

Reading Essentials and Study Guide



Chapter 14: Taxes and Government Spending

Lesson 3 State and Local Government Finances

ESSENTIAL QUESTION

How does the government collect revenue, and on what is that revenue spent?

Reading HELPDESK

Academic Vocabulary

constituents persons who are represented by an elected official

implemented put into effect

considerably to a noticeable or significant extent

Content Vocabulary

intergovernmental revenue funds that one level of government receives from another level of government

balanced budget amendment constitutional amendment requiring government to spend no more than it collects in taxes and other revenues, excluding borrowing

intergovernmental expenditures funds that one level of government transfers to another level for spending

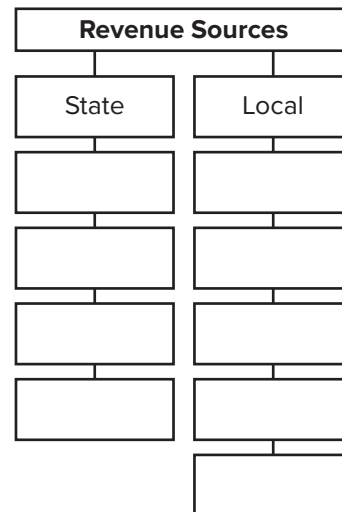
property tax tax on tangible and intangible possessions such as real estate, buildings, furniture, stocks, bonds, and bank accounts

tax assessor person who examines and values property for tax purposes

natural monopolies market structure in which average costs of production are lowest when all output is produced by a single firm

TAKING NOTES: *Key Ideas and Details*

Use a graphic organizer like this one to identify the sources of state and local revenue.



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State Government Revenue Sources

Guiding Question *Where do states get most of their revenue?*

State governments collect their revenues from several sources. Figure 14.8 shows the relative sizes of these sources. We will focus on the largest sources of state revenue.

Intergovernmental Revenues

*The largest source of state revenue is **intergovernmental revenue**. These are funds that one level of government collects and gives to another level of government for its expenses. States receive most of these funds from the federal government to help pay for the state's expenses for welfare, education, highways, health, and hospitals.*

Employee Retirement

State employees contribute to their own retirement funds. In recent years, they have been asked to contribute a larger share of their income to these retirement funds. This accounts for the relative size of this category. State workers would include some faculty and staff at smaller colleges, some workers at public schools, and most highway and public safety officials.

Sales Taxes

*Most states have also **implemented** sales taxes to add to their revenue. A sales tax is a general tax on consumer purchases of almost all products. The tax is a percentage of the purchase price, and is included in the final price a consumer pays. Merchants collect the tax at the time of sale. Then the merchants send the taxes to the proper state government agency on a regular schedule. Most states allow merchants to keep a small portion of what they collect to pay for their time and bookkeeping costs. The sales tax is one of the largest sources of revenue for states, although five states do not have a general sales tax. States without sales taxes are Alaska, Delaware, Montana, New Hampshire, and Oregon.*

Individual Income Taxes

*All but seven states rely on the individual income tax for revenue. The seven states that do not are Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming. The tax brackets are **considerably** different in each state. Taxes can be progressive in some states and proportional in others.*

Other Revenues

States rely on a range of other revenue sources, including interest earnings on surplus funds; tuition and fees from state-owned colleges, universities, and technical schools; corporate income taxes; and hospital fees. While the percentages for revenue sources in Figure 14.8 represent most states, there are wide variations among states. For example, Alaska is the only state without either a general sales tax or an income tax, so it has to rely on other taxes and fees for its operating revenue.



Reading Progress Check

Contrasting How do states without individual income taxes find sources of revenue?

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State Government Expenditures

Guiding Question *What are the largest state government expenditure categories?*

Individual states also have expenses, as does the federal government. States must also approve spending before distributing funds, as the federal government does.

The Budget Process

*There are different processes that states use to create a budget and get approval for spending. For example, some states such as Kentucky have biannual budgets, or budgets that cover two years at a time. In most states, the process is similar to the federal government's process. But unlike the federal government, some states have a **balanced budget amendment**. This is a law added to the state constitution that requires that annual spending cannot exceed revenues.*

This amendment often requires states to cut spending when revenue drops. Revenue may fall if sales taxes or state income taxes decrease because of general economic decline.

Intergovernmental Expenditures

*The largest category of state spending is **intergovernmental expenditures**. You can also see this in Figure 14.8. These are funds that one level of government transfers to another level for spending. These funds come from state revenue sources such as sales taxes. The state distributes the funds to counties, cities, and other local communities to cover different educational and other municipal costs.*

Public Welfare

The second-largest category of state spending is public welfare. This spending may be in different forms, such as cash support, payments for medical care, spending to maintain welfare institutions, and other welfare costs.

Higher Education

State governments have traditionally taken responsibility for the large task of funding state colleges and universities. In most states, the tuition that students pay covers only a portion of higher education expenses. States usually budget funds to pay the remainder of the cost. Today, the cost of higher education is the third-largest category of expenditure.

Employee Retirement

Many states have their own insurance and retirement funds for state employees. The state invests the money for these funds until employees retire, become unemployed, or are injured on the job. This category is a major expense because of the large amounts contributed to the funds. The people who receive the funds are teachers, legislators, highway workers, police, and other state employees.

Other Expenditures

The other expenses in the state budget categories are relatively small. As you can see in Figure 14.8, states spend money on a wide range of activities. These include corrections; utilities such as electricity, gas, and water; hospitals; and parks and recreation. But highways and road improvements may require larger amounts of state money.

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Reading Progress Check

Explaining How does a balanced budget amendment work?

Local Government Revenue Sources

Guiding Question *How are local government revenue sources different from those of federal and state governments?*

Local governments have different revenue sources, just as state governments do. You can see this in Figure 14.9. These sources include taxes and funds from state and federal governments. We will learn more about the main categories.

Intergovernmental Revenues

Local governments receive the largest part of their revenues as intergovernmental transfers from state governments. These transfers make up a little over one-third of local revenues. These funds are usually for education and public welfare. A much smaller amount comes directly from the federal government, mostly for urban renewal.

Property Taxes

*The second-largest source of revenue for local governments is the **property tax**, which is a tax on possessions. Such possessions usually include real estate, buildings, furniture, farm animals, stocks, bonds, and bank accounts. Most states also charge a property tax on automobiles.*

The property tax that raises the most revenue is the tax on real estate. States rarely collect taxes on other personal property, except for automobiles, because of the problem of valuation. The **tax assessor** is the person who figures out the value of property for tax purposes. How would the tax assessor know the value of everyone's furniture, clothing, or other property? Instead, most communities hire one or more persons to assess the value of a few large items such as buildings and vehicles.

Sales Taxes

Many cities have their own sales taxes. Merchants collect these taxes along with the state sales taxes at the point of sale. While these taxes typically are much lower than state sales taxes, they are the third most important source of local government revenue.

Utility Revenues

*The third-largest source of local revenue is the income from public utilities. Public utilities supply water, electricity, sewer services, and even telecommunications. Many of these companies are **natural monopolies** because of economies of scale. This means that it costs much less to have only one company produce the service.*

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For example, a community needs only one set of electrical power lines or underground water pipes, so one company usually supplies all of the services. When people pay their utility bills to these publically owned companies, the payments are counted as a source of revenue for local governments.

Other Revenues

Figure 14.9 shows different ways that local governments collect other types of revenue. Some local governments get part of their funds from hospital fees. Others collect income taxes from individuals and profits taxes from corporations. They may also collect interest on invested funds.

If local governments spend more than they collect in revenues, they can borrow from investors. These borrowed funds are usually small in comparison with what the federal government borrows. But they can still be an important source of local government funding. In general, local governments have limited revenue sources in comparison with state and federal levels of government.

Reading Progress Check

Recalling Which property tax earns the most revenue for local governments?

Local Government Expenditures

Guiding Question *On what do local governments spend money?*

Local governments include counties, parishes, townships, municipalities, tribal councils, school districts, and other special districts. Figure 14.9 shows the different categories of expenses made by these local governments.

The Budget Process

At the local level, the mayor, the city council, the county judge, or some other elected representative or group has the power to approve spending. The methods for approving spending and the dates of the fiscal year are different from one local government to the next.

Usually, the amount of revenue from property taxes, city income taxes, and other local sources is relatively small. The small amount limits the spending of local agencies. Some states even prohibit local governments from spending more than they collect in revenues.

Exploring the Essential Question

State and local governments generally take responsibility for different categories of services. For example, state government usually funds universities while local government usually supports elementary and secondary education. Why do you think state and local governments have assumed these specific responsibilities?

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Elementary and Secondary Education

Local governments have the main responsibility for elementary and secondary education. Expenses in this category include administrators' and teachers' salaries, wages for maintenance and cafeteria workers, textbooks, and other supplies. School districts also pay for the construction and upkeep of all school buildings. Schools make up more than one-third of all local government spending, which makes it the largest item in most local budgets.

Utilities

Government-owned public utilities serve communities by providing services such as sewer treatment, electricity, natural gas, and water. For most local governments, spending on these utilities is the second-largest expense. It can average about 10 percent of local spending.

In the typical community, most utility costs are for schools, libraries, civic centers, and administrative buildings. Street lighting and traffic lights are other utility costs.

Hospitals

Many local communities have their own hospital. The increasing cost of health care is one of the reasons that hospitals rank so high on the list of local government expenditures. However, state governments also contribute to the construction and maintenance of local hospitals, which helps keep the cost down.

Police and Fire Protection

Most communities keep a full-time, paid police force. Many have fire departments with paid, full-time firefighters as well. But some smaller communities with smaller budgets keep only volunteer fire departments to keep the cost down.

Other Expenditures

Highways, roads, and street repairs take most of the remaining spending. This category includes repairing potholes, installing and repairing street signs, plowing snow, and other street-related items that state budgets do not cover.



Reading Progress Check

Synthesizing Which local expenditures would you categorize as mandatory spending, and why?
