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Minnesota House of Representatives

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TO: Members of the House Committee on Taxes

FROM: Pat Dalton, Legislative Analyst (651-296-7434)
Matt Massman, Fiscal Analyst (651-296-7171)
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RE: Fungibility of local government revenue sources

Advocates for counties and cities have claimed that one of the measures used in the formulation of the governor's proposal for aid cuts, total governmental funds revenues, as reported by the Office of State Auditor (OSA), is a flawed basis for cutting a jurisdiction's revenues. In particular, they argue that basing cuts on total revenues implies that all such revenues are fungible and that any reduction in a local government's general revenues can be addressed through spending cuts anywhere in the local government's budget. In reality, advocates suggest that many components of the jurisdiction's revenue stream are actually restricted to funding narrowly-prescribed program areas, and cannot be looked at as revenues that can be used to "plug a hole" elsewhere in the budget. Consequently, advocates argue that a cut being characterized as a certain percentage of a jurisdiction's budget actually represents a higher percentage of spending when you consider the parts of the budget that are discretionary.

In this memo, we attempt to analyze the validity of this argument by looking at the components of "all revenues" in the OSA data, and to categorize those revenues as to their level of fungibility; that is, to look at what parts of a local government's revenue stream can actually be diverted to plug holes in another part of the budget. In the two tables that follow (one for cities, the other for counties), we have attempted to list the revenue sources in order of their fungibility, from most fungible to most restricted. We also list the amounts of revenues in each category, to give an idea of the relative importance of each category.

Decisions about fungibility are based on two components – how many restrictions are placed on the use of the funds, and what is the size of the revenue stream relative to the amount of spending in the program area to which it is attached. Hotel/motel taxes are considered to be highly restricted because they must be used for tourism promotion, and the magnitude of the stream is such that it is not safe to conclude that jurisdictions would spend that much on tourism if the tax was unavailable. County criminal justice aid is listed in the "pretty fungible" category because

even though its spending is restricted, the amount is small enough that it is generally safe to conclude that the amount would be spent on criminal justice services even in the absence of the aid.

A flaw in the exercise stems from the fact that it is not really possible to say how fungible a source of revenues is just by knowing which category it falls into in the Auditor's report. This is especially true of the many different categories of "grants"; they need to be looked at individually for each jurisdiction. Then, there are revenue types that belong in one category for some jurisdictions but another for others – an example is local sales taxes, which are generally restricted by the terms of the authorizing legislation, except in Duluth where they are completely fungible and St. Paul where they are somewhat fungible.

The order in which revenue types are listed within each fungibility category was deliberate; revenues near the top of each group are considered more fungible, or less restricted, than revenues listed near the bottom of that group. We would be remiss in not pointing out that there is much uncertainty in all of this, that some categories of funds might be fungible for some jurisdictions but not in others, and that we are somewhat guessing in a number of the categories. Finally, this is a task on which similarly situated persons could differ because of the many assumptions that must be made.

One last point to address is that some people have suggested that debt payments should be excluded from the auditor's "total revenues" measure, on the theory that jurisdictions do not have flexibility in making these payments. Debt payments are certainly a fixed cost but local governments have other fixed costs as well.

It is possible to reduce the total revenue measure for debt payments, \$662 million in the case of cities and \$175 million in the case of counties, but only if no other adjustments are made. If, for example, aid cuts were to be made based on "all revenues" excluding "mostly restricted" revenues, it would not be possible to subtract out debt service paid from "mostly restricted" revenue sources from debt service paid from all other revenue sources.

PD/ab

**Classification of City Government 2000 Revenues
 (amounts in \$millions)**

Clearly fungible	Property taxes	852
	Franchise taxes	68
	Gravel & Gambling taxes	2
	Local government aid	391
	HACA	201
	Taconite aid	11
	Interest earnings	268
	Net transfers from enterprise funds	64
	All other revenues	290
	Total	2,147
Pretty fungible	Licenses and permits	128
	Fines and forfeits	36
	Total	164
Partly fungible	Federal Comm Dev Block Grants	66
	State highway grants	102
	Fees and service charges	300
	Other Federal grants	88
	Other state grants	201
	County grants	22
Total	779	
Mostly restricted	Tax increments	286
	Local sales tax	84
	Hotel/motel taxes	25
	Special assessments	238
	PERA Aid	5
	Total	638
	Grand total	3,728

**Classification of County Government 2000 Revenues
 (amounts in \$millions)**

Clearly fungible	Taxes	1,517
	HACA	211
	Attached machinery aid	2
	Disparity reduction aid	14
	Interest earnings	193
	Net transfers from enterprise funds	-4
	All other revenues	178
	Total	2,111
Pretty fungible	Licenses and permits	19
	Fines and forfeits	25
	Criminal justice aid	19
	Total	63
Partly fungible	Federal highway grants	43
	Federal human services grants	263
	State highway grants	385
	State human services grants	441
	Fees and service charges	375
	All other Federal grants	90
	Other state grants	213
	Total	1,810
Mostly restricted	Special assessments	26
	Federal disaster grants	7
	PERA aid	5
	Police aid	7
	Total	45
	Grand total	4,029