount which would have been raised if the aggregate of local units in each county had exerted an approximately median level of effort—in this case 3.3 cents in taxes for every dollar of personal income. Those counties in which effort was below the state median show an expected per capita amount (4) which is greater than the per capita amount actually raised (3). Those counties with effort below the state median receive less than the $13.13 as a penalty. For example, Braxton County shows an effort of 3 cents per dollar, 10 percent below the state median of 3.3 cents. Since the expected revenues are 10 percent above revenues Braxton County receives a 10 percent penalty on state aids; i.e., it receives 10 percent less than the per capita grant of $13.13, or $13.13 − 1.31 = $11.32 per capita. However, if Braxton County local governments were to raise local effort by 10 percent, the additional $1.31 in per person state aids would be forthcoming. In fact, as shown in the last column of Table 10, Braxton County stands to gain 46 cents per person in state aids for every one dollar increment in per capita local revenues until the county per capita general revenue level reaches the norm of $23.60. Thus, it is conceivable that with state money as the carrot, the state government could pull a reasonable amount of effort from local units of government.

But, as with any plan, this one is not free from conceptual as well as practical difficulties. First, an undesirable situation could exist if the within-county variation in local government effort is large. For example, city A, though exerting a high

level of effort, may be penalized because of the low levels exerted by cities B and C located in the same county. This could be partially corrected by allowing the effort ratio, along with population and employment, to enter in the distribution of aids **within** counties. A second critique to be aimed at this general method is that a per capita distribution is not geared to provide proportionately greater relief to the more highly urbanized counties—those possibly in greatest need of general purpose assistance. This problem could be resolved by the state legislature's choice of the basic allocator. A third difficulty involves adjusting the distribution to account for the spill-overs resulting from among-county interactions in employment and trading activity; for example, population-effort allocation of aids to Kanawha County would not consider the nonresidents who come daily into the county to work or to shop. A final problem with imposing an effort requirement is that of measurement per se. A personal income series is available annually on a county basis.[10] But this still leaves the problem of intracounty effort variations to be resolved. However, there are enough potential solutions to make one confident that imaginative researchers and state legislators could produce a satisfactory method of dealing with each of these problems. Certainly the problems mentioned here do not seem so unsolvable when it is recalled that the legislature found a way to assign over 30 different industry rates to the state's major business tax.

Grants vs Income and Sales Taxes

Two final considerations would seem to be in order in considering the relative merits of the general purpose grant-in-aid solution to the local fiscal problem relative to the local sales and income tax alternatives. Consider first the equity features. The aid program with an effort requirement could serve the purpose of equating the intercounty distribution of not only local government tax effort but also state government tax burden. If the grant fund (approximately $25 million in this example) was financed by an increment (graduated) in the state personal income tax, the goal of intercounty and income class burden equity could be served well. As indicated above, the prospects for reducing both spatial and interpersonal regressivity are substantial. Alternatively, financing this aid fund by

[10]From the West Virginia University Bureau of Business Research.

either a consumer or gross sales tax increment is apt to increase the already high regressivity of the state tax structure. In terms of adequacy, state assistance distributed on a per capita-effort basis will probably not provide the measure of relief to more highly urbanized counties as will the income or sales tax.

But it might be argued that the direct grant alternative leaves the state government with a substantially greater measure of control over fiscal behavior. Given the already high degree of financial centralization, this feature would seem to increase the potential for the state to play a major coordinating role. Under the grant plan it would be within the ability of the state to (a) determine a "minimum requirement" level of fiscal effort for local governments, (b) even out the intercounty and interpersonal variance in state revenue burden, (c) coordinate school with general purpose aid formulas, and (d) expedite the development of the public sector in the "growth points" of the state. This measure of control might also provide the state with the means for making more effective those nonrevenue measures designed to cope with the local fiscal problem—e.g., permissive legislation to enable inter-local financial cooperation and planning, and moves to reorganize and render more efficient the structure of local government.