1999

Kentucky Metropolitics

Institute on Metropolitan Opportunity
University of Minnesota Law School

Kentucky's Rural/Metropolitan Fiscal Divide

A Statewide Agenda for Sustainable Communities

A Report to The Mountain Association for Community Economic Development (MACED)

and

The Southern Rural Development Initiative (SRDI)

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May 2000

FOREWORD

Kentucky's Rural/Metropolitan Fiscal Divide is a project of the Metropolitan Area Research Corporation (MARC). It was made possible with the support of the Southern Rural Development Initiative (SRDI) and the Ford Foundation. Lisa Bigaouette, Bill Lanoux, Scott Laursen, Michael Neimeyer, Ben Oleson, Liesa Stromberg, Andrea Swansby and Aaron Timbo, all at MARC, assisted in the production of this report. Myron Orfield is MARC's president.

Since 1995, the Metropolitan Area Research Corporation (MARC) has completed (or is in the process of completing) studies of social separation and sprawl in twenty-three regions of the United States.[1] These studies have been conducted in conjunction with representatives of universities, research centers and private and public organizations throughout the country. Financial support for these studies have been provided by over fifteen of the nation's leading philanthropies—including the Ford, MacArthur, and Rockefeller foundations—and the U.S. Department of Housing and Urban Development.

Further information on MARC's history, research projects and methodology can be found on its website: http://www.metroresearch.org.

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INTRODUCTION

Across Kentucky, rural communities and their residents are persistently isolated from the social and economic opportunities available in the state's metropolitan areas. For residents of these rural communities—particularly ones in outlying areas of the state—this separation can significantly reduce the overall quality of life that they and their families enjoy. Because fewer jobs are available in the areas where they live, workers are forced to commute long distances. Poverty and economic hardship pass from one generation to the next, offering little hope of escape. And schools, facing the challenges that poverty creates, become increasingly dependent on the state for basic needs. For many rural communities, the challenges of this social and economic separation create a cycle of decreasing jobs and increasing poverty that only becomes worse over time. Other communities struggle just to maintain a fragile balance, desperately seeking to attract any new jobs they can find.

Many local public officials and non-profit organizations have found that extensive community development efforts to provide new jobs, better schools, and social services simply cannot provide enough resources to sustain long-term improvements in struggling rural communities. While such efforts may bring some improvements, rural communities as a whole continue to lag far behind metropolitan areas in job opportunities and standard of living.

While the causes of these disparities between metropolitan and rural areas of the state are obviously complicated, there are at least three major factors contributing to these differences. These include: 1) a long-term shift in the population of this country away from rural areas; 2) the decline of traditional rural industries (including mining, agriculture and heavy manufacturing) brought about by increasing mechanization and cheap labor overseas, and; 3) a system of local government financing that contributes to an imbalance between spending needs and the ability to generate revenue. It is the last of these factors—the "fiscal disparities" between spending needs of local governments and their ability to generate revenue—that is a particular focus of this report.

While larger metropolitan regions surrounding Lexington, Louisville, and Cincinnati are experiencing economic growth and relative stability, smaller rural towns and unincorporated areas far from these urban centers are struggling. Evidence of this can be seen in the disparate abilities of counties to generate revenues from property taxes, which accounted for nearly two-thirds of all local tax revenue in outlying rural counties during 1996.[2] Metropolitan counties generated about $30,600 more property tax wealth *per household* than adjacent rural counties, and $37,740 more than rural counties in outlying areas of the state. This relatively low property tax capacity in outlying rural areas means that, without significant state funding, local governments in these areas are less capable of generating the public revenues needed to provide the social and economic infrastructure to attract jobs, adequately fund local schools, or build strong communities that provide stability to local residents and businesses. Even after state funding is taken into account, Census Bureau estimates suggest that rural counties, on average, generate significantly less general revenue per capita than metropolitan counties.

Kentucky's Rural/Metropolitan Fiscal Divide illustrates and analyzes the broad social, economic, and fiscal trends that are contributing to the steady decline and isolation of outlying rural communities. The results of this study provide striking evidence of the fiscal disparities that exist in the state and the need for policy changes at the state level to reduce these disparities and allow a more equitable distribution of tax resources. Further, it describes how these disparities prevent sustainable rural economic growth, constrains the ability of rural localities to provide adequate services to local taxpayers, forces rural residents to commute long distances to find work, and increases the concentration of poverty in rural areas. It is MARC's hope that this report will help to promote an informed and lively discussion of the opportunities for greater collaboration involving local governments, community development organizations, and state policy makers. Only through such collaboration will it be possible to address the challenges facing rural Kentucky and promote an environment where all citizens of the Commonwealth can have a high quality of life—no matter where they choose to live in the state.

In presenting the data, Kentucky's counties are divided into three categories: 1) metropolitan counties, 2) rural counties adjacent to metropolitan areas, and 3) rural counties in outlying areas of the state (see the Appendix for lists of counties in each category). By dividing the state into these three categories, it becomes easier to recognize how the geographic location of a county relative to a metropolitan area affects its level of social and economic isolation. Further, it can help counties to network with each other in developing strategies to address similar problems and to forge cooperative efforts to influence statewide policies.

The report concludes by describing a number of policy strategies that have been proven effective in reducing fiscal inequities and social separation in a number of other states. These strategies are general in nature and are intended to help further discussions on policy reform. Ultimately, any strategies undertaken to address social and fiscal disparities must be tailored to address the uniqueness of Kentucky's economic, political and social environment.

THE PROCESS OF SOCIAL AND FISCAL SEPARATION IN KENTUCKY

The separation between rural and metropolitan counties in Kentucky can be attributed to numerous factors occurring both at the local level and at a broader scale. For instance, at the local level, a major employer may decide to lay off workers or move overseas. If new jobs are not created to fill the gap, unemployment and poverty can increase or people may move away—draining resources from the community and destabilizing its long-term health. At the state level, decisions concerning the level of funding for development projects, education, health care, or other social programs can determine whether a particular community is able to provide basic services to its residents; rural counties particularly dependent on the state for assistance often find it difficult to engage in long-term planning regarding these issues because the level of funding they receive is likely to change from year to year. Even national and international forces can contribute to the separation of rural counties, such as the shift from a resource-based economy (agriculture, mining, manufacturing) to one where jobs are concentrated in service-oriented and high technology industries.

In order to adapt to these changes and maintain social and economic stability, communities throughout Kentucky must be able to provide certain basic resources. These include efficient transportation networks so that businesses can reach customers throughout the world, a highly educated and skilled workforce that helps to attract new employers, and quality schools that make a community attractive to families with children. Rural communities often find that they are unable to provide one or more of these basic resources, due in large part to their lack of sufficient public revenues. Meanwhile, metropolitan communities, which already have a large population, numerous job opportunities, and relatively large public revenues, continue to provide an attractive setting for businesses and families to locate. Ultimately, the ability of a community to provide the basic building blocks necessary for social and economic growth is one of the most significant determinants of which side of the social and fiscal divide they find themselves.

In analyzing the many causes of social and fiscal separation among Kentucky's rural and metropolitan communities, three stand out as particularly important. These are:

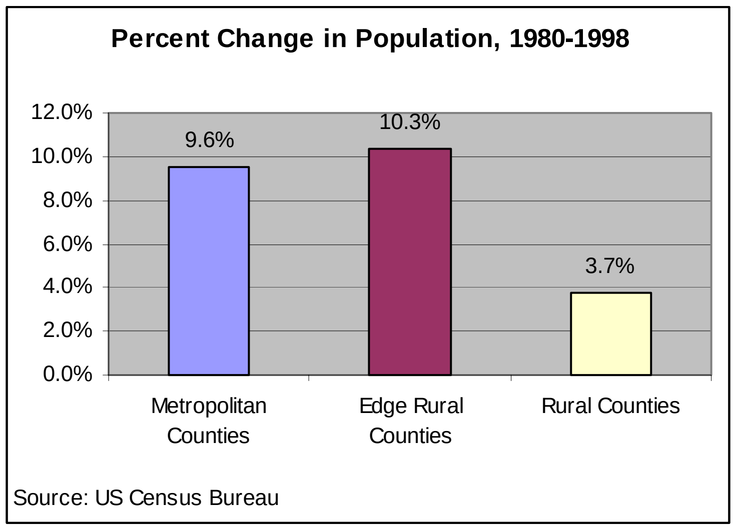
- The concentration of population growth in and around metropolitan areas;
- The decline of resource-based industries as sources of employment; and
- The dependence of local governments on local taxes as a means of generating revenue.

The first two causes relate to broad and long-lasting national and international trends over which local governments and communities have little direct control. However, the manner in which local governments are able to respond to these forces, and the resources they have available to them, plays a significant part in determining the stability of their communities and the opportunities available to their residents. Thus, the third cause—the dependence of local governments on local taxes as a primary means of generating additional revenue—is particularly important in determining how well a community can respond to new challenges and maintain a high quality life. By recognizing that community stability and quality of life are in large part determined by the methods available to local governments to generate revenue, rural development advocates, policymakers, rural residents and others interested in the sustainability of rural communities will be better prepared to advocate for the structural and administrative changes necessary to reverse their social and fiscal separation from metropolitan areas.

Since 1920, when America first became a majority urban nation, the percentage of people living in urban areas has steadily increased. By 1996, 80 percent of the U.S. population lived in metropolitan areas, with the balance living in rural areas and small towns. Kentucky, which is less urban centered than many states, has a metropolitan population that has remained relatively stable at about 48 percent since 1980. However, the overall stability in the ratio of rural residents to metropolitan residents says nothing about where population growth is occurring within the various rural areas. In looking at rural Kentucky's population growth at the county level, it is clear that the majority of growth in rural areas is occurring in those counties that are adjacent to metropolitan areas. At the same time, the population of many outlying rural areas has actually declined or grown very little. This shifting of rural population growth to counties with greater access to metropolitan jobs and resources suggests that many households are choosing to move away from the more isolated areas of the state, reducing the ability of local governments in these areas to spread the costs of basic public services over a large population and keep taxes low.

Figure 1: Percent Change in Population, 1980-1998

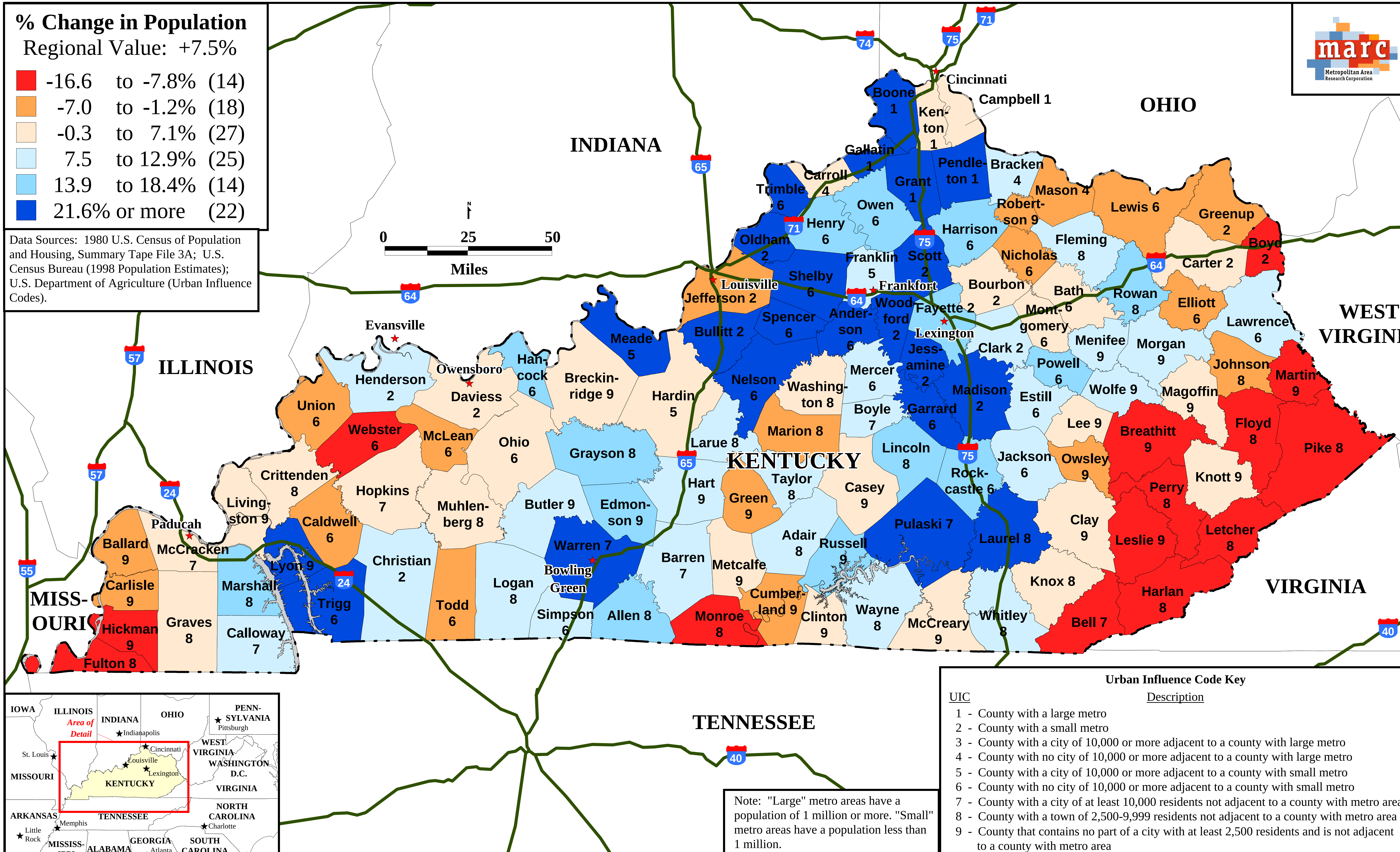
Altogether, the population of Kentucky grew by 8 percent between 1980 and 1998. Of all counties, outlying rural counties grew at the slowest rate (about 4 percent). About one-third of these outlying counties saw their populations decrease over the period, with the greatest decreases concentrated in the eastern and western coalfield areas of the state. Among these were Harlan County (-17 percent), Letcher County (-15 percent), Martin County (-13 percent), Webster County (-9 percent) and Union County (-7 percent). Meanwhile, counties located either in metropolitan areas or adjacent to them each grew by about 10 percent between 1980 and 1998.[3] The fastest growing counties were heavily concentrated around the state's primary metropolitan areas of Lexington and Louisville, as well as counties included in the Cincinnati metropolitan area. Among the fastest growing metro counties were Boone County (74 percent), Oldham County (60 percent), and Scott County (41 percent). Edge rural counties experiencing significant population growth include many adjacent to the Jefferson and Lexington metropolitan areas, such as Spencer County (63 percent), Anderson County (48 percent), Nelson County (30 percent), and Shelby County (27 percent).



THE DECLINE OF RESOURCE-BASED INDUSTRIES AS SOURCES OF EMPLOYMENT

In the past, Kentucky's economy—and particularly its rural economy—has been based largely on the resource-dependent industries of mining, agriculture, and manufacturing. In recent years, however, technological changes in these industries have made them a less significant source of employment for workers. Agriculture and mining have become increasingly mechanized, allowing them to become more productive while at the same time requiring fewer workers. In manufacturing,

Figure 1: Percentage Change in Total Population by County, 1980-1998



low wages in other countries has increased competition and caused many manufacturers to move out of the United States. While Kentucky has experienced relatively strong growth recently in manufacturing employment, the industry—along with agriculture and mining—it has been suggested that it is likely to decline over the long term as a source of employment. Since the agriculture and mining industries have historically been such a significant part of the rural economy, their decline has contributed significantly to the current disparities that exist between rural and metropolitan areas of Kentucky. If the forecasted declines in manufacturing employment are realized, rural Kentucky's economy will be even further weakened in the future. Thus, if these rural areas are unable to find alternate sources of employment, it is likely that existing fiscal disparities will persist.

A recent report by the Kentucky Long-Term Policy Research Center recognizes this need for greater economic diversity within the state, suggesting that Kentucky must look for ways to diversify its economy if it is to remain strong:

> "While mining and agriculture remain vital to the economic well-being of the state, both industries face uncertain long-term prospects. Likewise, in spite of emerging strength, manufacturing employment is predicted to decline over the long term. As a consequence of these anticipated changes, the Commonwealth's future economic prosperity will hinge on its ability to successfully negotiate a shifting economic landscape, to anticipate coming changes and skillfully manage them."[4]

Perhaps nowhere in the state is the importance of adapting to the "shifting economic landscape" more important than in its outlying rural areas, where many counties continue to depend on one or more of these industries as a major source of employment and earnings. Of the 98 rural counties in the state, 51 of them were considered dependent on mining, agriculture, or manufacturing as a major source of earnings in 1990.[5] Of these, 35 were located in outlying areas of the state. All together, counties dependent on one of these three industries experienced slower overall job growth between 1980 and 1996 than other areas of the state—particularly those counties dependent on agriculture and mining. Kentucky counties not considered dependent on these three industries saw their overall employment grow by 36 percent (from 28 to 38 jobs per 100 persons), while those counties dependent on mining, manufacturing, or farming had total employment growth of only about 26 percent (from about 21 to 26 jobs per 100 persons).[6] If the rural counties still largely dependent on these industries are to prevent further separation from metropolitan counties, it is essential that they have sufficient resources to attract employers in stronger industries and provide opportunities for their workers in the mining and agriculture industries to acquire training suitable for other industries.

THE DEPENDENCE OF LOCAL GOVERNMENTS ON LOCAL TAXES AS A MEANS OF GENERATING REVENUE

Cities and counties in Kentucky are dependent on three main sources of revenue for public services and infrastructure. These are: 1) taxes on property and (in some cases) wages, 2) state aid, and 3) fees for local services such as solid waste management, parks, street construction, and public hospitals. Each of these sources accounts for about one-third of the average county's budget, though rural counties tend to be more dependent on state aid and fees and metropolitan counties more dependent on taxes.[7] Of these three main sources, however, taxes on property and wages (which are not charged in every county) are perhaps most important to local governments because they represent the most direct source of *additional* revenue. Because the amount of state aid that a locality receives can change widely from year to year and fees for local services often generate only enough revenue to cover the cost of providing them, the ability of a local government to increase its revenues through its own actions depends almost entirely on its success in increasing its property tax base or by attracting more employers and taxing the wages of employees.

Thus, the ability of a community to generate sufficient revenue ultimately depends on characteristics of its residents—their population, the market value of their property, and the amount of money they make at their jobs. The more favorable these characteristics are in a community (large population, high property values, high-paying jobs), the better able it is to generate the revenues necessary to pay for public infrastructure and services without raising the tax rate. On the other hand, a county with less favorable characteristics (small population, low household income, low property values, few employment opportunities) has more difficulty in generating revenue, and therefore greater difficulty providing needed infrastructure and services.

The balance between tax capacity and the costs of providing public services is referred to as fiscal health—defined as "the ability [of local governments] to provide adequate public services without placing unreasonable tax burdens on their residents."[8] The dependence that Kentucky's local governments have on local taxes creates several challenges for rural counties, which tend to have the characteristics that contribute to poor fiscal health. Foremost among these challenges is the difficulty that many rural areas have in providing the basic public infrastructure and services necessary to promote economic growth and help stabilize and strengthen their communities. These include a quality public education system, efficient and safe wastewater treatment and solid waste management, well-maintained roads with adequate capacity for commercial activity, public utilities, police and fire protection, and health care. With their low tax base, however, rural jurisdictions are much more limited in their ability to generate the large up-front costs that the provision of these services and infrastructure require. Whether they choose to raise tax rates or do without some of this infrastructure, it becomes increasingly difficult to attract new residents and economic development—especially when households and businesses can locate in larger communities that already have this infrastructure or are better able to provide it.

Addressing the factors that contribute to a low tax base (low property values, few employment opportunities, high poverty) requires significant resources and the need for additional revenue. For instance, a lack of employment opportunities might point to a need for spending on infrastructure that would attract economic development. And a high incidence of poverty and its effects might require more spending on education, job training, housing assistance, and public health services. Ironically, then, outlying rural counties most in need of additional services and infrastructure are the least able to generate sufficient tax revenues to meet those needs. This not only weakens rural communities and distances them from the benefits of economic growth occurring in places like Louisville and Lexington, but also leads to an even greater social divide among metropolitan and rural communities as people and businesses seek communities with quality services and adequate infrastructure.

"Outlying rural counties most in need of additional services and infrastructure are the least able to generate sufficient tax revenues to meet those needs"

Compounding the disparities among metropolitan and rural tax capacity is the impact of the local occupational tax on county revenues. This tax allows communities to generate additional revenue by taxing a portion of the wages earned by employees working in the county—regardless of whether they live in that county or not. Since county revenues primarily serve residents of that county, the local occupational tax represents an opportunity for counties to generate revenue from people that it has minimal responsibility to provide with public services. Of course, a county must also provide public services to its residents that work in other counties—without the benefit of being able to tax them on their wages. For metropolitan counties, where people often work and live in different counties, there is likely to be somewhat of a balance between those who commute in and those who commute out. For rural counties however, a significant imbalance often exists.

Due to the relative lack of jobs in rural counties, many rural residents must commute long distances to other counties where jobs are more readily available. The rural counties thus have a significant net outflow of workers, mostly to metropolitan counties. The share of these commuters' income that goes towards the local occupational tax is effectively paying for public services in the county where they work—services from which they are less likely to directly benefit. On the other hand, these workers return home in the evening to counties that did not receive an equal amount of tax revenue from those commuting into the county. In this way, rural commuters (who often have relatively low incomes to begin with) are effectively subsidizing the costs of public services in metropolitan counties (which already have a greater ability to generate revenue), while the counties they live in may be struggling to provide public services of their own. Thus the local occupational tax is a regressive tax that not only places a disproportionate burden on low-income workers, but on the low tax-base counties in which they reside, and contributes to an even greater degree of social and fiscal separation.

A low tax base relative to other counties in the region, then, is among the first signs that a county is at risk of the social and economic decline that will eventually isolate its residents (if the decline has not already occurred). When the tax base is especially low, a county may be unable to provide even *basic* public services. This not only contributes to the fiscal and social isolation of residents in these areas, but also threatens the American ideal that all people should have equal access to basic educational and economic opportunities—regardless of who they are or where they live.

Besides the local impacts of dependence on local revenue sources, there are additional harmful aspects that contribute to broad, statewide social separation. First, wealthier communities with large tax bases and relatively few spending needs have a distinct advantage over less affluent communities in attracting and retaining economic development that provides the greatest benefits to the community—such as high wages and health care for employees, additional tax base, economic diversity, and opportunities for spin-off developments. Over time, these communities consistently "win" the competition for economic development, leading to a concentration of revenue-generating land uses and high-paying jobs in relatively few communities. As these communities become even more desirable as places to live and work, they draw in new residents and commuters from other areas and create a demand for even more economic development to serve the growing population.

Meanwhile, as property and housing values increase in these growing communities, the relatively few poor residents that live there must either devote a greater share of their already limited incomes to housing (deepening their poverty) or move into less expensive communities—either in poor metropolitan communities or further out into poor rural communities. Often, these places are already struggling to provide their existing, low-income residents with jobs and public services. As the concentration of low-income residents increases in these rural communities, and the financial resources necessary to provide educational and economic opportunities for them decreases, it becomes even more difficult to attract economic development. In this way, as communities consistently "lose" the competition for economic development, they become even less likely to reverse their social and economic decline. The sense of urgency that comes with this decline often encourages local officials to compete even more fiercely with neighboring communities or accept the most undesirable of land uses—such as low-paying manufacturing or retail jobs, large industrial livestock operations, landfills, prisons, and highly polluting industries—none of which provide a significant increase in livable-wage jobs or help to create a base of wealth that could stabilize the local economy. Longer-term, more effective solutions that recognize the need for rural communities to join together and influence social and economic development patterns at the state level get lost in the shuffle.

Wasteful Public Subsidies to Attract Economic Development

A particularly disturbing effect of local governments' dependence on local taxes is that it provides an incentive for cities and counties to compete with each other for property that generates large property tax revenues. In most cases, this competition requires that a local government offer businesses and developers lucrative public subsidies or tax breaks in order to convince them to locate in their community rather than another. Often, the development that they can attract represents the "cast-offs" of metropolitan areas—development that provides relatively low pay, few benefits, or is undesirable for environmental or aesthetic reasons. While these developments may help to provide a few jobs and pay for immediate needs by providing some additional tax revenue, they are often unable to provide the long-term benefits that rural areas need to stabilize their economy and promote growth. In other words, accepting development simply for the sake of development does little to improve the underlying conditions that created the weak tax base, poverty, and lack of jobs in the first place—a small population, low household incomes, an unskilled workforce, and low-wage jobs without health care benefits. Further, these public subsidies often fail to have their intended effect, which is to increase the local tax base and improve the quality of life for residents. As one tax expert has commented, "The price of victory [in attracting an employer]…might be poorly maintained roads and parks, inferior schools, cuts in police protection and ineffective social programs….The bottom line is that business incentives [as an economic development strategy] are rarely as good as they look."[9]

A recent example of this wasteful inter-jurisdictional competition was given in a study entitled "Kentucky's Low Road to Economic Development: What Corporate Subsidies are Doing to the Commonwealth."[10] One case study in the report shows how the state of Kentucky and the governments of three counties have provided millions of dollars—through grants, bonds, and tax abatements—to attract a chicken processing company that pledged to build facilities in Henderson, Webster, and McLean counties and to employ about 1,300 full-time workers. To build these facilities, the company received a $94 million revenue bond from the state to cover start-up costs ($72 million for Henderson, $14 million for Webster, and $8 million for McLean), up to the same amount in tax incentives through the Kentucky Rural Economic Development Act (KREDA), and more than $10,000 in job training grants from the Cabinet for Economic Development. They also were able to lease land from Webster County at rate significantly lower than the $525,000 cost the county incurred in obtaining the property.

Despite these significant investments by the state and three counties, the chicken processing facilities have provided little benefit to the counties or their residents. The company has yet to pay any local property taxes in any of the three counties. It received a ten-year property tax abatement from Webster County and a five-year property tax abatement from McLean County; because of the structure of the deal in Henderson County, the company does not pay any local property taxes. Further, workers and residents have complained of dangerous working conditions, health concerns due to the odors created during the plants operations, and the degradation of historic landmarks in the community.

EVIDENCE OF THE FISCAL DIVIDE

The ability of a local government to pay for needed public services and infrastructure through local taxes is one of the most basic elements of a community's health and stability. Roads and highways, public education, libraries, police and fire protection, correction facilities, public housing, parks, solid waste management, and public health care: all of these depend on public tax revenues because of their high costs and importance to community well being. Thus, the amount and quality of public services that a community can provide has a significant effect on the quality of life for its residents and the opportunities that they have to contribute to society.

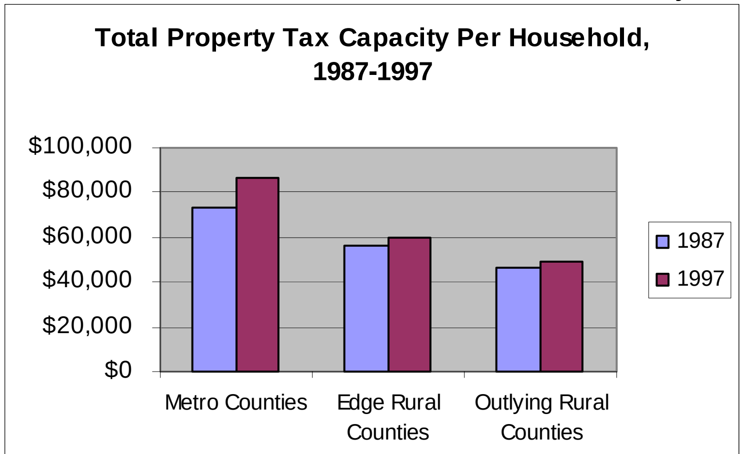
When many people with relatively high incomes live in the same community, taxes required to provide public services are likely to be less of a burden for each individual resident. By contrast, when large numbers of low-income residents live in the same community, the opposite is true. The share of each resident's income required to provide public services is comparatively high. Local government officials in relatively poor communities must make the difficult choice between raising taxes on people who can least afford it in order to provide the same level of service as wealthier communities, or reducing the number of services that they provide.

As poverty begins to concentrate in some communities and their ability to raise sufficient tax revenues for public services decreases, significant social divisions begin to form and solidify. Relatively wealthy communities, because they can provide adequate services at a low cost per taxpayer, become more attractive places to live and work. However, the strong demand for housing in these areas raises the cost of housing so that only higher income people can afford to live there. As more and more people with relatively high incomes move in, the amount of taxes that each taxpayer must pay is likely to decline (depending on how efficiently the local government is able to provide the same services to these new residents). On the other hand, low-income communities that struggle to provide public services at a reasonable tax rate become less desirable. People unable to afford housing in the most desirable communities must live in these lower-income communities instead. Eventually, as people seek communities with the most expensive housing they can afford, lower-income residents become highly concentrated in the poorest communities—generally core cities in metropolitan areas or rural communities with few jobs and under-funded schools.

As a result of these widely divergent paths, wealthy communities become more and more attractive while poor communities become less so. High-paying employers, wealthy residents, and other revenue-generating developments flow to these wealthy communities, while poor areas are left with development that generates minimal revenues in their own communities. Not only do these poor communities have trouble attracting new development that would provide additional tax revenues, they also tend to see their costs of providing services rise as poverty and social need concentrate in their communities. The older homes and trailer homes that are found in these communities require more fire protection, higher crime rates require more police protection, the cost of public education rises as students enter with greater social needs, and public health costs increase when people who can't afford preventive health care are stricken with more serious health conditions.

Figures 2 and 3: Total Property Tax Capacity

Total property tax capacity, which includes residential, commercial and industrial property, is the single largest measure of the ability of a local government to directly generate tax revenue—accounting for about half of all local taxes.[11] Further, the property tax base available to a community signifies whether or not that community has characteristics that contribute to economic stability, such as commercial and industrial properties that generate jobs and create higher incomes, and middle- and upper-class homes that live in valuable and desired homes. By contrast, a community with a low property tax base is not likely to have much economic development or growth and will have greater difficulty in generating enough revenue to provide needed public services to its residents.



Source: Kentucky Department of Local Government, Division of Financial Services

Figure 2 shows clearly that the most valuable property in the state in 1997 was concentrated in the Louisville, Lexington, and Cincinnati metropolitan areas, while outlying rural counties had significantly lower property tax capacity. In aggregate, the gap between metropolitan counties and rural counties (particularly outlying rural counties) is considerable. Metropolitan counties enjoyed an average total property tax base of about $86,550 per household—about $17,900 greater than the state average. Rural counties located at the edges of these metropolitan areas averaged a total property tax base of about $55,975. Outlying rural counties were even further back at just over $48,800 per household.

The significant disparities that existed in 1997 represent an even wider gap than existed a decade before, as shown in Figure 3. Between 1987 and 1997, the total property tax base grew almost 18 percent in metropolitan counties—from an average of $73,572 to $86,550 per household. Edge rural counties on the other hand, which already had lower valued property than metropolitan counties, saw their property tax base rise by only 7 percent—from $55,921 to $59,975 per household. Outlying rural counties saw the smallest increase in total property tax base on what was already the lowest average property tax base in the state—rising 6 percent from $46,050 to $48,810 per household. These disparities in total property tax base are largely attributable to the concentration of commercial and industrial properties in metropolitan areas. A number of counties, mostly concentrated in western Kentucky, saw their total property tax base actually decline—some by as much as 45 percent.[12]

Figures 4 and 5: Residential Property Tax Capacity

The value of residential property in a community, separate from the value of commercial or industrial property, provides more direct evidence of the desirability of a community as a place to live. Tracking the value of residential property can help to determine other social and economic characteristics of a particular community—such as the availability of jobs in the vicinity, the wages that these jobs pay, the overall wealth of residents, the amount of private investment that is taking place, and the level of social need that exists. Thus, the property tax capacity of residential property helps to highlight not only the overall ability of a community to generate property tax revenues, but

Figure 2: Total Property Tax Base per Household by County, 1997

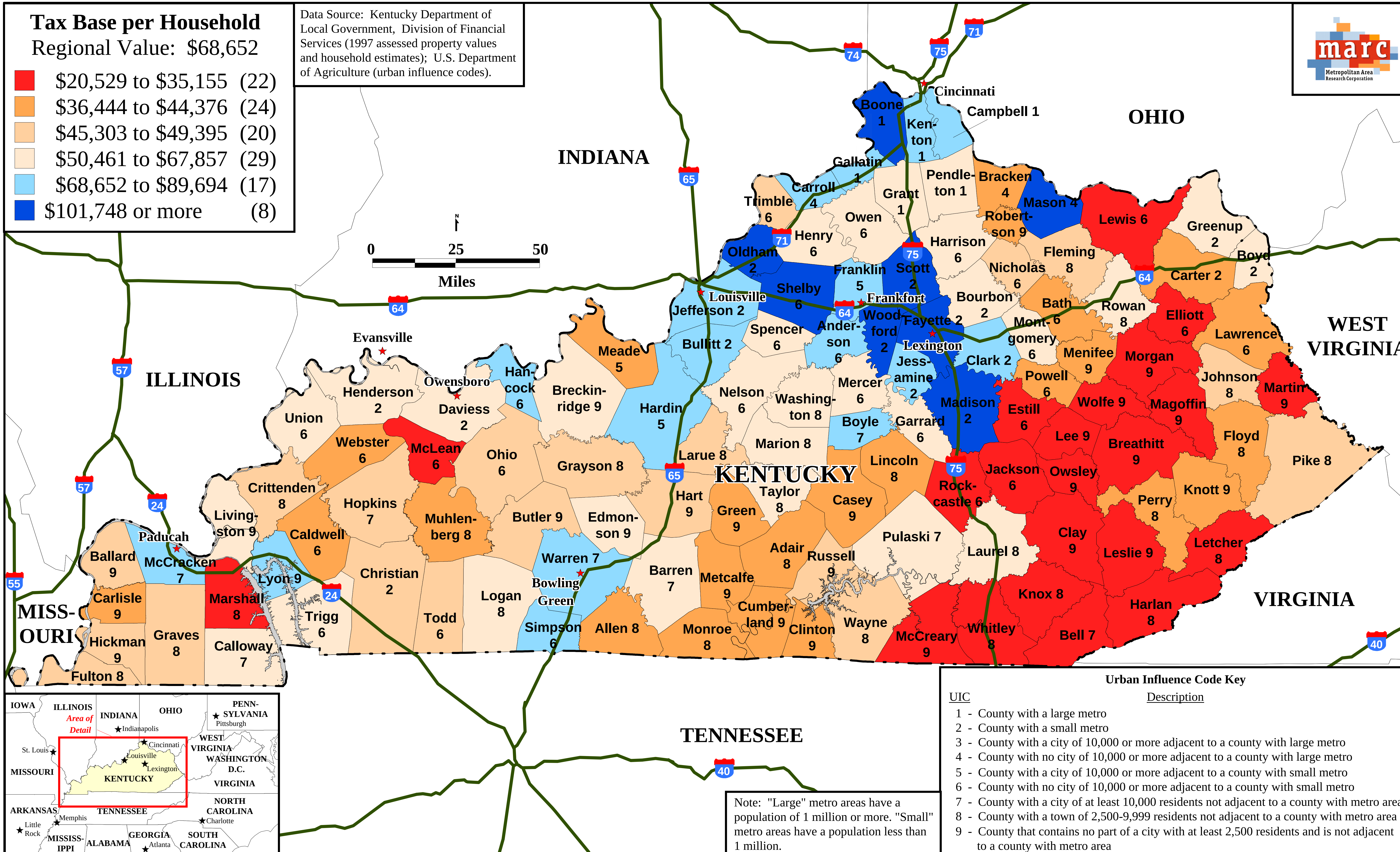


Figure 3: Percentage Change in Total Property Tax Base per Household by County, 1987-1997 (Adjusted by CPI)

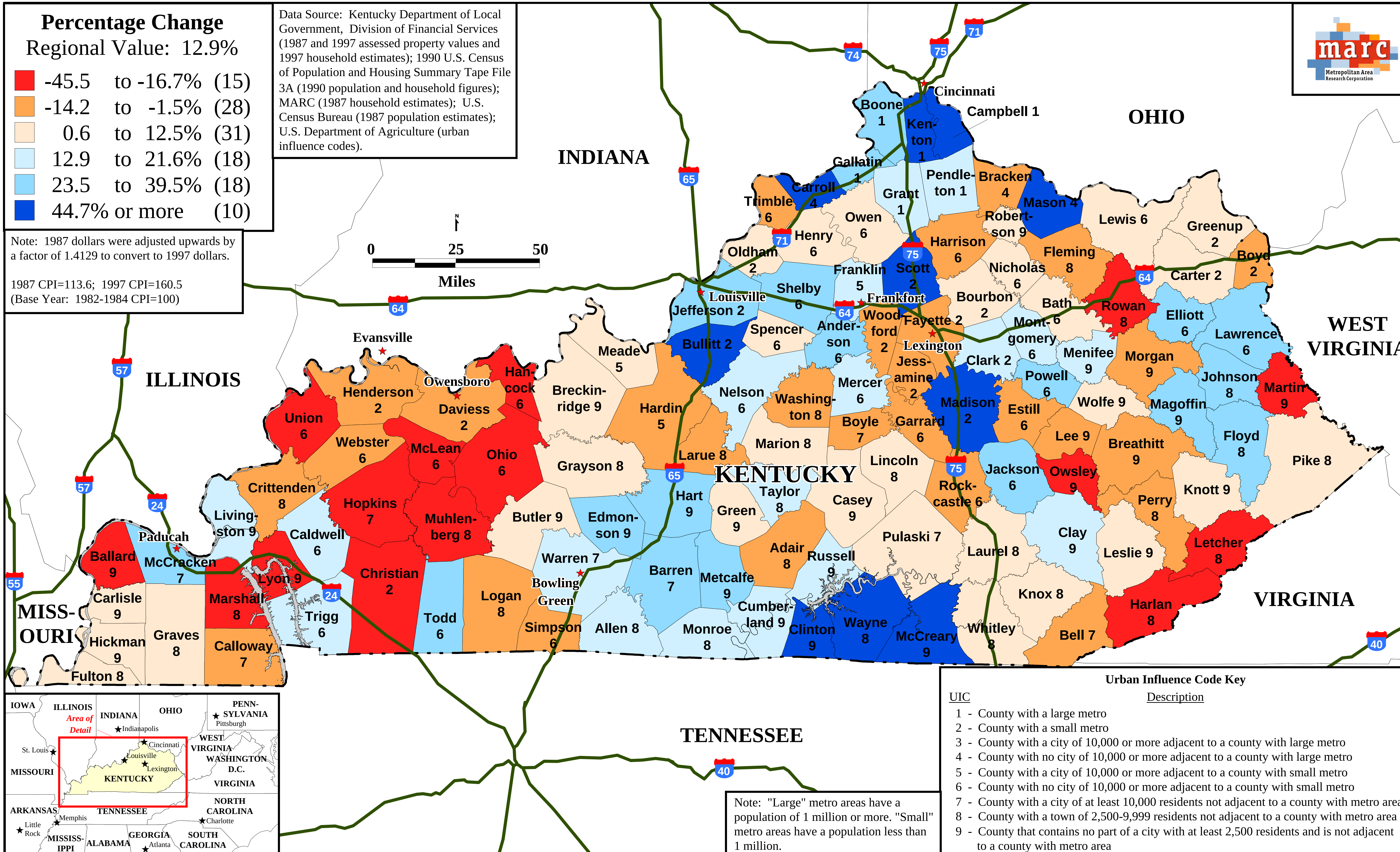


Figure 4: Residential Property Tax Base per Household by County, 1997

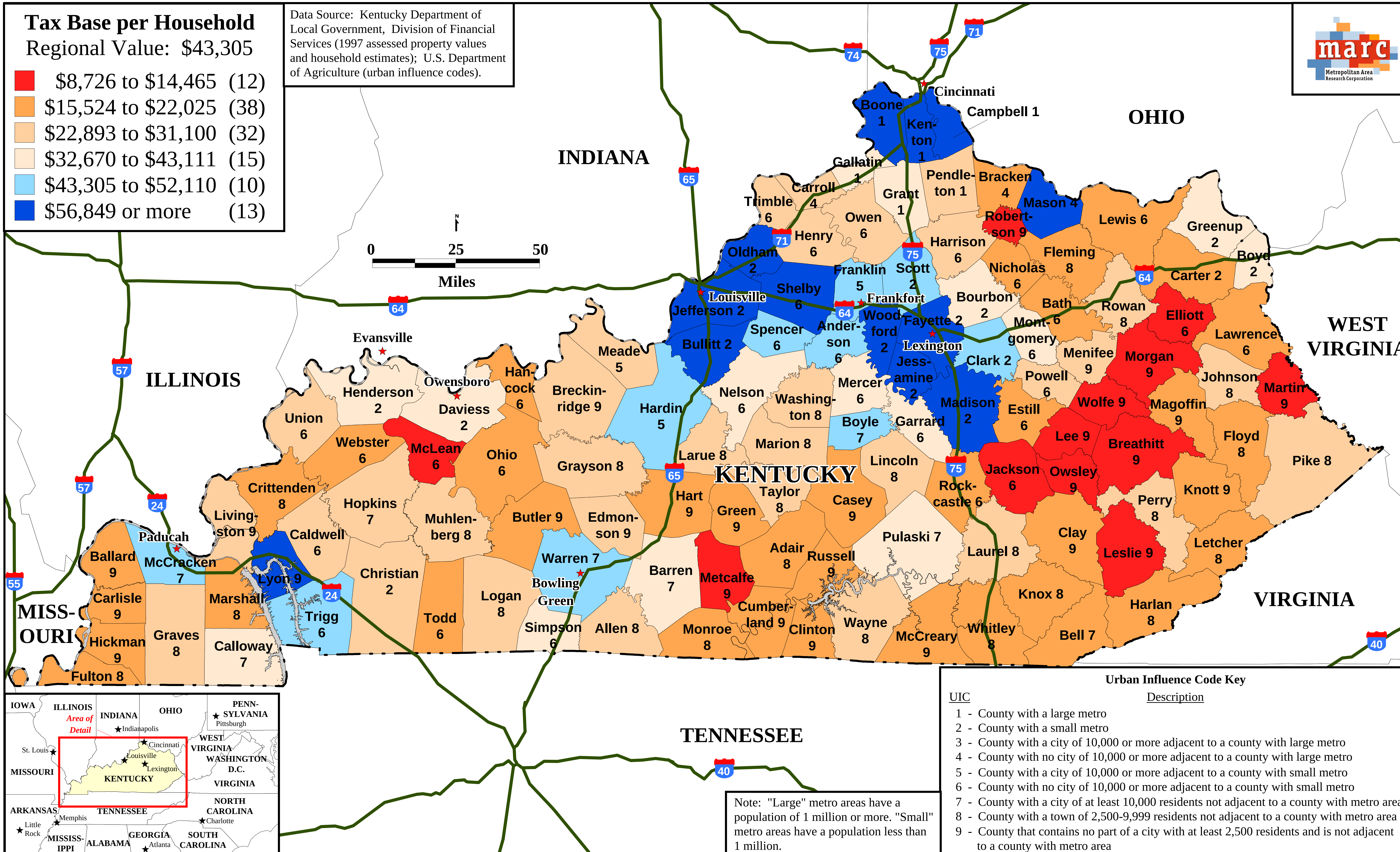
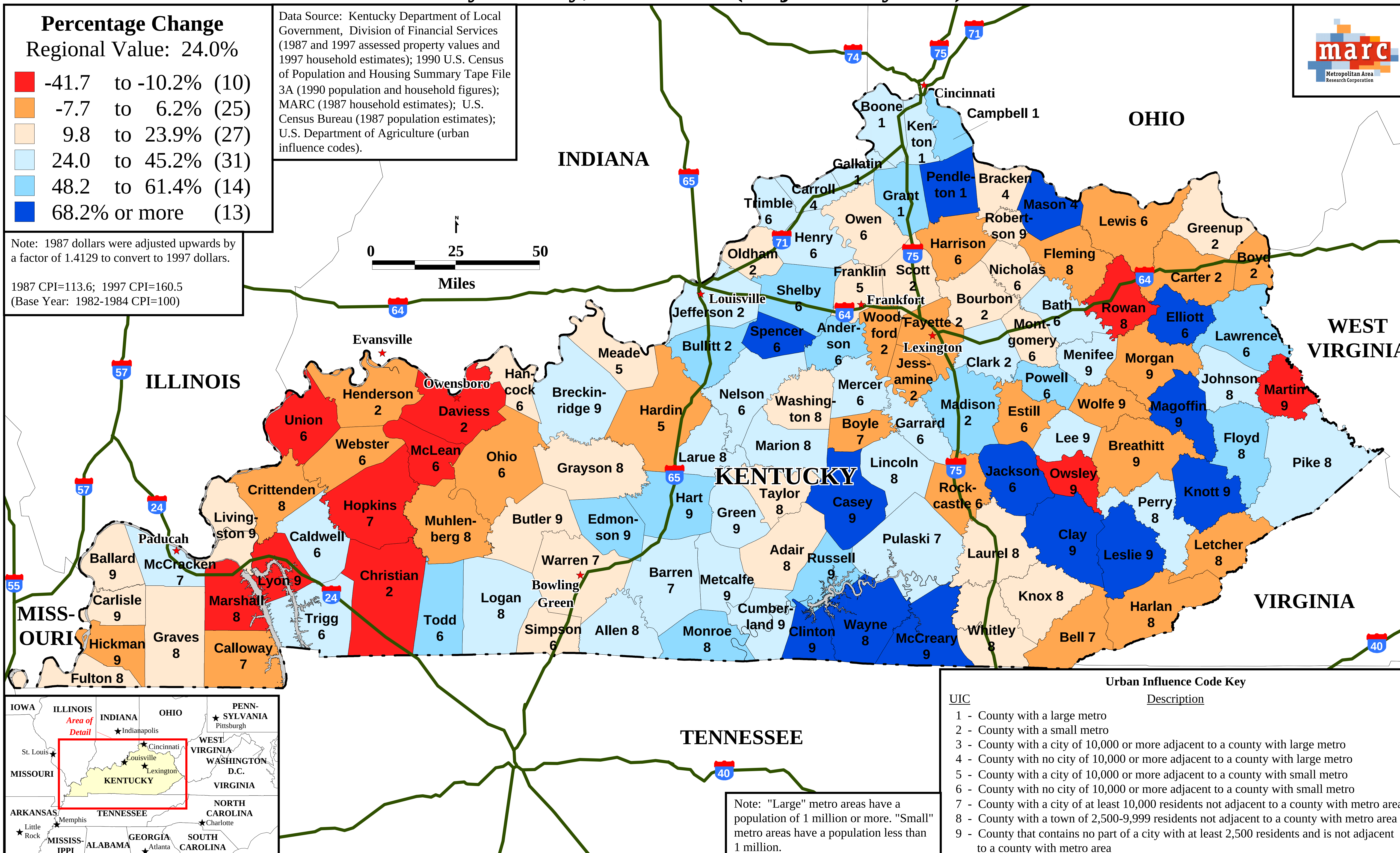


Figure 5: Percentage Change in Residential Property Tax Base per Household by County, 1987-1997 (Adjusted by CPI)



Note: "Large" metro areas have a population of 1 million or more. "Small" metro areas have a population less than 1 million.

Urban Influence Code Key

UIC	Description
1	County with a large metro
2	County with a small metro
3	County with a city of 10,000 or more adjacent to a county with large metro
4	County with no city of 10,000 or more adjacent to a county with large metro
5	County with a city of 10,000 or more adjacent to a county with small metro
6	County with no city of 10,000 or more adjacent to a county with small metro
7	County with a city of at least 10,000 residents not adjacent to a county with metro area
8	County with a town of 2,500-9,999 residents not adjacent to a county with metro area
9	County that contains no part of a city with at least 2,500 residents and is not adjacent to a county with metro area

also helps signify whether other factors are present that affect the ability of a local government to generate revenues from non-property taxes.

Figure 4 shows the residential tax base in Kentucky's counties during 1997. Clearly, the most valuable homes and residential property are concentrated in the three main metropolitan areas of the state—Louisville, Lexington and Cincinnati. Of the 13 counties in the state with a residential property tax base greater than $56,000 per household, ten of them were located in these metropolitan areas. Overall, the metropolitan counties of the state had an average residential property tax capacity of almost $59,000 per household—about $15,700 more than the state average. Edge rural counties, on the other hand, had an average residential property tax base of about $33,400 per household while outlying rural areas averaged under $27,000.

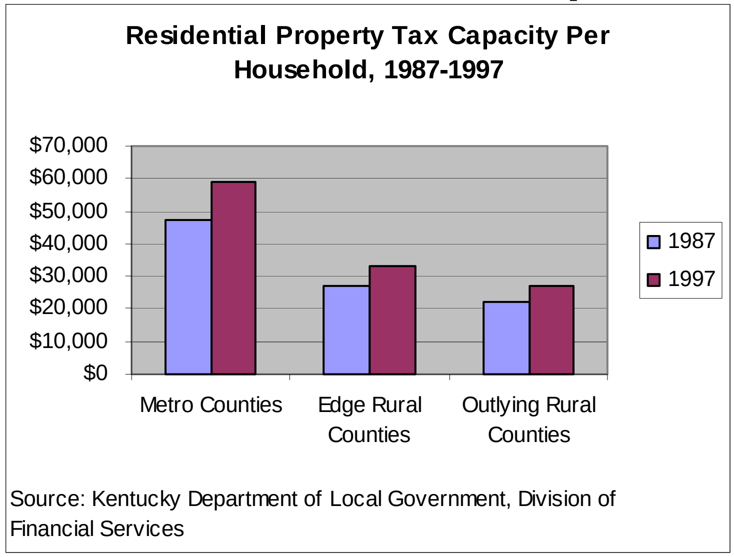


Figure 5 shows that little has changed in these large disparities in residential property tax base since the late 1980's. Between 1987 and 1997, the value of residential property across the state increased by 24 percent. In the aggregate, edge rural and metropolitan counties grew at about the same rate over this period—rural counties seeing an increase of about 24 percent compared to a 25 percent increase in metropolitan counties. Even outlying rural counties were only slightly behind, with an increase in their residential property tax base of 22 percent.

However, these aggregate comparisons between rural and metropolitan counties mask significant losses in residential property tax base for some parts of the state. The most pronounced changes took place in counties of the western region of the state between Paducah and Owensboro, where the residential property tax base dropped by as much as 40 percent. A significant number of counties in eastern Kentucky also experienced declining or relatively stagnant residential property values, such as Owsley, Martin, Letcher, and Harlan counties.

Figures 6 and 7: Local Occupational Tax Revenues

A local occupational tax is charged in 84 of the state's 120 counties—including 16 of the 22 metropolitan counties. For counties with large numbers of jobs, this tax represents a significant source of additional revenue that can be used to provide additional public services, improve existing ones, or reduce tax rates on other local taxes.

As is shown in Figure 6, however, counties that receive the greatest revenues from this tax are highly concentrated in counties of the state's two main metropolitan areas—Louisville and Lexington. These counties (Jefferson, Fayette, Woodford and Scott) collected an average of $1,024 per household in 1995. For all metropolitan counties that impose the tax, the average revenue generated was measured at $688 per household. Rural counties, on the other hand, have far fewer jobs and thus collect much lower per household revenues. As a whole, rural counties that imposed a local occupational tax generated just $205 per capita—about 3 ½ times less than the average metropolitan county and five times less than the counties of the Lexington and Louisville metropolitan areas.

Figure 6: Local Occupational Tax Revenues per Household by County, 1998

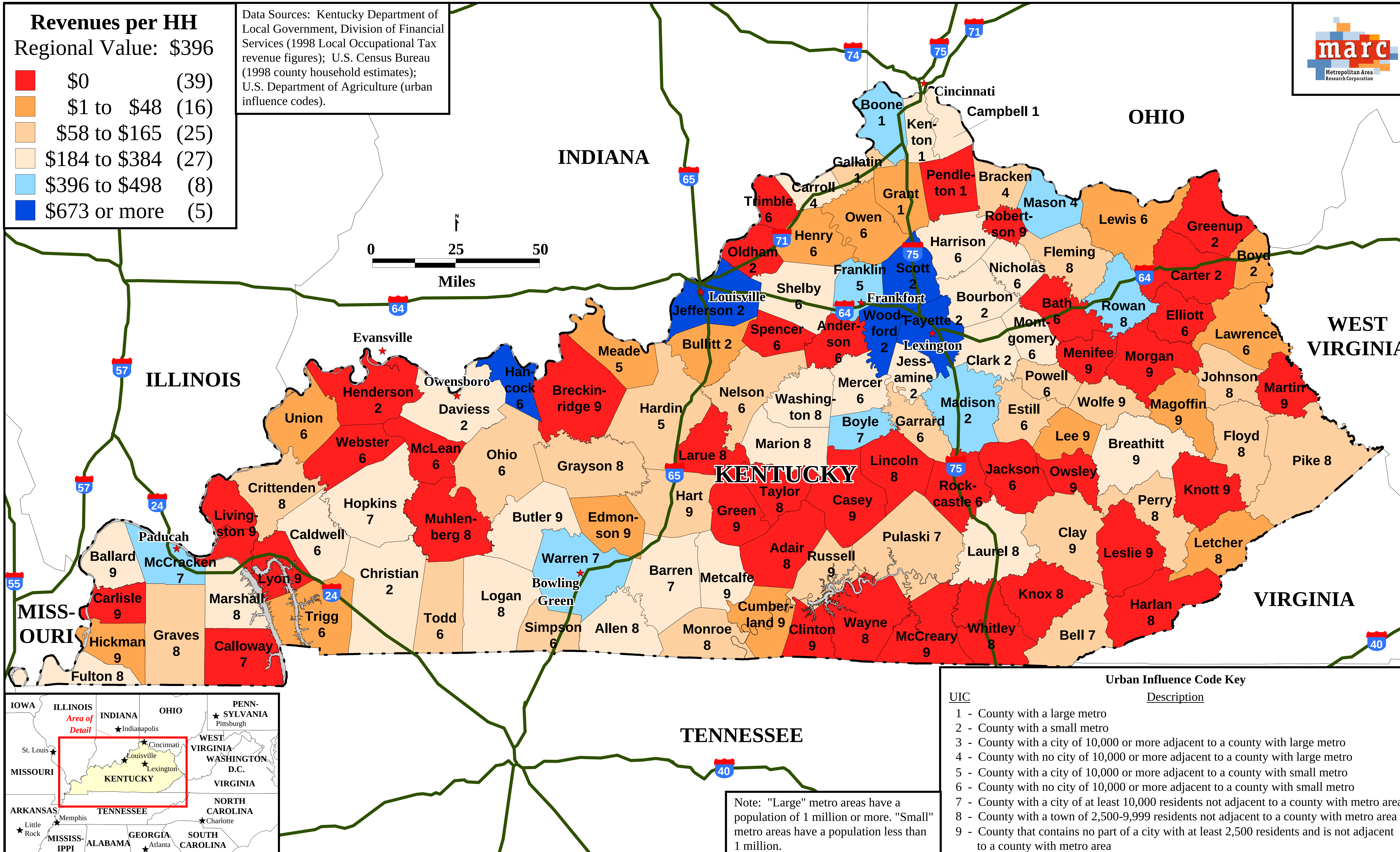
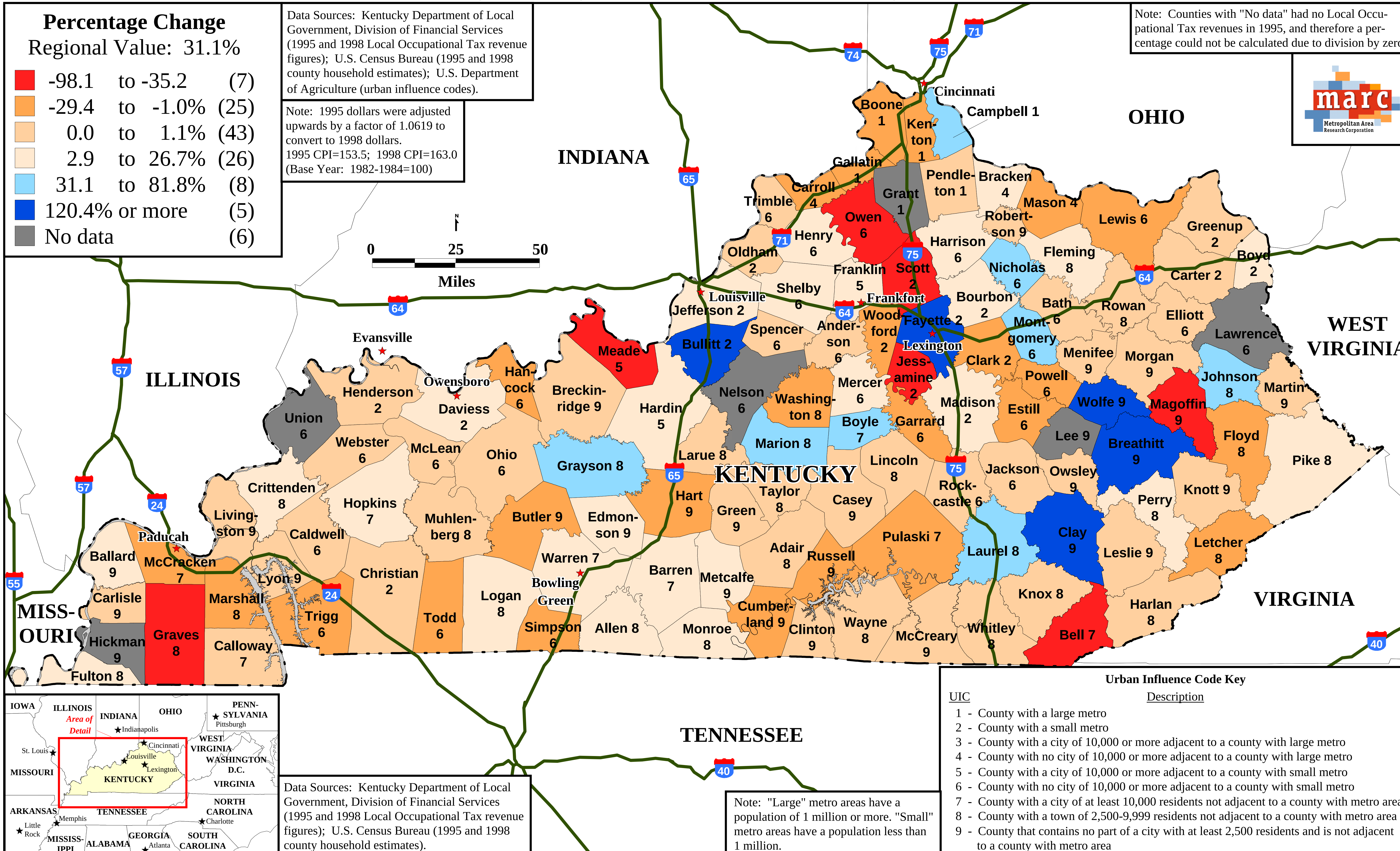
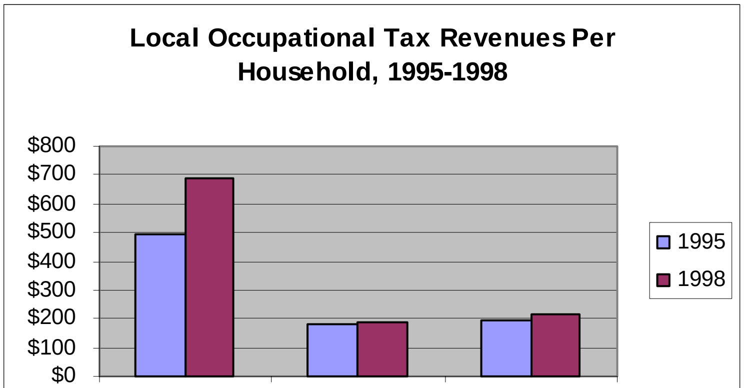


Figure 7: Percentage Change in Local Occupational Tax Revenues per Household by County, 1995-1998 (Adjusted by CPI)



Among these rural counties, those at the edges of metropolitan areas had the lowest revenues per capita, at $188 per household. Outlying rural counties imposing a local occupational tax had slightly higher revenues, at $214 per household. The relatively low revenue from the occupational tax in edge rural counties is likely due to the decision of employers to locate in adjacent metropolitan areas where they can draw employees from both metro counties and the adjacent rural counties.



Source: Kentucky Department of Local Government, Divison of Financial Services

Further, as Figure 7 shows, the continued job growth in metropolitan counties over the last several years has only served to increase disparities in the revenue-generating capacity of metropolitan and rural counties. Between 1995 and 1998, local occupational tax collections increased in metropolitan counties by almost 40 percent—from $493 to $688 per household. Jefferson and Fayette counties saw the great majority of this growth, with Jefferson increasing its collections from $537 to $673 per household and Fayette rising astronomically from $939 to $2,070 per household. Despite significant declines in Woodford and Scott counties, these four core metropolitan counties saw their overall occupational tax collections increase by more than 55 percent—from $659 to $1,024 per household. By contrast, edge rural counties saw their collections from this tax rise only slightly—from $180 to $188 per household. Outlying rural counties also rose minimally from $197 to $214 per household.

Given that metropolitan counties already are able to collect much higher revenues from property taxes than those in rural areas, the local occupational tax only serves to deepen the disparities. Further, the metropolitan counties that generate large revenues from this tax do so by taxing a significant number of rural commuters—those who live in rural areas but commute into metropolitan counties to find work.[13] Essentially, this amounts to a transfer of wealth from relatively poor rural areas to relatively wealthy metro areas. Metropolitan counties are able to generate revenue from people for whom they need provide very few public services, while poor rural counties see their tax capacity decline even further relative to those in metropolitan counties.

THE EFFECTS OF SOCIAL AND FISCAL SEPARATION: ISOLATION AND PERSISTENT POVERTY

Many rural communities in Kentucky are facing significant social separation brought about by the fiscal disparities between them and the metropolitan areas of the state. These disparities, if not addressed effectively, threaten to leave rural residents even further isolated from the rest of the state. Representatives of the state's rural areas must recognize the common challenges they face and work to create state policies that support them rather than hindering their full participation in the state and national economy.

One of the most devastating consequences of the social and fiscal separation of rural communities is the persistence of concentrated poverty and social need in many rural towns and school districts. For those who become trapped in the cycle of poverty, nearly every aspect of life is affected —from their education and health to the availability of employment opportunities and the stability of their communities. The profound isolation created by high and persistent concentrations of poverty also intensifies the flight of individuals and families from affected communities and the decline of the local economy. Ultimately, the rural poor become concentrated in communities that are becoming more and more overwhelmed by the social challenges that poverty creates. At the same time, the resources to deal with these challenges decrease.

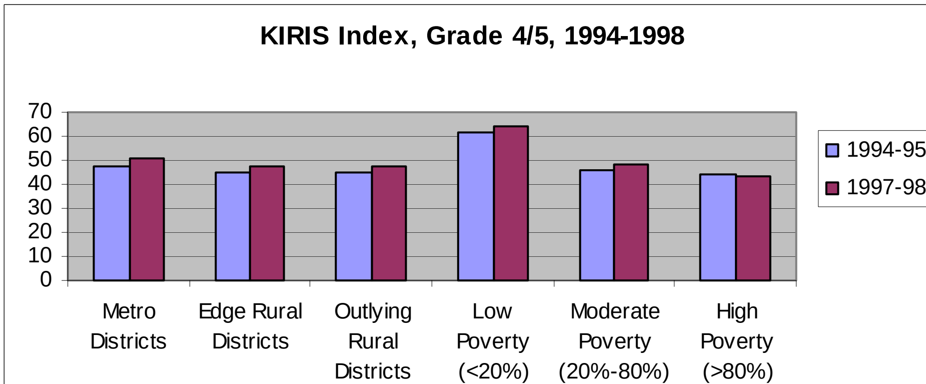
Outlying rural counties in Kentucky have some of the most persistent and severe concentrations of poverty in the United States. In 1995, 24 percent of the residents of these counties lived in poverty—compared to just 17 percent in rural counties adjacent to metropolitan areas and 14 percent within the state's metropolitan areas.[14] The most severe concentrations of poverty are concentrated in eastern Kentucky, but many outlying rural counties throughout the central and western areas of the state contain poverty rates in excess of 22 percent as well. The national poverty rate in rural areas, by contrast, has fluctuated around 16 percent since 1980.[15] For more than half of Kentucky's rural counties, concentrated poverty has been a part of life for several generations, as poor children grow up without the resources to escape the poverty into which they were born. Since data was collected in 1960, 54 of the state's 98 rural counties have had a poverty rate of at least 20 percent. Forty-three of these were located in outlying areas of the state.[16]

For the individuals and families left behind in these poor rural communities, the effects of this persistent poverty include a profound isolation from educational and employment opportunities that could help them to escape the vicious cycle of poverty and improve the quality of their lives. This is because communities and schools[17] represent a series of reinforcing social networks that define social norms and either contribute to success or create an environment for failure. Communities and schools not overwhelmed with the social challenges of highly concentrated poverty are more likely to be streams flowing in the direction of success because they have the ability to provide the social and economic resources necessary for personal and community growth.

On the other hand, the concentration of poverty in outlying rural areas intensifies the difficulty that these communities have in providing opportunities for economic and social growth because of the relatively few resources available to them. Poor rural areas must not only compete with metropolitan areas for economic development and job growth, they must do so with the additional burden of a high concentration of poverty and other social needs—characteristics that companies do not favor when deciding where to locate. Counties must provide additional income assistance, job training, public health care, and public safety services if they want to create a positive environment for growth. School districts must try and educate poor students that come from families without enough money for basic food, clothing, and housing costs or enough education to provide the support and example that is needed for high academic achievement. Cities and towns must try and provide public water, wastewater treatment, and other public services with little wealth from which to generate revenues. Workers often are forced to drive long distances to jobs because companies cannot find adequately trained people and retailers located in more affluent areas. As a result of these challenges, economic investment continues to be made elsewhere and poverty persists.

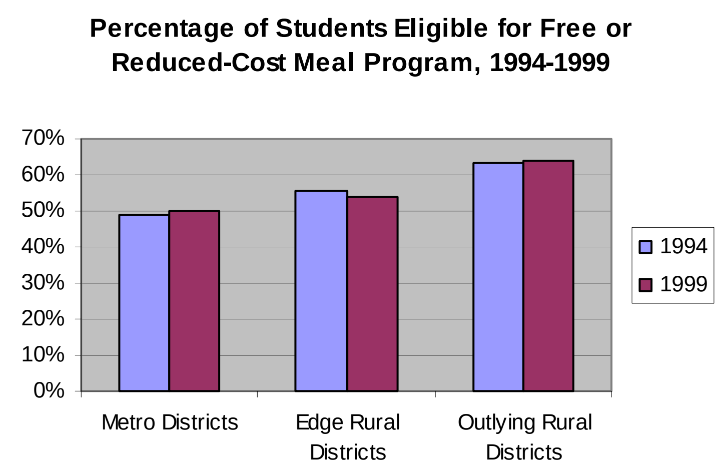
Figures 8 and 9: Poverty Among Elementary School Students

Concentrated poverty in elementary schools is particularly influential in social and fiscal separation. When parents begin to see high concentrations of poverty in the schools their children attend, they perceive (rightly or wrongly) that the quality of education is reduced because of that poverty. If they have the financial resources and the ability to find jobs in other school districts, they often move their children to those schools.



Source:Source: Kentucky Accountability Results for Schools and Districts, Dec. 1998. Student Poverty data is from the Kentucky Department of Education. Percent poverty refers to the percentage of students eligible for free or reduced-cost lunches.

The connection that people draw between poverty and academic achievement based on their own perceptions is often confirmed in state or school district testing. Poor schools consistently score lower than more affluent schools on standardized tests throughout the nation, and Kentucky is no exception. According to data from the Kentucky Instructional Results Information System (KIRIS), school districts with the highest percentage of students eligible for free or reduced cost meals (the most widely used measurement of student poverty) had consistently lower test scores than more affluent districts. Further, these poor districts showed less improvement between 1994 and 1998 than those in more affluent districts. Elementary schools in school districts with more than 80 percent of the students eligible for free or reduced-cost lunches consistently scored lower on their KIRIS index than other districts—actually dropping from an average score of 44.1 in 1994 to 43.5 in 1998. By contrast, in the most affluent districts, where student poverty was below 20 percent, the KIRIS index for elementary students rose from 61.8 to 64.0. This pattern was consistent throughout the state; above-average poverty (mostly in outlying rural and eastern Kentucky districts) is associated with lower improvement in the KIRIS index.



Source: Kentucky Department of Education

Figure 8: Percentage of Elementary Students Eligible for Free and Reduced Meals by School District, 1999

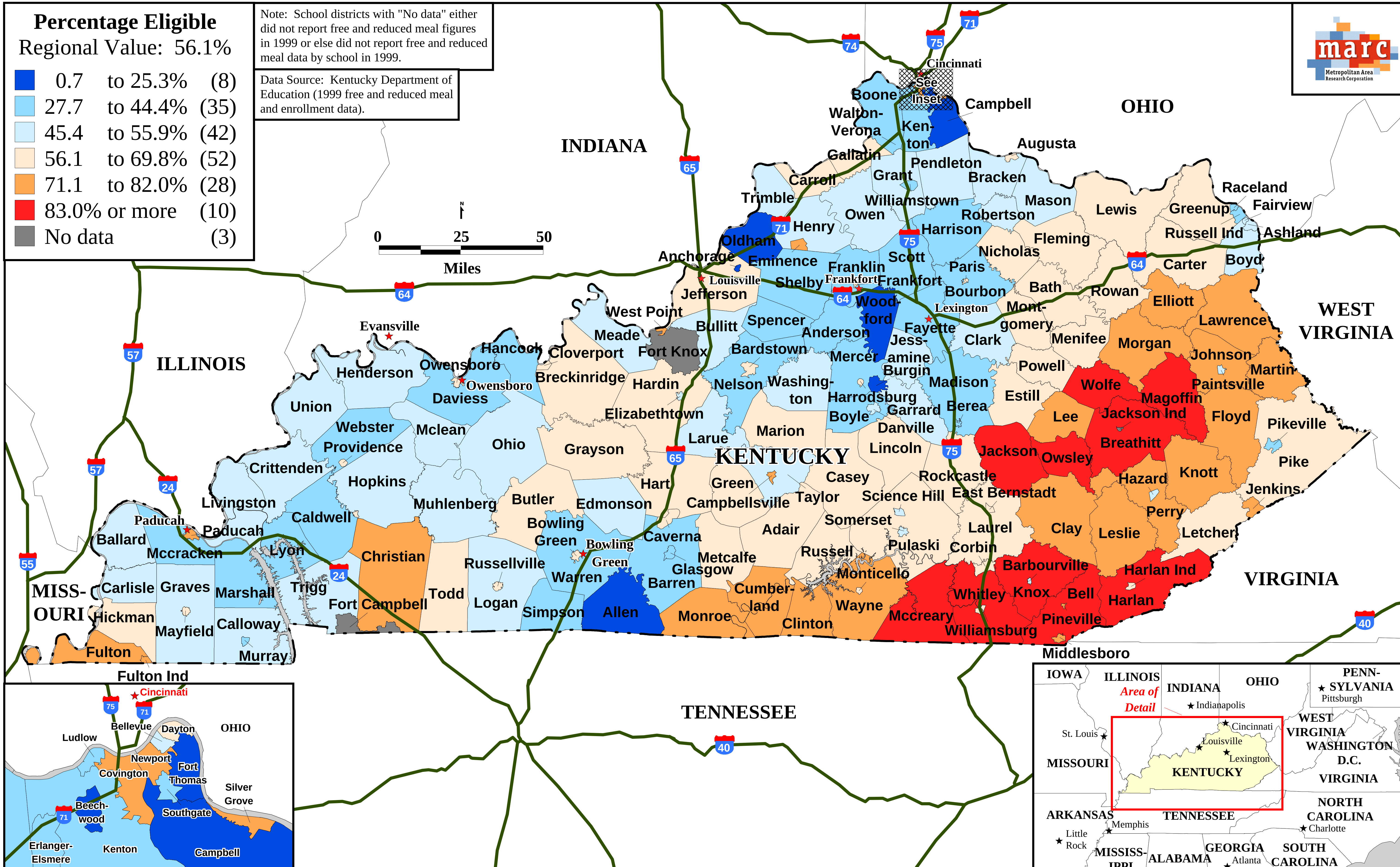


Figure 9: Change in % Points - Elementary Students Eligible for Free & Reduced Meals by School District, '94-'99

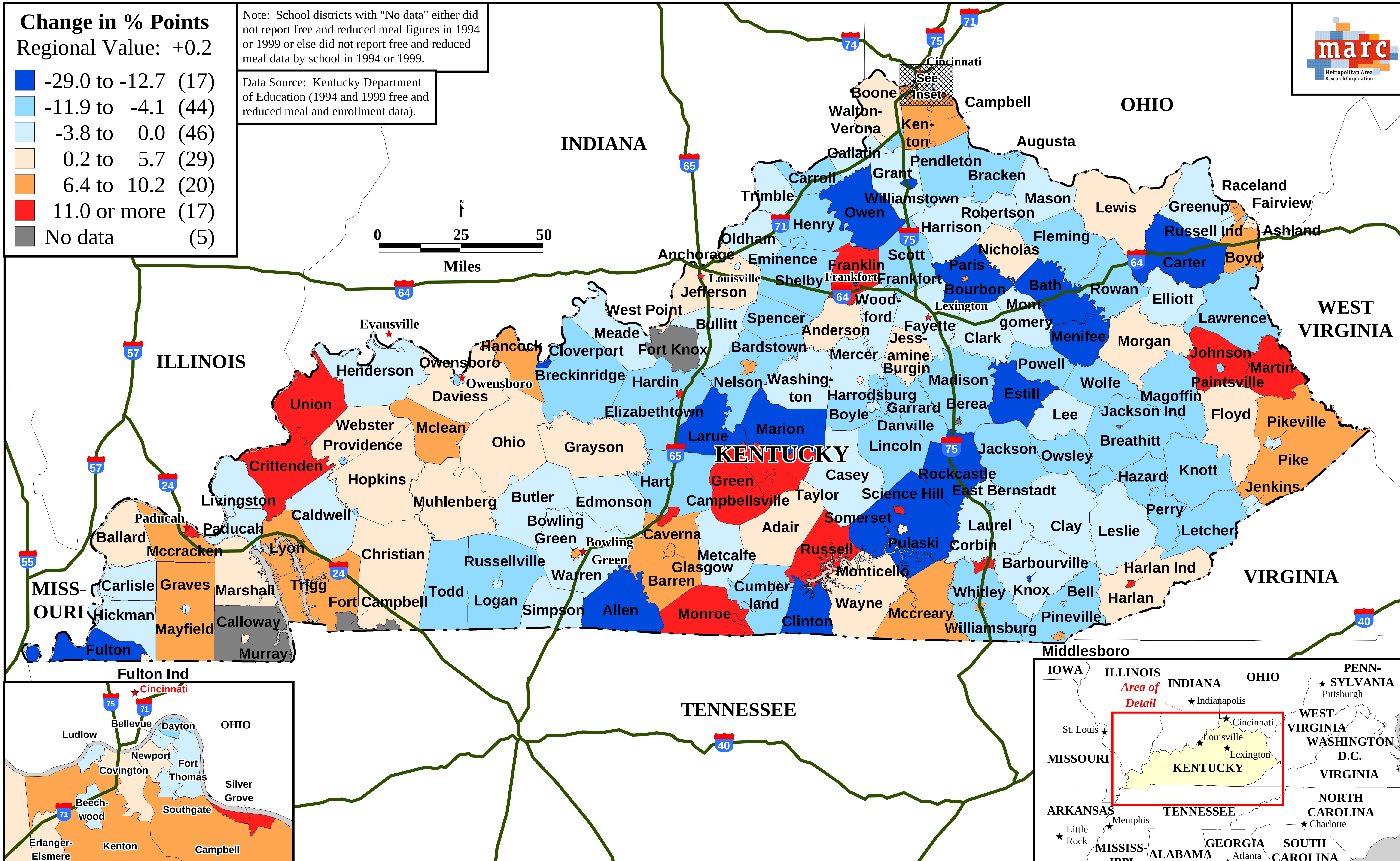


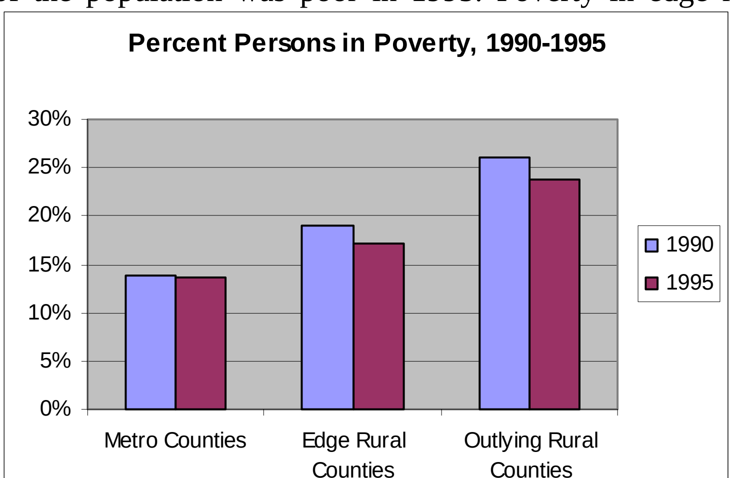
Figure 8 shows that the poorest school districts in 1999 were concentrated in outlying rural school districts, where the percentage of students receiving free or reduced-cost meals averaged 64 percent. Rural districts at the edges of metropolitan areas were slightly lower than the state average of 56 percent, with 54 percent of their students eligible for the assistance. Metropolitan districts as a group had the lowest student poverty, averaging 50 percent eligibility.

Figure 9 shows that the disparities that existed in 1999 were very similar to those that existed in 1994—evidence that while the disparities are not worsening significantly, they are also not improving. Between 1994 and 1999, both metropolitan and outlying rural school districts saw their student poverty grow slightly–by about one percentage point in both cases. Still, outlying rural districts had a student poverty rate 14 percentage points higher than metropolitan districts—the same gap that existed in 1994. Only rural districts at the edges of metro areas saw their student poverty decline overall, dropping from 56 to 54 percent eligibility during the period.

Figures 10 and 11: Persons in Poverty

As poverty increases in a community, the likelihood that economic development will take place in that community decreases. This is largely due to the lack of a highly trained workforce and the limited buying power that is associated with poverty. Further, a high concentration of low-income residents makes it more difficult for these communities to generate sufficient revenues to meet the level of need that exists. Thus, once the concentration of poverty reaches a significantly high point in a community, it is very likely to experience further social and economic decline.

Kentucky's poverty is disproportionately concentrated in Kentucky's rural counties, which in 1995 contained half of the state's total population, but nearly two-thirds of its poor. Figure 12 shows that the greatest concentrations of poverty could be found in outlying rural counties, where 24 percent of the population was poor in 1995. Poverty in edge rural counties was significantly lower, at 17 percent of the population. Metropolitan counties had the lowest average poverty rates in the state with a poverty rate of less than 14 percent—well below the state average of 18 percent.



Source: US Census Bureau, Small Area Income and Poverty Estimates

Since 1990, the disparities in poverty have become somewhat less severe, although not very significantly. Between 1990 and 1995, the percentage of people in poverty throughout outlying rural counties declined by about 2 percentage points, from 26 to 24 percent. Rural counties at the edge of metropolitan regions also saw their poverty rate decline by 2 percentage points, from 19 to 17 percent. Metropolitan counties as a whole had a poverty rate that remained stable at 14 percent. Several areas of the state experienced moderate increases in poverty, most notably the counties of the Huntington-Ashland metro area, Kenton and Campbell counties in the Cincinnati area, Jefferson County in the Louisville area and the western counties of the Lexington metropolitan area.

Figure 10: Percentage Persons in Poverty by County, 1995

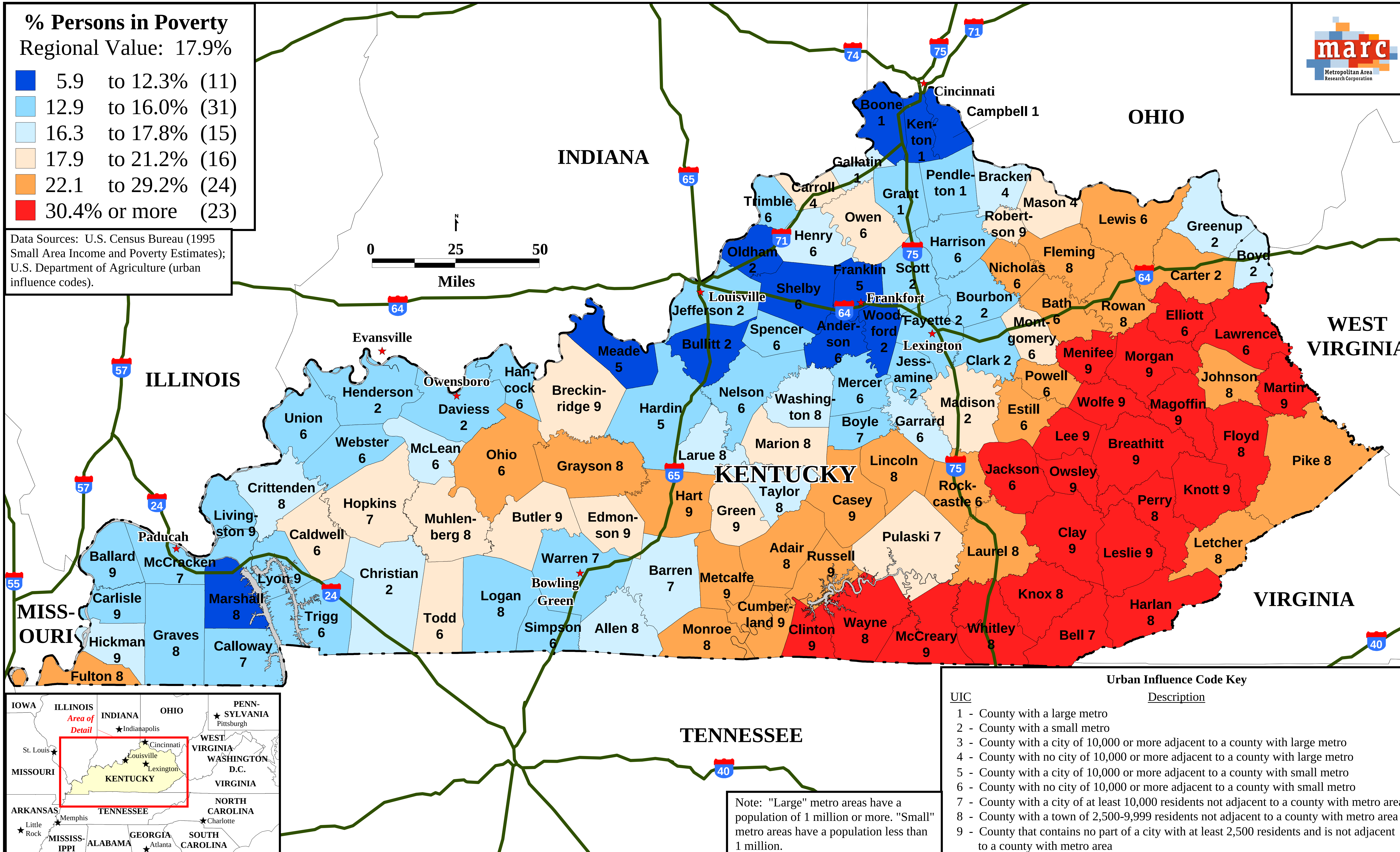
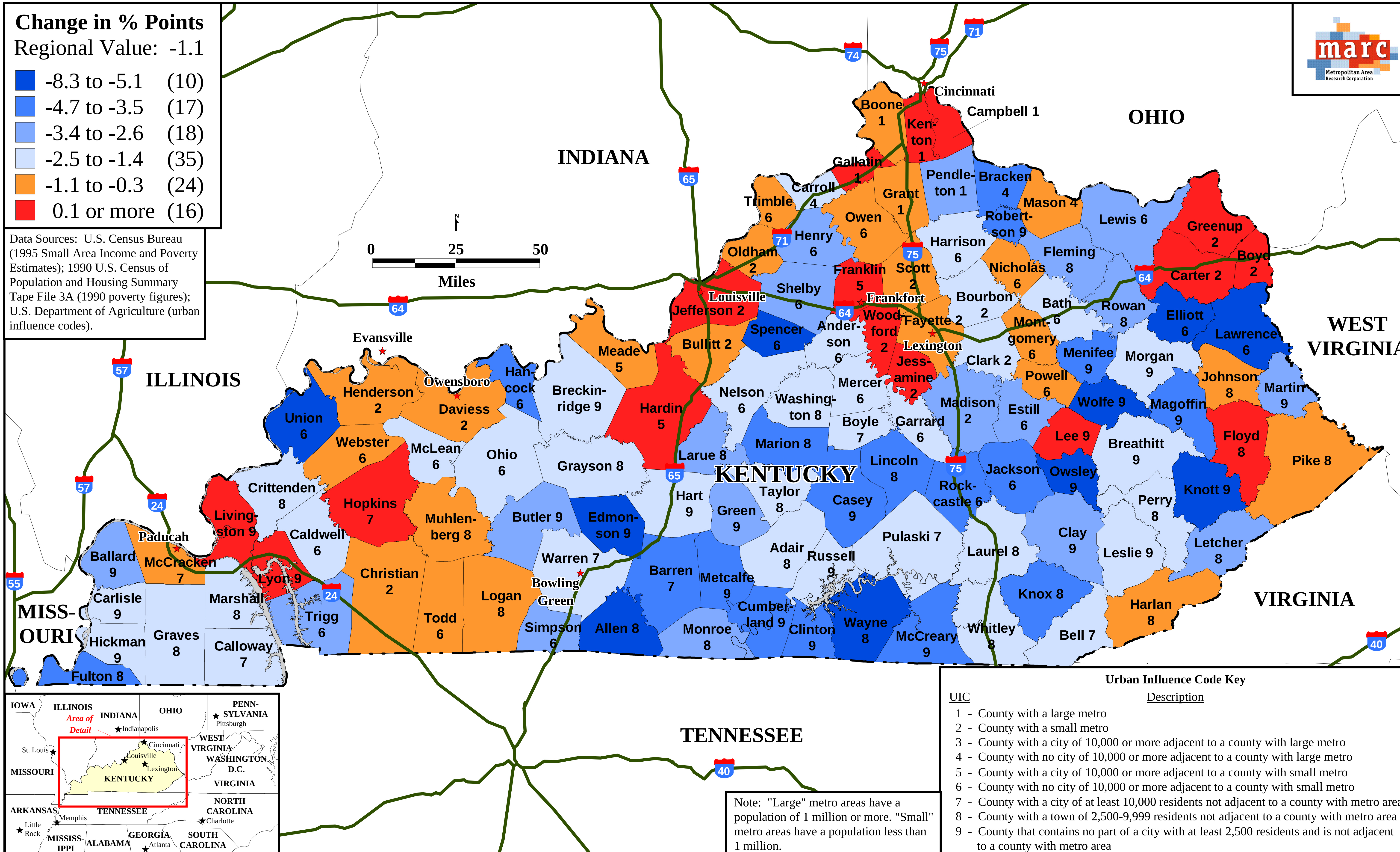


Figure 11: Change in Percentage Points - Persons in Poverty by County, 1990-1995



Figures 12 and 13: Median Household Income

Median household income provides an indication of the overall wealth and stability of a community. It also provides indirect evidence of the amount of social need that exists within a community. Those areas where household incomes are relatively low tend to have more need for local government spending on public services such as public health care, housing assistance, and job training. They also tend to have fewer high-paying jobs available for residents.

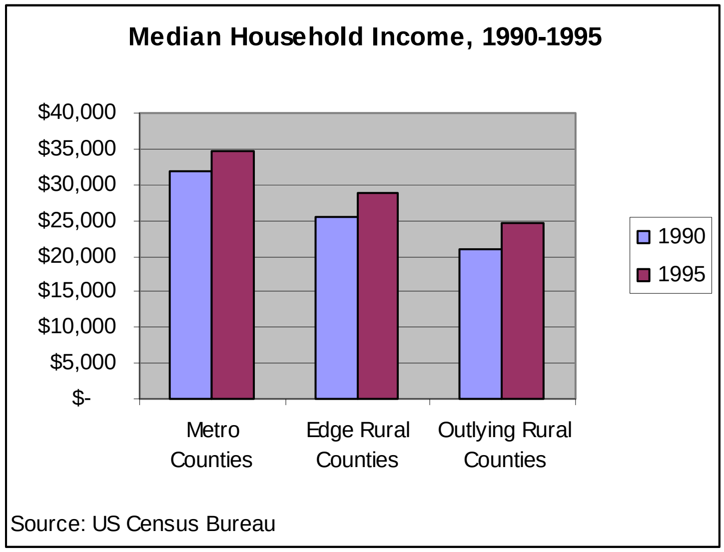


Figure 12 shows that the state's highest median household incomes are located almost exclusively in metropolitan areas, including Louisville, Lexington, Cincinnati, Evansville-Henderson, and Owensboro. McCracken County (Paducah) and Warren County (Bowling Green) also have relatively high household incomes. Altogether, metropolitan counties had an average median household income of about $34,800—about $4,500 more than the state average. Edge rural counties on the other hand, averaged just $28,800. Outlying rural counties, where poverty is especially high, averaged just over $24,500.

The disparities that existed in median household income in 1995 have improved somewhat since 1990, although a significant gap continues to exist. Outlying rural counties saw the biggest increase over the period, rising 17 percentage points, from $20,900 to $24,500. Edge rural counties saw their household incomes grow from $25,600 to $28,800—an increase of 13 percent. Metropolitan counties, despite a relatively small increase of 9 percentage points, continued to have the highest median incomes in the state—rising from $31,900 to $34,800.

Figure 12: Median Household Income by County, 1995

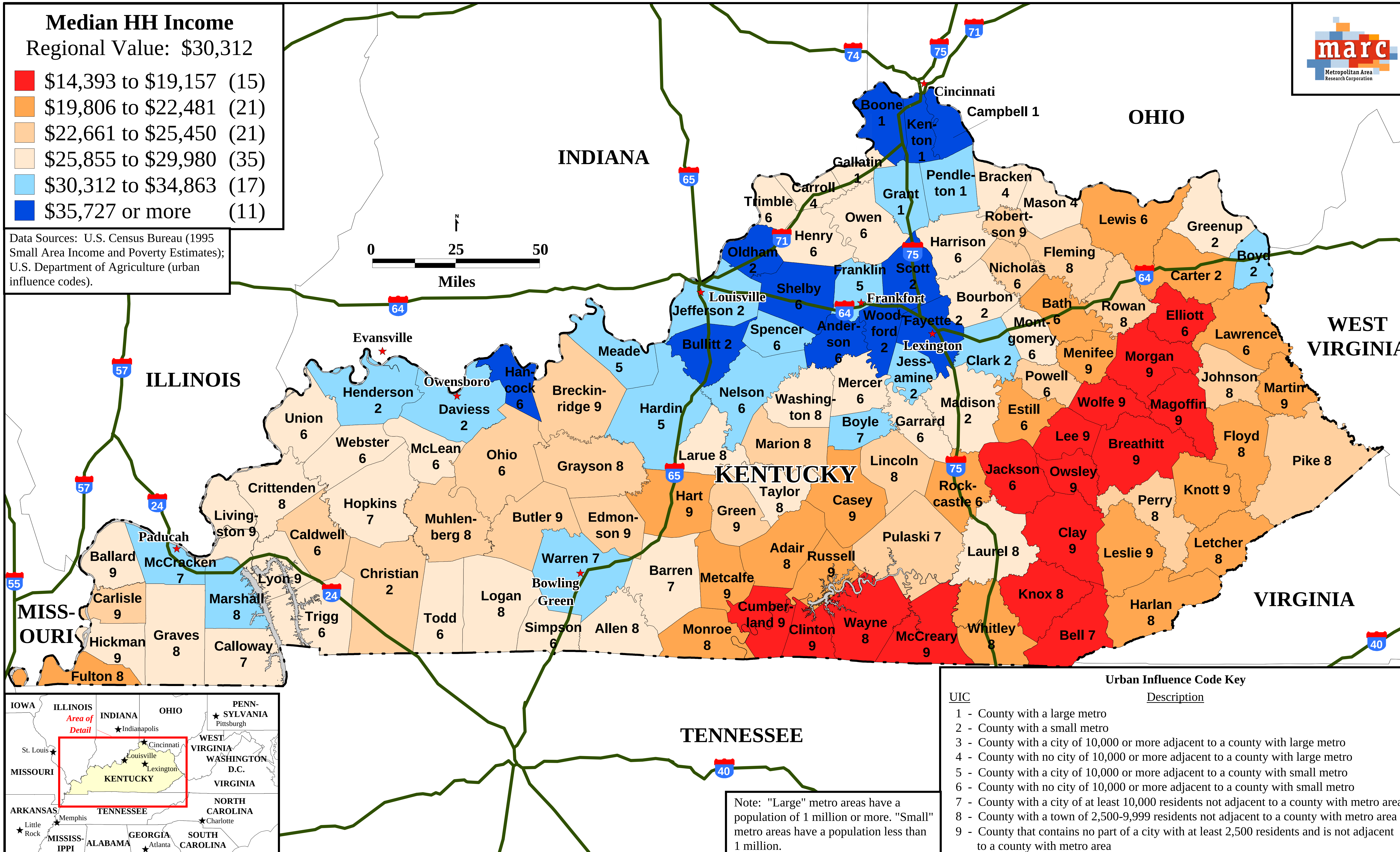
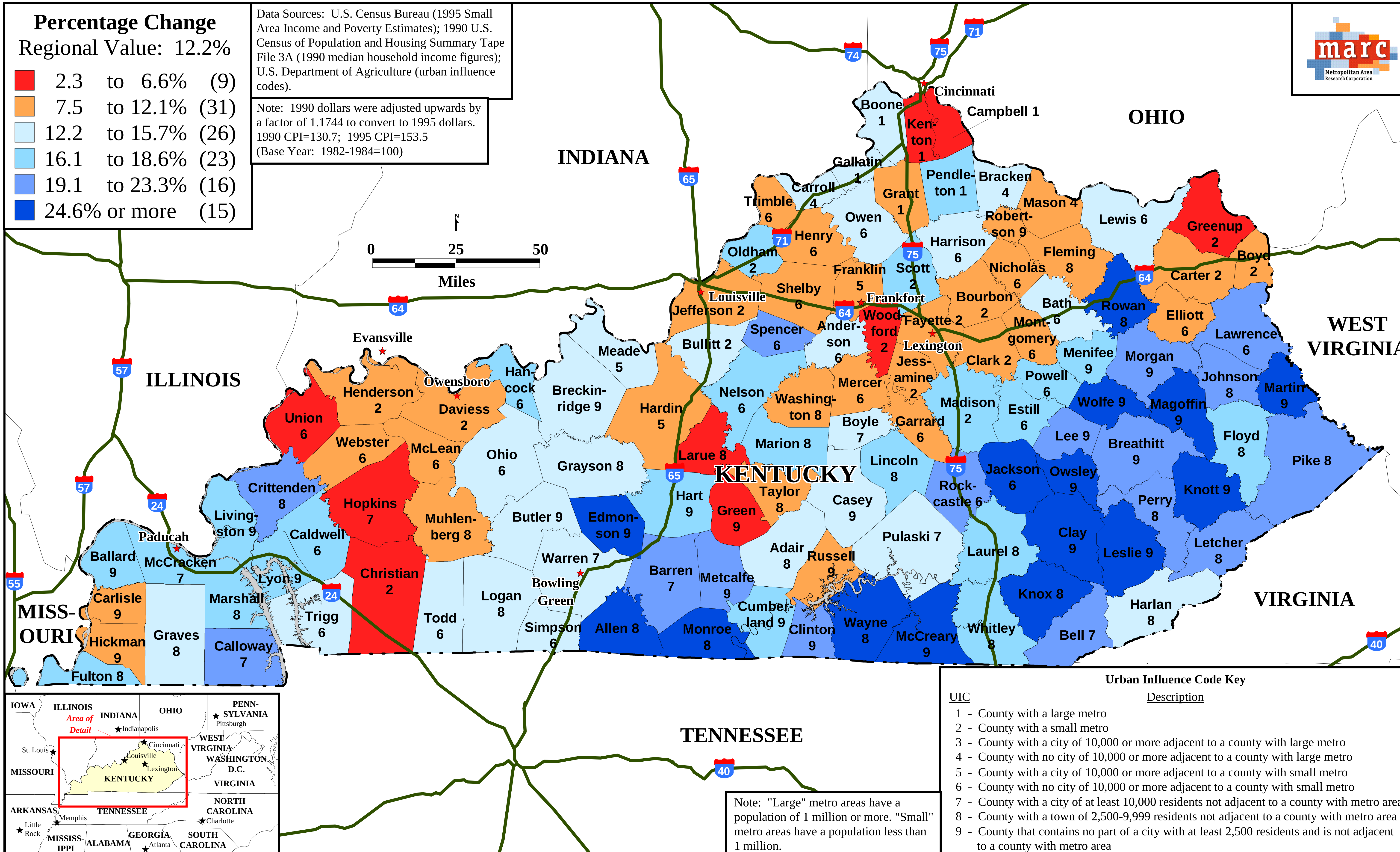


Figure 13: Percentage Change in Median Household Income by County, 1990-1995 (Adjusted by CPI)



STATE AND REGIONAL SOLUTIONS TO SOCIAL AND FISCAL SEPARATION

The maps and information presented in this report demonstrate the need for a statewide approach to stabilizing and supporting all areas of the state—rural and metropolitan. These efforts need to reduce fiscal and social disparities across the state so that rural communities are better able to provide the basic infrastructure and public services necessary to promote sustainable development and growth. As has been shown throughout this report, there are many factors that have contributed to the social and fiscal separation that exists in the state. All of these factors—stagnant or declining populations, dependence on declining industries, tax policies that create imbalances between social need and fiscal resources and lead to wasteful competition for economic development—must be thoroughly considered in the development of effective and equitable strategies for reducing social and fiscal separation.

MARC and a growing core of scholars, government officials, and rural activists believe that statewide social separation calls for a strong, multifaceted, regional response. To combat the patterns that lead to social separation, there are two areas of reform that must be sought on a state-wide scale: 1) greater fiscal equity among the state's counties; and 2) improved cooperation among local governments in community development decisions. These reforms are inter-related and reinforce each other both substantively and politically.

ADDRESSING SOCIAL SEPARATION IN KENTUCKY: THE NEED FOR A REGIONAL VIEW

Increasing concentrations of poverty, inadequate public infrastructure, schools without sufficient resources and low tax resources are among the factors that persistently separate rural areas from the economic, educational and social opportunities that are often taken for granted in metropolitan areas. These disparities have made it increasingly difficult for many rural counties, school districts and cities to generate sufficient revenue and provide other resources to adequately serve their population and provide a positive environment for economic development. Without the ability to provide such basic services these places are unable to attract sufficient economic activity to support the area's population and sustain the local economy. Unable to generate the revenue needed for these services on their own, many of these rural communities have become dependent on federal and state assistance that can fluctuate widely from year to year—making long-term planning extremely difficult.

The effects of the challenges created by these fiscal and social disparities can be seen through a number of social and economic trends. Among these are a population that is declining or growing relatively slowly, persistently high poverty, a loss of traditional jobs, a lack of basic public infrastructure and a declining local tax base. As these trends worsen, the slow but steady economic and social decline of a community can begin to feed on itself. Greater numbers of people choose not to live in rural communities. Land values often remain low, reducing the amount of tax revenue that can be generated with reasonable tax rates. Long-term rural employers cut back on jobs or relocate—leaving employees behind who may have few other job skills that would allow them to earn livable wages in another industry.

Overall, the persistent separation of rural and metropolitan counties serves to *reduce* the very resources needed to address the problems it causes, and creates an increasing sense of urgency for those trying to reverse social and fiscal separation. This urgency often forces localities to consider only short-term, local solutions to problems that require a long-term, regional, and statewide approach.

As a result, many of the efforts to create economic investment and halt the decline of disinvestment and dwindling resources fail to address the root of the problem. While they may provide short-term relief to a community's problems, these efforts are ultimately very limited in the overall impact they can provide.

One of the factors contributing to fiscal and social inequities is the highly fragmented nature of community development decisions by local units of government. Because of this fragmentation, caused in large part by the dependence on revenues generated by local land uses, communities located in the same region often fail to consider the regional consequences of their community development decisions. Neighboring local governments may compete with each other for the most desirable land uses—such as expensive housing or large commercial and industrial businesses—spending public funds to attract land uses that would have settled somewhere in the region in any case. From a regional perspective, this competition does not make much sense, except that it *might* provide additional tax base for the "winning" community. Freed from dependence on the local tax base, local governments could more freely work together to share in the benefits and responsibilities of regional growth.

"Regional cooperation in community development… recognizes that the social and economic health of any particular community is dependent largely on the health of the entire region"

The concept of regional cooperation in community development recognizes that the social and economic health of any particular community is dependent largely on the health of the entire region it is located in. In other words, if individual communities are to grow and prosper, they must not only consider what is good for their own citizens, but what is good for the entire region. A regional community development plan encourages inter-governmental cooperation rather than competition, greater equity in the provision of public resources and services, and reduced fiscal and social separation. When struggling local governments work together to address their common concerns, they are much more likely to achieve their goals than if they worked individually.

Combined with tax-base sharing, a regional community development plan frees up public tax dollars, staff, and other resources—previously used to provide subsidies, tax breaks and other incentives to attract additional tax base—to be used more effectively and efficiently to provide the social and physical infrastructure that will help the region as a whole sustain stability over long periods of time. This regional focus is becoming especially important (and often necessary) in a highly competitive global economy, where companies must not only compete with those in the next city but with those located halfway around the world. The ability for local governments to recognize their shared interest in promoting economic stability throughout the region will help to ensure that the they are better prepared to weather the economic fluctuations that can occur so quickly in an expanding global economy.

"Kentucky's rural advocates…must understand that the forces determining their fate require action and solutions beyond their own borders."

While not always recognized, the great majority of the challenges that face rural Kentucky localities are the result of social and economic forces taking place outside of the communities where the effects are felt. Some of these are national or even international in scope, such as the decline of farming, heavy manufacturing, and mining as major sources of employment in America. Others relate to statewide trends or policies that may be beneficial for some localities and harmful for others, such as when the state decides to make investments in one area of the state rather than others. Still other forces occur at the regional level, such as the influence of economic growth in metropolitan areas on the less urbanized communities surrounding them. If the state's rural communities are to be sustained as viable places to live and work, the power of these international, national and regional forces in determining what happens in Kentucky's rural communities must be understood and acted upon by local residents, government officials, and rural development organizations. In other words, Kentucky's rural advocates—including local government officials, legislative representatives and rural development organizations—must understand that the forces determining their fate require action and solutions beyond their own borders.

GREATER FISCAL EQUITY

Greater fiscal equity across the counties of Kentucky can help to reduce revenue and tax-rate disparities and allow communities to create an orderly and efficient *statewide* land-use plan by: 1) easing the persistent revenue shortfalls of communities and allowing them to re-invest in their community; 2) reducing the pressure on communities to accept any economic development they can get without regard for the long-term costs and benefits; and 3) undermining fiscal incentives that encourage wasteful competition for economic development, including the use of public subsidies to lure companies from one part of the state to another.

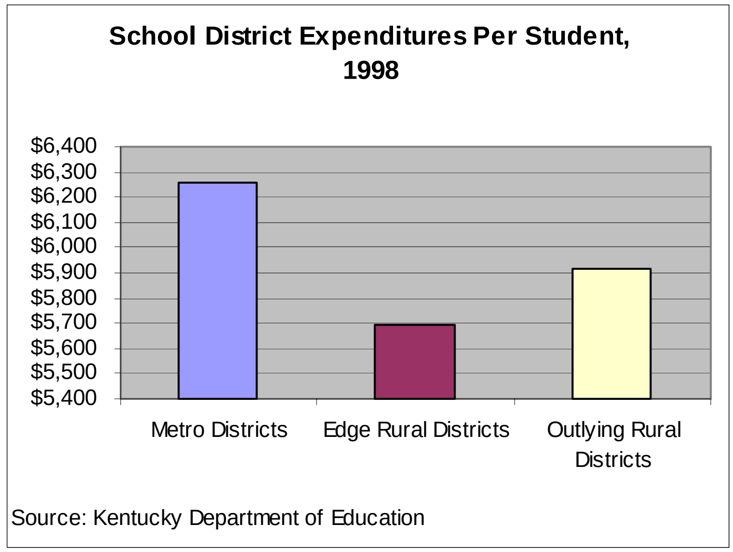
These solutions are mutually reinforcing. Reducing the dependence on local sources of revenue for local government operations lessens these fiscal disparities and reduces the incentives for counties to compete with one another for certain land uses.[18] Once these incentives to compete are minimized and a stable base of shared local resources has been created, local governments are much more likely to create a statewide community development plan that supports the economic development of the entire state. Greater fiscal equity also helps to ensure that public services and infrastructure are provided more equitably throughout the region.

Nearly every state and many metropolitan areas in the nation have already implemented fiscal equalization formulas that create greater fiscal equity among local jurisdictions. A few have addressed this problem through consolidation or annexation (such as when Lexington and Fayette County consolidated in 1974), but this is increasingly rare. The most common form of fiscal equalization is school equity, which reduces the dependence of schools on locally generated revenue (usually property taxes). Kentucky has recently implemented an equity system called "Support Education Excellence in Kentucky" (SEEK) as part of the 1990 Kentucky Education Reform Act (KERA). Through KERA, which has received national acclaim, a base level of funding is defined for each school district that guarantees a certain amount of revenue per pupil. In addition to this base funding, school districts also receive state aid based on, among other factors, the number of "at-risk" students (defined as students eligible for the free lunch program), "exceptional students" (defined in terms of the level of physical or emotional impairments), and transportation costs.

"Once [the] incentives to compete are minimized…it becomes much more likely to create a statewide community development plan that supports the economic development of the entire state."

Figure 14: School District Expenditures per Student

Through Kentucky's school equity system, the state has taken a significant step toward reducing the fiscal inequities among school districts that is created by dependence on local revenue sources. School district expenditures per student are thus more reflective of the level of need that exists within the district. This state equalization of school district revenues has allowed the poorest school districts, whose students face significant challenges in obtaining the education they need to succeed later in life, to provide services and materials that they otherwise could not. Most of these poor school districts are located in eastern Kentucky and in the central city school districts of Jefferson and Fayette.

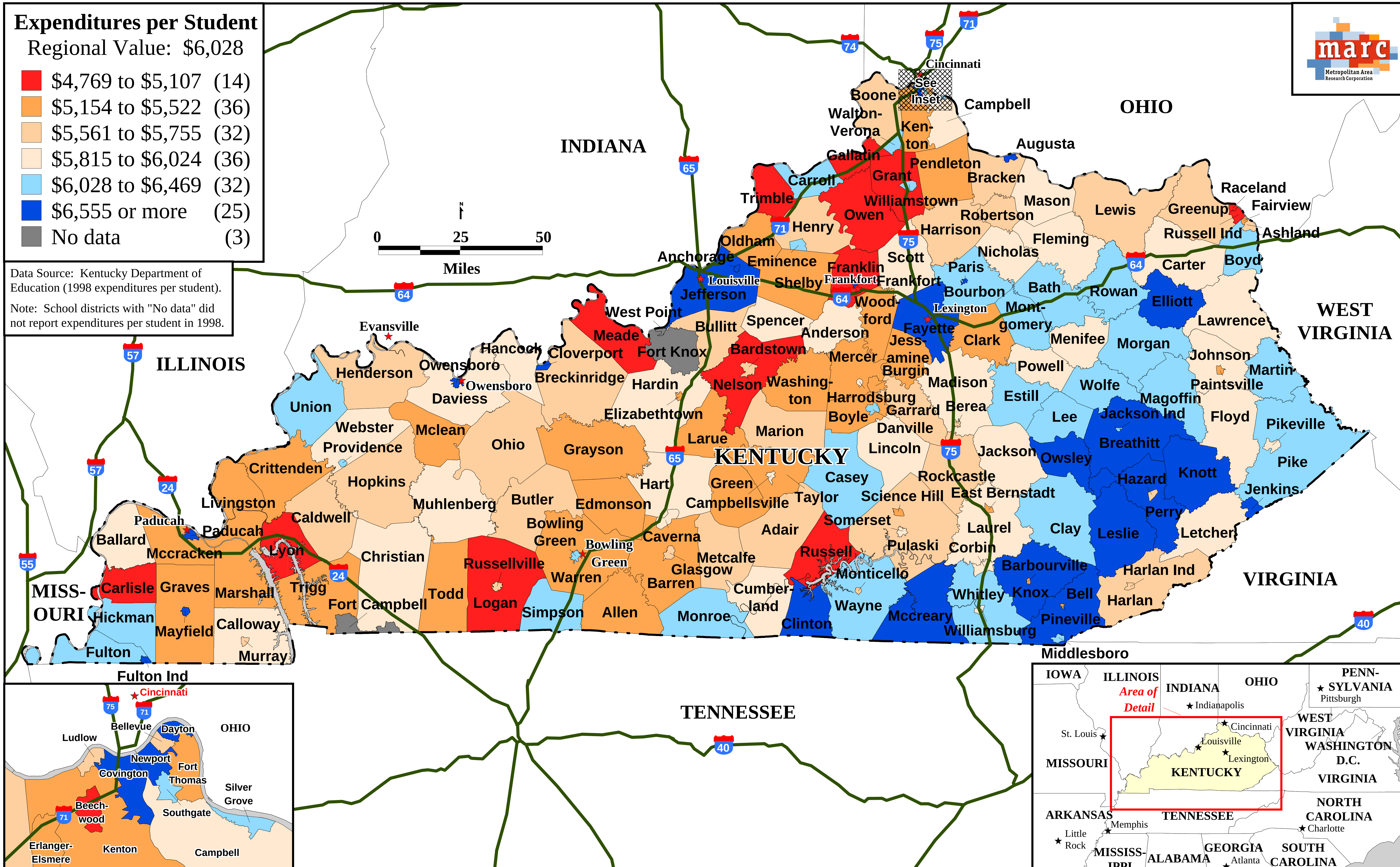


Despite the significant state funding of these poor school districts, however, inequities still exist. Metropolitan school districts, on average, still spend the largest sum of money per student at about $6,260, although this figure is somewhat inflated by the high spending in Jefferson and Fayette districts, where student poverty is relatively high. Without these two, the average metro school district's spending drops to about $5,770 per student—about $260 less than the state average of $6,028. Outlying rural districts on the whole have per student expenditures at about the state average, with $5,910 per student. Districts in rural counties at the edge of metropolitan areas had the lowest average spending per student, at about $5,700. Overall, 89 percent of all school districts had spending per student within $1,000 of the state average. The gap between the highest and lowest spending school districts was less than $3,000 per student.[19]

School equity systems such as the one in Kentucky represent one way in which the sharing of fiscal resources is already being done throughout the United States. For schools, this sharing helps to reduce disparities among school districts, lessen the burden on communities that receive few tax revenues, and equalize educational opportunity. The SEEK program in Kentucky, and school equity systems in almost every state, represent an example of how greater equity in fiscal resources can be achieved when there is sufficient political will. It represents an important model of success, not only for educational funding, but also for a more equitable distribution of the resources local governments need to provide basic public services. To address disparities among local governments, states have created strong statewide general revenue sharing systems where a portion of the tax revenue collected by the state is redistributed to jurisdictions based on a formula that takes into consideration factors such as population, tax rates, local wealth and/or social need. Among these are Michigan, Wisconsin and Minnesota. A statewide system of general revenue sharing that takes into account the difference in the local cost of living and governmental services could be even more effective.

The most effective equity mechanisms are those that share the *sources* of tax revenue, rather than just the *revenues.* The most comprehensive and well-known example of tax-source sharing is in the Minneapolis-Saint Paul metropolitan area of Minnesota. Under this mechanism, the local tax *base* of cities or counties is pooled, rather than the revenues generated from this base. A uniform tax rate is

Figure 14: Expenditures per Student by School District, 1998



then applied to this pool and the revenues are redistributed to local governments based on a formula that favors those with low tax capacity. Unlike a statewide school equity system or a general revenue sharing system, the sharing of tax base helps to reduce differences in tax rates across jurisdictions (low tax-base communities often must raise their tax rates to generate sufficient revenue for their high needs, discouraging businesses and homeowners to move in) and create greater equity among *all* local governments that depend on the property tax for revenues—school districts and special districts as well as cities and counties. Tax-base sharing also creates an environment in which local units of government can recognize their interdependence and work more cooperatively together to generate economic and social development that benefits the region as a whole.

Whatever the method, a statewide or regional equity system must be simulated before discussion begins, so that all parties participating can understand its impact. In order for such a system to succeed, the proposed reform must provide additional tax base to at least two-thirds of the regional population. A substantial portion, if not a majority, of residents in the state should ultimately see increased local revenues for their community and thus, better local services.

REGIONAL ECONOMIC DEVELOPMENT AND COMMUNITY DEVELOPMENT PLANNING

Any policy reform addressing social and economic disparities in Kentucky must focus on bringing meaningful economic development to rural areas. Rural economic development must provide communities and residents with more than just jobs; it must provide diverse employment opportunities that create wealth for rural residents and a stable tax base so that rural communities not only retain employment opportunities, but also expand on them.

The evidence provided in this report suggests that few, if any, rural communities have the resources to attract this type of economic development on their own. Besides a low population, rural communities often have few highly trained workers, highly concentrated poverty, and an inadequate tax base. They cannot provide the critical mass of physical or demographic resources that today's industries require when competing in a global market. Compounding this problem, rural counties often end up draining their already limited resources by competing with each other to attract economic development that actually makes meaningful economic development more difficult. For instance, the chicken processing facilities discussed earlier in this report may have provided much- needed jobs, but the odors and general unattractiveness of the operations made the area less attractive to those people and companies who might otherwise have moved into the community

Because of the inability of any single rural community to provide the strong foundation required for economic development, alternative solutions must be found. One promising alternative is for rural counties and local governments to pool their resources and work cooperatively to attract quality economic development that provides long-term benefits to their residents. The Local Government Economic Development Fund (LGEDF) created by the state General Assembly in 1992 provides a starting point for this type of reform. Through this fund, counties that generate coal severance and process taxes are able to access a portion of the revenues and use these funds to create regional industrial parks that will help them attract industrial jobs and reduce their dependence on the volatile coal mining industry. Any tax revenues and other proceeds generated from these projects are then shared by the participating counties. By combining their resources, these counties are better able to create an environment for meaningful economic development that none of them could have created on its own. Instead of attracting low-quality, low-skill jobs that do little to help the local economy, these types of agreements can allow rural communities to attract jobs that will help them create wealth and attract even more development.

The LGEDF fund is a model of the type of revenue-sharing efforts that could be undertaken statewide to help attract quality economic development to rural counties so desperately in need of it. By encouraging local governments to create *regional* economic development plans, and freeing them from the incentives to compete with one another, meaningful community development is much more likely. Rural counties, with the assistance of the state, might provide local colleges and universities with the resources needed to train students in high-technology fields. At the same time, they might develop regional economic development zones that could attract and support greater economic diversity so that these students wouldn't have to move to metropolitan areas to find jobs in their field. Infrastructure could be provided more efficiently, public services such as job training programs and health care could reach more people, and public funds would be more effective in achieving true improvements. By focusing economic development in the places most likely to be successful, and sharing in the tax revenues and other resources generated, the economic and social divides between metropolitan and rural communities could be significantly reduced.

The sharing of state and local resources to generate economic development can also have significant environmental benefits—a topic of increasing concern in rural communities and throughout the state. Because many rural communities have so few jobs and so little resources with which to provide schools, roads, and other infrastructure, the need for jobs and additional tax revenue has taken a higher priority than the protection and management of local environmental resources. The long-term environmental damage that this can cause is considerable. For instance, mining and timber operations can increase pollution of local rivers and lakes and ground water can be made unfit for human consumption when large agricultural feedlots or heavy fertilizers are allowed to seep into the soil.

These types of problems threaten or degrade a large number of valuable environmental resources in Kentucky—many of which have an important recreational and economic value to the state and its residents regardless of where they live. When communities desperate for jobs are able to pool their resources and avoid the competition that forces them to lower environmental quality requirements when attracting businesses, they are much more likely to consider the long-term consequences of economic development on the environment. The most valuable environmental resources can be better protected because the counties these resources are located in are able to share in the benefits of economic development taking place elsewhere.

CONCLUSION

Rural counties, especially those located in outlying areas of the state, are experiencing an increasing fiscal separation from the metropolitan areas of the state. This separation has left poor, isolated rural communities without sufficient resources to provide basic public services and infrastructure or create much needed jobs and stability in their communities. At the same time, wealthier metropolitan communities that already have a greater ability to provide public services continue to attract additional tax base that allows them to provide even more public services and attract even more development. Rural communities are also being forced to compete for less beneficial land uses that offer little long-term stability to the community. Over time, these patterns produce persistent disparities among counties and other units of local government that separate the state socially, economically, and politically—making less feasible the cooperation necessary to solve vital present and future problems and develop a shared vision of the state's future. The status quo represents a divisive system that wastes money, energy, time, and human potential. It is preventing Kentucky from reaching its full potential in terms of economic growth, social stability, environmental stewardship, and quality of life.

This report represents an attempt to stimulate and further a statewide approach to addressing growing fiscal and social disparities and instability. While its recommendations are sure to be controversial, it represents only a best first effort, subject to the negotiation, reformation, and synthesis that occurs in all political progress. It is MARC's hope that the counties and cities of Kentucky can work together—reason together—to solve their mutual problems and to create a positive vision for a future that *all* can invest in.

APPENDIX: CLASSIFICATION OF KENTUCKY COUNTIES

Edge Rural Counties (35)		Metropolitan Counties (22)		Outlying Rural Counties (63)	
Anderson	Meade	Boone	Grant	Adair	Lee
Bath	Mercer	Bourbon	Greenup	Allen	Leslie
Bracken	Montgomery	Boyd	Henderson	Ballard	Letcher
Caldwell	Nelson	Bullitt	Jefferson	Barren	Lincoln
Carroll	Nicholas	Campbell	Jessamine	Bell	Livingston
Elliott	Ohio	Carter	Kenton	Boyle	Logan
Estill	Owen	Christian	Madison	Breathitt	Lyon
Franklin	Powell	Clark	Oldham	Breckinridge	Magoffin
Garrard	Rockcastle	Daviess	Pendleton	Butler	Marion
Hancock	Shelby	Fayette	Scott	Calloway	Marshall
Hardin	Simpson	Gallatin	Woodford	Carlisle	Martin
Harrison	Spencer			Casey	McCracken
Henry	Todd			Clay	McCreary
Jackson	Trigg			Clinton	Menifee
Lawrence	Trimble			Crittenden	Metcalfe
Lewis	Union			Cumberland	Monroe
Mason	Webster			Edmonson	Morgan
McLean				Fleming	Muhlenberg
				Floyd	Owsley
				Fulton	Perry
				Graves	Pike
				Grayson	Pulaski
				Green	Robertson
				Harlan	Rowan
				Hart	Russell
				Hickman	Taylor
				Hopkins	Warren
				Johnson	Washington
				Knott	Wayne
				Knox	Whitley
				Larue	Wolfe
				Laurel	

Note: Counties are classified based on the US Department of Agriculture's Urban Influence Codes. The urban influence codes classify all counties and county equivalents in the United States into 9 mutually exclusive groups. These groups classify metro counties by the size of the metro area they are in and nonmetro counties by their adjacency to each size of metro area and by the size of their own largest city or town. Further information on the Urban Influence Codes can be found from the US Department of Agriculture, Economic Research Service: http://www.econ.ag.gov

ENDNOTES

[1] MARC projects either completed or in process include: Atlanta, Baltimore, the Central Valley of California, Chicago, Denver, Detroit, Grand Rapids (MI), Houston, the State of Kentucky, Los Angeles, Milwaukee, Minneapolis-St. Paul, Philadelphia, Phoenix, Pittsburgh, Portland (OR), Saginaw, San Diego, San Francisco Bay Area, Seattle, South Florida (Miami), St. Louis, and Washington DC.

[2] US Census Bureau, State and Local Government Finances by Level of Government, 1995-96. Retrieved April 24, 2000 from the World Wide Web: http://www.census.gov/govs/www/esti96.html

[3] Of the 22 metro counties, four experienced a decline in their population. These were Bourbon County (-0.2 percent), Jefferson County (-2 percent), Greenup (-6 percent), and Boyd (-11 percent).

[4] "The Context of Change: Trends, Innovations and Forces Affecting Kentucky's Future," Kentucky Long-Term Policy Research Center, Michal Smith-Mello and Peter Schirmer, December 1994

[5] Dependence on an industry is defined based on the classification system used by the Economic Research Service's (USDA) 1989 Revised County Typology. Using this system, dependence is based on the percentage of total earnings that come from farming (20 percent), mining (15 percent) or manufacturing (30 percent). Data for determining dependence was from 1990-1997.

[6] Employment data is from the Regional Economic Information System, Bureau of Economic Analysis. Population data is from the US Census Bureau.

[7] US Census Bureau, State and Local Government Finances by Level of Government, 1995-96.

[8] Howard Chernick and Andrew Rechovsky, "Urban Fiscal Problems: Coordinating Actions Among Governments," *Government Finance Review*, August 1995.

[9] Michael P. Ettlinger, Testimony before the Kentucky Legislative Research Commission Subcommitte on Tax Policy Issues (September 1, 1999). Democracy Resource Center: Lexington, KY. Retrieved April 12, 2000 from the World Wide Web: http://209.211.3.58/

[10] "Kentucky's Low Road to Economic Development: What Corporate Subsidies are Doing to the Commonwealth," Jason Bailey and Liz Natter, Democracy Resource Center, 2000.

[11] US Census Bureau, State and Local Government Finances by Level of Government, 1995-96.

[12] The largest percent declines in total property value per household between 1987 and 1997 took place largely in the western and eastern parts of the state. Counties included Marshall (-60 percent), McCreary (-43 percent), McLean (-42 percent), Rowan (-39 percent), and Hancock (-37 percent). Overall, 44 counties saw their total property tax base per household decline—24 of which were outlying rural counties and 13 of which were rural counties at the edges of metropolitan areas.

[13] The most recent comprehensive commuting data is from the 1990 US Census, when about 10 percent of rural Kentucky residents commuted to work in metropolitan counties. More recent data on the rural/metropolitan transfer of wealth will not be available until data from the 2000 Census is released.

[14] US Census Bureau, 1995 Small Area Income and Poverty Estimates

[15] Economic Research Service, US Department of Agriculture

[16] "1989 Revised County Typology for Kentucky," Economic Research Service, US Department of Agriculture. Retrieved April 13, 2000 from the World Wide Web: http://www.ers.usda.gov/epubs/other/typolog/

[17] Jomills Braddock II and James McPartland, "The Social and Academic Consequence of School Desegregation," *Equity & Choice* (February 1988): 5; see also Gary Orfield and Carole Ashkinaze, *The Closing Door: Conservative Policy and Black Opportunity* (Chicago: University of Chicago *Press*, 1991), 131; James Rosenbaum, Marilyn Kulieke, and Leonard Rubinowitz, "Low-Income Black Children in White Suburban Schools: A Study of School and Student Responses," *Journal of Negro Education* 56, no. 1 (1987): 35; Rosenbaum, Kulieke, and Rubinowitz, "White Suburban Schools;" U.S. Department of Education, Office of Educational Research and Improvement, "Urban Schools: The Challenge of Location and Poverty,"

[18] In the Twin Cities region in the early 1980's, reformers attempting to pass legislation for metropolitan land-use planning used tax-base sharing as a quid pro quo to gain political support in the low fiscal capacity developing

suburbs. When low tax base communities were told that an urban service line was going to be drawn through the middle of their cities and that land outside that boundary would be zoned at agricultural densities, they cried foul. They argued that they needed the land for the development of tax base and to pay for overcrowded schools. Compromise and acceptance was reached when they were shown the potential benefits of a tax-base sharing system, *i.e.* that they would receive new taxable property value and would actually gain fiscal capacity per capita faster than they would solely through the development of lower-valued residential property. In the end, in Minnesota the low tax base communities accepted land-use planning in exchange for tax-base sharing.

[19] This figure does not include the West Point ($11,750) and Anchorage ($9,495) school districts, which had much higher spending per student than any other school districts in the state.