How diversified are small town revenues? Revenue diversification is analyzed among towns governed by town meetings. Using previously developed diversification measures, the findings confirm that these localities draw from less diverse revenue streams than other state and local governments. The reasons for these variations include differences in home rule status as well as tax and expenditure limitations imposed by states. The authors suggest that revenue allocation in these jurisdictions is substantively different from other forms of local government because these communities rely much less on sales taxation than states and municipalities. Their essay proposes possible options for improvement, along with other criteria by which small towns can assess their revenue diversification.

State and local governments have long been responsible for raising revenue to pay for services and programs demanded by citizens. Over time, elected officials and public administrators have found innovative, and perhaps creative, ways to generate revenue. The extent to which governments diversify their revenue structures is an important inquiry for both scholars and practitioners. Revenue diversification has been studied by public administrators as well as economists, with the former focusing on how diversification promotes revenue stability and the latter emphasizing revenue complexity and fiscal illusion. But much of the scholarly work to date has only looked at a piece of the puzzle. In particular, there is sparse research on revenue diversification at the local level of government. Moreover, the municipal-level research that has been conducted is rather limited in scope.

To fill a void in the literature, this essay offers two contributions to the study of revenue diversification. First, we explore revenue diversification with respect to town government. Town governments are a less studied but important form of local government. Most local government research focuses on mayor-council or council-manager systems that govern cities and villages. Towns, as defined here, use the town meeting. The town meeting allows citizens to have direct input into how revenue is raised and spent, among other governing decisions. Because of this unique characteristic, it is plausible to expect revenue diversification to be different for towns, as opposed to more representative forms of local government such as council-manager or mayor-council systems. In particular, we are interested in determining the extent to which towns have diversified revenue structures, the way in which towns diversify their revenue structures, and the reasons underlying changing trends regarding town reliance on particular revenue sources. These are questions that remain unexplored in the extant literature. Yet these questions are important because town governments finance essential public services to millions of citizens throughout the United States.

Our second contribution is the development of a definition and measure of revenue diversification for town governments that deviates from what has been proposed for states and municipalities. We believe this new measure better captures revenue diversification strategies among town governments. Through a more appropriate measurement for towns, we are able to provide a more accurate assessment of the extent to which town governments have diversified revenue structures. In addition, this new measure correlates better with the way in which town governments diversify their revenue structures, which is inherently different from states and other local governments because of variations in home rule status, tax and expenditure limitations (TELs), and dependence on sales tax revenue.

Experiencing Small Town Revenues: To What Extent Are They Diversified?

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The following section provides a brief history of taxation and revenue diversification. We then discuss town government structure, its unique features, and the relevance of revenue diversification to towns. To address our proposed research questions, we proceed by analyzing town revenue diversification over a 30-year period in five states: Connecticut, Maine, Minnesota, Vermont, and Wisconsin. These are the only states in which all towns maintain the traditional and unique governing structure of the town meeting. Throughout the essay, we discuss the likely reasons for low levels of revenue diversification among town governments, as well as potential factors underlying the changing trends in revenue structures uncovered by our analysis.

Revenue Diversification Overview

Revenue Diversification in Historical Context

With origins dating back to colonial times, the property tax is the oldest form of taxation for contemporary government in the United States. Although state governments began to diversify their revenue structures away from property taxation following the Great Depression, local governments were slower to follow this trend. The property tax revolts initiated by California's Proposition 13 in 1978 and quickly followed by Massachusetts' Proposition 2½ in 1980 placed limits on property tax growth across the nation. Leading up to Proposition 13, the Advisory Commission on Intergovernmental Relations issued a report endorsing the use of income and sales taxes for local governments as means of promoting more balanced revenue structures (ACIR 1974). In particular, the commission advocated the tradition of strong local governments and encouraged states to authorize the use of local sales and income taxes (ACIR 1974). Despite this prodiversification sentiment, the tax revolts ensued.

Proposition 13 emerged from an era of dramatically increasing property values in the early to mid-1970s, which placed significant property tax burdens on California residents. In addition, inequities in the property tax system fueled concerns over school funding, which led to the California Supreme Court decision in *Serrano v. Priest* (1977) mandating equalization of school financing. Some scholars suggest the *Serrano* decision was the impetus for the tax revolts (Fischel 2004), while others have found no connection between the two events (Martin 2006; Stark and Zasloff 2003). Nonetheless, Proposition 13 diminished property tax assessments to 1975 levels, severely limited assessment increases for properties without a change in ownership, and placed strict voter approval requirements on all future local tax increases (Galles and Sexton 1998).

Similarly, Proposition 2½ was intended to lower the property tax burden and halt the rate of local government spending in Massachusetts. Property taxes in Massachusetts were comparatively high because the state's local governments were more dependent on property tax revenue compared to other states' localities (Rothenberg and Smoke 1982). However, the state of Massachusetts modified the initiative's initial provisions, and, combined with local voter overrides, drastic budget cuts among local governments never materialized to the extent envisioned by advocates of Proposition 2½ (Wallin 2004).

Although citizen revolts did not occur in every state, the consequences of the tax revolts have been widespread. Even throughout states in which revolts did not occur, many state legislatures passed laws imposing tax and expenditure limitations. As such, the tax revolts and ensuing TELs significantly changed the fiscal environment for local governments across the United States because property taxation was the primary target of the antitax sentiment. Although the effects of TELs are somewhat dependent on the type of restriction imposed, evidence suggests that comprehensive TELs and full disclosure requirements are effective in constraining property tax growth and reducing reliance on property taxation (Brown 2000; Cornia and Walters 2006). The long-run effect of TELs on restraining property tax growth is stronger than the short-term impact (Dye, McGuire, and McMillen 2005). As a result, the property tax as a percentage of total revenue has declined over time (Brunori 2003).

The second-largest source of local government revenue (next to the property tax) consists of other tax revenues, particularly the local-option sales tax (Brunori 2003). Some local governments have shifted their revenue structures away from taxation altogether and toward miscellaneous revenue and user charges and fees (Hoene 2004; Shadbegian 1999; Thompson and Green 2004). Consequently, almost all governments across the country now impose user charges and fees on government services such as parks, sanitation, sewage, airport services, and parking (Brunori 2003). In fact, intergovernmental grants, user charges and fees, and miscellaneous revenue have become perhaps the most important revenue sources for local governments (O’Sullivan 2001). It is important to note, however, that these shifts in revenue structures are somewhat dependent on the types of services provided by local governments. In particular, diversification toward nontax revenue sources such as user charges and fees requires that the services provided are amenable to market-type exchanges and pricing mechanisms (Mikesell 2007). Local governments that have privatized many of these services or that offer services that are not conducive to a benefits-received approach to financing might exhibit less diversification, as these alternative revenue sources are not feasible financing options.

Evidence also suggests that TELs disproportionately constrain local governments that serve economically poorer and higher risk populations, which diminishes the governments’ abilities to meet constituent needs (Mullins 2004). The negative effects of TELs might be exacerbated during economic downturns (James and Wallis 2004) and, in turn, create incentives for financial managers to implement precarious fiscal management practices (Martell and Teske 2007). Conversely, if a local government is managed by budget-maximizing bureaucrats, property tax limits have the potential to improve public welfare by minimizing self-interested opportunities for inefficient budget expansion (McGuire 1999; Primo 2006). In addition, there is evidence to suggest that well-designed fiscal policies and political institutions are more effective in constraining government growth than restrictions on spending (Krol 2007).
In summary, the consequence of the tax revolts has been twofold for state and local governments. First, state-imposed TELs have resulted in decreasing dependence on property taxation among states and municipalities. Second, the incidence of restrictions targeted toward the property tax has prompted governments to seek out alternative revenue sources to supplant property tax revenue, which has resulted in greater diversification among state and municipal revenue structures. In this essay, we are particularly interested in determining the extent to which town governments have followed this trend of revenue diversification. As we will see, TELs are an important factor in our analysis of towns.

Defining Revenue Diversification
The extant literature has struggled to agree on a single definition of “revenue diversification.” However, revenue diversification fundamentally requires two things. First, there should be a variety of sources from which a government generates revenue. Second, there should be a balance among these sources in terms of the proportion of revenue derived from each. Early definitions of revenue diversification (1960–75) identified balanced state and local tax structures as comprising 20 percent to 25 percent each of revenue from the individual income tax, the general sales tax, and the local property tax (Suyderhoud 1994). In the early 1980s, greater recognition was given to the contribution of user fees and severance taxes. Nonetheless, it was still suggested that the individual income tax should account for 20 percent to 35 percent of state and local tax revenues, while general sales and local property taxes should contribute between 20 percent and 30 percent each (Suyderhoud 1994). Placing more emphasis on property and sales tax contributions, Shannon (1987) defined a balanced tax system as comprising property taxes, general sales taxes, and individual income taxes, each contributing 25 percent to 43 percent of total revenues.

Shannon’s (1987) definition of revenue diversification was an improvement over earlier definitions and more closely resembled the tax structure of state and local governments by placing greater weight on property and sales taxes. However, the measure yielded little variation in diversification among states because of its reliance on only three revenue categories (Suyderhoud 1994). As a result, Suyderhoud (1994) offered a more comprehensive and quantifiable definition incorporating four revenue categories—property taxes, individual and corporate income taxes, general sales taxes, and all other revenues, including nontax revenues—into a single measure of diversification based on the Hirshman-Herfindahl Index (HHI). This contribution motivated subsequent empirical examinations of diversification among states and municipalities (Carroll 2005; Carroll, Eger, and Marlowe 2003; Hendrick 2002; Suyderhoud 1994). These studies provide perhaps the most consistent definitions and quantitative examinations of revenue diversification among state and local governments by using the HHI approach to measure diversification. Moreover, these studies offer relatively consistent findings regarding the level of diversification among the entities examined. Table 1 provides a summary of these studies.

The first column of table 1 refers to the author of each study summarized. The second and third columns illustrate how each author calculated the HHI measure of diversification. The HHI measure requires a calculation of the proportion of total revenue generated from each source selected for measuring diversification (see note 1 herein for the HHI formula). As shown in table 1, these proportions were calculated by the authors by dividing each revenue source listed in column 2 by the basis identified in column 3. Counting the number of revenue sources identified in column 2 reveals the total number of revenue sources that each author selected for measuring diversification, which is the other piece of information required for calculating the HHI measure. The fourth and fifth columns summarize the focus of each analysis in terms of which governmental units were studied and the time period under examination. The final two columns of table 1 provide the mean and median HHI scores as they are reported by the authors in the original studies. With median HHI values ranging between 0.79 and 0.94, the studies summarized in table 1 reveal relatively high levels of diversification among the 50 states and several municipalities within Illinois.

Town Government Overview
The aforementioned studies are useful for furthering our understanding of state and local governments’ revenue structures. However, the singular focus on Illinois municipalities limits our knowledge on revenue diversification at the local level of

<table>
<thead>
<tr>
<th>Author</th>
<th>Revenue Sources</th>
<th>Basis for Calculating Revenue Proportions</th>
<th>Unit of Analysis</th>
<th>Time Period</th>
<th>Mean HHI</th>
<th>Median HHI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Suyderhoud (1994)</td>
<td>Property tax, general sales tax, personal and corporate income tax, other tax, and nontax revenue</td>
<td>Total of Each Measured Source</td>
<td>50 states with state-local revenue</td>
<td>1986</td>
<td>0.85</td>
<td>0.94</td>
</tr>
<tr>
<td>Hendrick (2002)</td>
<td>Property tax, general sales tax, other tax, other nontax revenue</td>
<td>Total Own Source</td>
<td>266 municipalities in Chicago metropolitan region</td>
<td>1993–1997</td>
<td>0.85</td>
<td>0.88</td>
</tr>
<tr>
<td>Carroll, Eger, and Marlowe (2003)</td>
<td>Property tax, general sales tax, other tax, other nontax revenue</td>
<td>Total Own Source</td>
<td>76 cities and villages in Cook County, Illinois</td>
<td>1996–2000</td>
<td>0.7483–0.7757</td>
<td>0.7934–0.8113</td>
</tr>
<tr>
<td>Carroll (2005)</td>
<td>Property tax, personal and corporate income tax, general sales tax, motor fuel tax, other tax</td>
<td>Total Tax</td>
<td>50 States</td>
<td>1990–2000</td>
<td>0.8069</td>
<td>—**</td>
</tr>
</tbody>
</table>

* Findings in table 1 are recorded exactly as reported in the original article.
** Median HHI was not reported in Carroll (2005).
government. In this essay, we aim to enhance our understanding of revenue diversification by studying town governments. Town governments—or townships, as they are sometimes called in Midwestern states—are the oldest form of local government in the United States and are often praised as the closest form of true democracy. Alexis de Tocqueville (1956) first recognized the unique attributes of town governments:

In America, not only do municipal bodies exist, but they are kept alive and supported, by town spirit. The township of New England possesses two advantages, which strongly excites the interest of mankind,—namely, independence and authority.

Town governments are substantively different from other forms of local government, which are typically structured as mayor-council or council-manager governing bodies. Unlike cities and villages, town governments derive much of their governing power from the town meeting, which is generally held once a year. At the town meeting, citizens gather to vote on the annual budget, proposed tax levy, policy pursuits, and other government business. With this form of government, town citizens maintain direct control over governmental affairs and actively participate in self-governance. This type of empowerment differs from representational systems (i.e., mayor-council and council-manager forms of government), in which the power to conduct the government’s business is shared by elected officials in the executive and legislative branches. With a representational form of government, citizens have only indirect control over governmental affairs through the electoral process. Moreover, some might argue that the representational form of government does not have such a rich history as town governments.

Yet this rich history and “democratic” structure has not discouraged many attempts (with some successes) to eliminate town governments, particularly in the Midwest (Snider 1957; Zimmerman 1970). Critics believe that improvements in efficiency and administration can be achieved through council-manager or mayor-council structures, especially in rural and sparsely populated areas. These other forms of local government are often seen as better equipped to administer public services and programs. Despite these criticisms and elimination attempts, town governments continue to be viable forms of government (Johnson 2005). While we have seen a modest decrease (approximately 5 percent) in the number of towns since the 1960s, the population of towns has actually increased (Johnson 2005). Moreover, research has not adequately or convincingly shown that other forms of government—even the favored council-manager form—are more efficient or better at providing public services than towns (Zimmerman 1970).

In 2002, the U.S. Census Bureau counted more than 16,000 towns and townships in 20 states. This number hardly pales in comparison to the 19,429 municipal governments (mostly cities) that exist throughout the United States. Towns serve more than 20 percent of the U.S. population, totaling more than 57 million people (U.S. Census Bureau 2002). While it is true that the majority of people reside in cities and metropolitan areas, there is a substantial population in the United States that lives in towns and townships. And contrary to popular belief, towns can be found in both urban and rural areas.

Town governments typically have an elected body—a board of supervisors or selectmen or trustees—to handle the day-to-day operations of the town. However, most of the powers and duties of elected town officials are derived from the state constitution, state statutes, and town meetings. Many town governments, particularly those in Midwestern states, have not been granted home rule. These governments are strictly guided by the state constitution and state statutes in the ways they may conduct elections and raise revenues, and in the kinds of services and programs they may provide. As Dillon’s rule entities, town governments are considered creatures of states and therefore possess only those powers that are expressly granted to them by the state, clearly implied, or essential for the government to function. Meanwhile, cities, villages, and other incorporated municipalities often have home rule status. Home rule provisions, granted either through the state constitution or statute, give local governments discretionary authority over all matters that are not expressly covered by statute. As a result, home rule governments have much greater autonomy and control over a variety of functions without being required to seek legislative permission (Frug 1999; Krane, Rigos, and Hill 2000).

Today, not all town governments continue to hold an annual town meeting. Some have changed their form of government to mayor-council or council-manager systems. Other towns have adopted a representative town meeting, at which electors are chosen to attend the town meeting (Zimmerman 1970). Our research here focuses exclusively on towns that continue to hold town meetings, because this characteristic traditionally and singularly differentiates towns from other forms of local government. As a result, our analysis includes towns from five states: Connecticut, Maine, Minnesota, Vermont, and Wisconsin. These are the only five states in which all towns continue to hold town meetings. In other states, some towns hold town meetings, while other towns have adopted more representational governing structures that are not traditional to town government. By limiting our analysis to these five states, we are able to control for the variation in governing structures among towns and ensure that our analysis focuses solely on town governments with the unique attribute of the town meeting. Our study therefore includes the population of states in which all towns similarly have a town meeting governing structure. This distinguishing characteristic is what gives us reason to believe revenue diversification among towns is substantively different from other local governments previously studied.

Revenue Diversification among Towns
There is no known study that examines revenue diversification among town governments. A related analysis of town governments found no evidence of fiscal illusion among Wisconsin towns.
incorporated areas with populations of more than 2,500; therefore, towns (which are unincorporated) and cities with populations of less than 2,500 are also not affected by TELs in Minnesota (Minnesota Department of Revenue 2008). In Wisconsin, TELs apply to all cities, villages, and towns alike (Wisconsin Department of Revenue 2008). Therefore, we might expect towns in Wisconsin to exhibit higher levels of diversification (compared to the towns in other states in our study) because of the effective property tax restrictions. However, the potential influence of TELs in leading to higher levels of diversification also requires alternative revenue sources to be available to a government facing restrictions. We discuss this issue further in the proceeding analysis.

**How Diversified Are Town Revenue Structures?**

As noted earlier, the extant literature lacks consensus on a definition and quantitative measure of revenue diversification. Moreover, diversification among town governments has not been studied previously, so a definition and quantitative measure that are applicable to this type of government do not exist. However, the studies summarized in table 1 provide some consistency by utilizing the Hirschman-Herfindahl Index approach to measuring revenue diversification. Although the studies vary in their definitions of diversification, identifiable by the categories used to calculate the HHI measure, the consistent quantitative approach provides an initial basis for determining the extent to which town governments have diversified revenue structures.

To assess the level of diversification among town governments, we first grouped towns located in the five states under analysis into three categories. The first category includes Wisconsin towns, which are the only towns in our study that are affected by tax and expenditure limitations and do not have home rule (i.e., they are Dillon’s rule entities). The second category consists of towns in Connecticut and Maine, which have home rule but are not affected by TELs. The final category includes towns in Vermont and Minnesota, which are Dillon’s rule entities and are not affected by TELs. For each category, we then calculated several HHI measures of revenue diversification using data from the government finance portion of the Census of Governments Survey conducted by the Census Bureau.8 The revenue diversification measures were calculated for all towns in the five states with available data. The measures were calculated by replicating both the time period and HHI formula used by each author in the studies summarized in table 1.9 The mean and median values pertaining to each replicated approach and each category of towns are reported in table 2.

The data reported in the first row of table 2 utilize Suyderhoud’s (1994) approach. We calculated revenue diversification for each town with available data for the year 1986 and used the following revenue categories in the HHI formula: property tax, general sales tax, personal and corporate income tax, and other tax and non-tax revenue.10 The data in the second row replicate Hendrick’s (2002) approach by calculating diversification using town data for each year from 1993 to 1997 and the revenue categories of property tax, general sales tax, other tax, and other non-tax revenue in the HHI formula.11 Using the approach of Carroll, Eger, and Marlowe (2003), the data reported in row three pertain to the 1996–2000 time period and also calculated HHI using the revenue categories of property tax, general sales tax, other tax,
diversification. Furthermore, towns with home rule status that systematically exhibit the lowest mean and median levels of revenue diversification are Dillon’s rule entities and are not affected by TELs, calculate HHI. Conversely, the towns in Vermont and Minnesota, among the three categories, regardless of the approach used to calculate the levels of diversification exhibited by towns and variation among the categories of towns affected differently by TELs and home rule provisions warrants further investigation into the revenue structures of town governments. In particular, an examination of trends over time might help to explain these preliminary findings pertaining to town revenue diversification.

There are two general conclusions to be drawn from the data reported in table 2. First, based on previously established measures of revenue diversification, town governments are significantly less diversified than state and municipal governments. The two state-level studies (Carroll 2005; Suyderhoud 1994) reported rather high levels of diversification, with mean HHI scores of 0.85 and 0.81. However, our replication of the HHI formulas and time periods used by these authors yielded mean HHI scores for towns ranging between 0.23 and 0.44 using the Suyderhoud (1994) approach and between 0.02 and 0.12 using the Carroll (2005) approach. The local-level studies (Carroll, Eger, and Marlowe 2003; Hendrick 2002) also reported high levels of diversification, with mean HHI scores among Illinois municipalities of 0.85 and the range of 0.75–0.78. Again, replicating the HHI formulas and time periods used by these authors produced mean HHI scores for towns in the range of 0.29–0.46 with Hendrick’s (2002) approach and 0.30–0.47 with the Carroll, Eger, and Marlowe (2003) approach. These patterns initially suggest that town governments have not diversified their revenue structures to the same extent as state and municipal governments.

The second conclusion that can be drawn from table 2 is that a comparison of HHI scores across the three categories of towns illustrates systematic variation in the levels of diversification exhibited by towns affected differently by tax and expenditure limitations and home rule provisions. Wisconsin towns, which are Dillon’s rule entities but are affected by TELs, maintain the highest mean and median levels of revenue diversification among the three categories, regardless of the approach used to calculate HHI. Conversely, the towns in Vermont and Minnesota, which are Dillon’s rule entities and are not affected by TELs, systematically exhibit the lowest mean and median levels of diversification. Furthermore, towns with home rule status that are not affected by TELS (i.e., towns in Connecticut and Maine) exhibit more diversification than Vermont and Minnesota towns but less diversification than Wisconsin towns. These findings suggest that both home rule status and the presence of tax and expenditure limitations are associated with higher levels of revenue diversification, but that TELs have an even larger influence than home rule provisions. The combination of systematically lower levels of diversification exhibited by towns and variation among the categories of towns affected differently by TELs and home rule provisions warrants further investigation into the revenue structures of town governments. In particular, an examination of trends over time might help to explain these preliminary findings pertaining to town revenue diversification.

### Trends in Town Revenue Diversification

Figure 1 illustrates trends in property tax reliance among towns for each census year from 1972 to 2002. Again, we grouped towns located within the five states into three categories based on home rule provisions and TELs. The trends seen in figure 1 represent the average proportions of property tax revenue to total own-source revenue for all towns within the states grouped into each category. Figure 1 shows that between 1977 and 2002, the towns unaffected by tax and expenditure limitations follow an almost identical and rather stable pattern of property tax reliance, regardless of whether the towns are Dillon’s rule or home rule entities. The average proportions of property tax revenue to total own-source revenue for these towns are also relatively high, with percentages consistently above 85 percent between 1977 and 2002. On the other hand, the towns in Wisconsin, which are Dillon’s rule entities but are affected by TELs, display noticeably lower dependence on property tax revenue compared to the towns that are unrestricted by tax and expenditure limitations. Wisconsin towns generated, on average, between 55.6 percent and 74.2 percent of total own-source revenue from the property tax. However, these towns also exhibit a noticeable and consistent upward trend in property tax reliance between 1982 and 2002, suggesting perhaps that the limiting effects of state-imposed TELs diminished over time. The average proportions of property tax revenue to total own-source revenue increased by 18.6 percent and 74.2 percent of total own-source revenue from the property tax. However, these towns also exhibit a noticeable and consistent upward trend in property tax reliance between 1982 and 2002, suggesting perhaps that the limiting effects of state-imposed TELs diminished over time. The average proportions of property tax revenue to total own-source revenue increased by 18.6 percent between 1977 and 2002.

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**Table 2** Revenue Diversification Calculations for Town Governments*

<table>
<thead>
<tr>
<th>HHI Formula and Time Period Replicated for Towns</th>
<th>Dillon’s Rule and TELs (WI)</th>
<th>Dillon’s Rule and No TELs (VT, MN)</th>
<th>Home Rule and No TELs (CT, ME)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean HHI</td>
<td>Median HHI</td>
<td>Mean HHI</td>
<td>Median HHI</td>
</tr>
<tr>
<td>Suyderhoud (1994)</td>
<td>0.44</td>
<td>0.44</td>
<td>0.23</td>
</tr>
<tr>
<td>Hendrick (2002)</td>
<td>0.46</td>
<td>0.47</td>
<td>0.29</td>
</tr>
<tr>
<td>Carroll, Eger, and Marlowe (2003)</td>
<td>0.47</td>
<td>0.48</td>
<td>0.30</td>
</tr>
<tr>
<td>Carroll (2005)</td>
<td>0.12</td>
<td>0.06</td>
<td>0.02</td>
</tr>
</tbody>
</table>

*The HHI scores reported in this table were calculated for all towns with available data in the five states under analysis, grouped by Dillon’s versus home rule and the presence of TELs, using the exact same HHI formula and time period as the corresponding study cited in column one. For information on the sample sizes, see notes 10–13 herein.
Examining Small Town Revenues

Figure 1 illustrates the rather stable and relatively high level of property tax dependence of towns unaffected by tax and expenditure limitations. This trend is remarkably similar for both Dillon’s rule and home rule entities not restricted by TELs, but diverges for Wisconsin towns that are constrained by tax and expenditure limitations. These findings suggest that even though home rule governments might have greater fiscal autonomy and presumably a greater number of alternative revenue sources at their disposal, these governments might not be motivated to reduce their reliance on property taxation because they are not forced to do so by state-imposed restrictions targeting the property tax. Although we assume that Dillon’s rule governments are less fiscally autonomous, it might be the case that Dillon’s rule governments are no less restricted in their revenue generating capabilities than home rule entities because they have been granted access to alternative revenue sources. To examine this issue further, table 3 provides information pertaining to whether the towns in each state generate revenue from property taxation as well as a variety of sources alternative to the property tax.

As can be seen from table 3, towns within all five states generate revenue from the property tax. The previous discussion highlighted the relative dependence on property taxation among towns faced with tax and expenditure limitations versus those unaffected by such measures. Aside from the consistency of property tax use among the towns, there are two other conclusions to be drawn from table 3. First, the patterns of use for general and selective sales taxes, licenses taxes, and income taxes are inconsistent with respect to Dillon’s rule versus home rule entities. For example, the towns in both Connecticut and Maine are home rule governments, but only Connecticut towns use the general sales tax. Moreover, the Dillon’s rule towns in Wisconsin also use the general sales tax to generate revenue. As can be seen in table 3, inconsistencies such as these are also evident for selective sales taxes, license taxes, and income taxes. These findings suggest that the availability of revenue sources alternative to the property tax is not necessarily contingent on home rule status. Moreover, a greater number of available revenue sources seems to provide towns the opportunity to diversify their revenue structures, but especially fosters motivation when towns face restrictions aimed at limiting property taxation.

The second conclusion evident from table 3 is that the only revenue sources (aside from the property tax) from which towns within all five states generate revenue are general charges and miscellaneous general revenue. These two revenue sources are available to the Dillon’s rule and home rule governments, as well as those restricted by and unaffected by tax and expenditure limitations. Figures 2 and 3 illustrate trends in the proportion of towns (grouped into the three categories based on home rule status

Table 3 Town Use of Alternative Revenue Sources

<table>
<thead>
<tr>
<th>Revenue Source</th>
<th>Dillon’s Rule and TELs</th>
<th>Dillon’s Rule and No TELs</th>
<th>Home Rule and No TELs</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>WI</td>
<td>MN</td>
<td>VT</td>
</tr>
<tr>
<td>Property tax</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>General sales tax</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Selective sales tax</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>License tax</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Income tax</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>General charges</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Miscellaneous general revenue</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>
and TELs) generating any amount of revenue from general charges and miscellaneous general revenue, respectively. Both illustrations show increasing use of general charges and miscellaneous general revenue by town governments within all states under analysis. According to figure 2, few towns generated revenue from general charges prior to the beginning of the tax revolts in 1978, particularly among the Dillon’s rule entities. With the largest increases in the percentages of towns generating revenue from general charges occurring between 1977 and 1982 for all three categories, it appears that the tax revolts were an influential factor. The remaining two decades illustrated in figure 2 show fairly stable trends for towns unaffected by tax and expenditure limitations and a small steady upward trend for Wisconsin towns restricted by TELs. In terms of miscellaneous general revenue, figure 3 shows generally higher percentages of towns using this revenue source overall and more similarity in trends among all three categories of governments. Again, the largest increases in towns utilizing miscellaneous general revenue occurred immediately after the
tax revolts for about a decade, before tapering off and remaining relatively stable during the last two decades.

These trends in general charges and miscellaneous general revenue demonstrate movement by town governments toward revenue sources other than the property tax. The increasing use of nontax revenue sources such as general charges by town governments emulates the patterns of diversification among states and municipalities. User charges and fees have become important revenue sources for both state and local governments (Carroll and Sharbel 2006), as nearly all governments throughout the country now use them to finance many government services such as parks, sanitation, sewage, airport services, and parking (Brunori 2003). Local governments in particular relied more heavily on user charges and fees to replace their lost property tax revenue resulting from the tax revolts and property tax limitations (Brunori 2003). However, the relatively stable reliance on the property tax (illustrated in figure 1) suggests that even though high percentages of towns are utilizing these alternative revenue sources, they are not generating sufficiently large amounts of revenue to supplant their dependence on property taxation. This likely contributes to lower levels of diversification exhibited by the town governments in our study.

However, even though town governments have emulated the diversification strategies of states and municipalities by utilizing user charges as an alternative revenue source, a fundamental difference in diversification strategies is also evident. Nearly all of the 50 states (with a few exceptions) levy a general sales tax. Since its development and widespread adoption during the Great Depression, states have become more dependent on sales tax revenue (Janata 1993). The states have particularly embraced the sales tax because it allows property taxation to be the primary tax revenue source for local governments (Carroll 2003). Moreover, the state sales tax has proven to be relatively stable during economic downturns and revenue elastic during inflationary periods, resulting in additional revenue for service expansion and adding to its popularity among the states (Pomp and Oldman 2001). Following a similar trend, the second-largest revenue source (next to the property tax) for local governments is other tax revenue, particularly the local-option sales tax (Brunori 2003). Thirty-three of the 45 states that levy a general sales tax allow local governments to generate revenue from this source; 23 states allow both cities and counties a local option (Brunori 2003). However, a look back at table 3 suggests that town governments have not followed the same pattern of sales tax utilization, as towns in only two of the five states generate revenue from the general sales tax. This suggests that the low levels of town diversification reported in table 2 are at least partially attributable to the measures used to calculate revenue diversification.

All four definitions of revenue diversification summarized in table 1, which were used to calculate the HHI measures of town diversification reported in table 2, include general sales tax as an individual category for calculating HHI. Aside from the property tax, this is the only other revenue category used by all four studies. The parallel trends of states and municipalities in utilizing the general sales tax as a primary alternative to the property tax undoubtedly justify using general sales tax as an individual category for calculating HHI and determining the level of diversification among both state and municipal governments. However, the limited availability of general sales tax revenue for town governments suggests that less emphasis should be placed on this source when measuring diversification for towns. Moreover, none of the previously established diversification measures uses general charges or miscellaneous general revenue as an individual revenue category. Yet these two sources are the only property tax alternatives used by towns within every state in our analysis. These differences between town governments and the revenue diversification strategies of states and municipalities demand a different definition and quantitative measure of diversification for examining town governments.

Sales taxes are currently levied in every state in the United States except Alaska, Delaware, Montana, New Hampshire, and Oregon. In addition, the state of Illinois (the focus of the municipal studies on revenue diversification) reserves 1 percent of its 6.25 percent base sales tax rate for cities, and allows for several other local taxes to be added on to the base rate. Conversely, there is limited opportunity for towns to utilize the general sales tax as an alternative revenue source among the five states in our analysis. Specifically, Maine levies a state sales tax, but does not allow an additional local option. Although Minnesota allows for local-option sales taxes, only four cities and one county levy a local tax. In Vermont, only one city and four towns levy a local-option sales tax.16 Although several towns in Wisconsin and Connecticut utilize the general sales tax, the average proportion of general sales tax revenue to total tax revenue amounts to less than 1 percent for towns in both states. As a result, the definitions and quantitative measures of revenue diversification offered within the literature and used to analyze state and municipal governments are probably not well suited for examining revenue diversification among town governments.

**A Better Measure of Diversification For Towns**

Based on our analysis of revenue utilization trends among towns, we propose the following definition of town revenue diversification: A diversified revenue structure for town governments consists of relatively equal reliance on revenue generated from property taxes, general charges, miscellaneous general revenue, and other taxes.

Using this definition, we recalculated town revenue diversification in the following way:

\[
HHI_{town} = \frac{1 - \sum_{i=1}^{n} R_i^2}{1 - (100%/n)} \tag{1}
\]

where \( R_i \) is the proportion of general own-source revenue generated by each of four revenue sources—property taxes, general charges, miscellaneous general revenue, and other taxes—and \( n \) is equal to 4.17 This definition and quantitative measure of revenue diversification for town governments (i.e., \( HHI_{town} \)) yield the trends illustrated in figures 4 and 5.

Figure 4 provides a comparison of our newly proposed \( HHI_{town} \) measure and the HHI measures from the extant literature summarized in table 1. The graph illustrates various mean HHI values for each census year from 1972 to 2002 for all towns.
observed each year. Similar to the analysis presented in table 2, we calculated the various HHI scores for all towns under analysis by replicating the HHI formula used by each author as well as our new measure. Using the various HHI scores for each town, the mean values for each census year were calculated in order to provide the comparison presented in figure 4. As can be seen from the graph, town revenue diversification follows a parallel trend over time among all of the HHI measures except for Carroll (2005), which displays levels of diversification for towns that undoubtedly suggest the measure is most inappropriate for measuring diversification among town governments. Among the other measures, $HHI_{town}$ reports consistently higher levels of diversification for towns between 1977 and 2002. However, our newly proposed measure of town diversification still yields $HHI_{town}$ scores for towns that are systematically lower than the diversification levels reported in table 1 for states and municipalities. This finding lends further support to our preliminary conclusion that towns are less diversified than states and other local governments, primarily because of their continued dependence on property taxation. Although town governments have alternative revenue sources at their disposal, the amount of revenue generated from user charges and miscellaneous general
revenue is insufficient to reduce their reliance on property taxation. This finding also supports our initial conclusion that the influence of tax and expenditure limitations is perhaps greater than home rule provisions, because home rule status does not necessarily provide towns with greater fiscal autonomy than Dillon’s rule governments if they have been granted access to alternative revenue sources.

Similar to the trends we have seen throughout the preceding analysis, figure 5 shows divergent trends between the Wisconsin towns restricted by tax and expenditure limitations and the remainder of towns unaffected by TELs. The Wisconsin towns exhibit a significantly higher level of diversification (HHItown) throughout most of the time period. Figure 5 also illustrates the influence of the tax revolts, with the largest increases in diversification occurring for all towns between 1977 and 1982. After this time, diversification trends remain relatively stable throughout the remainder of the time period for all towns, with a small decline among the towns in Wisconsin. Both Dillon’s rule and home rule towns unaffected by tax and expenditure limitations exhibit similar trends in diversification during the last two decades illustrated in figure 5. All of these findings lend further support to the conclusions drawn from our analysis thus far.

The levels of town diversification shown in figures 4 and 5 remain generally lower than those summarized for states and municipalities in table 1. Nonetheless, we believe that our proposed measure (HHItown), adapted for application to town governments, more accurately captures the diversification strategies of town governments and therefore provides for a better estimate of diversification trends over time for these unique governments. By placing less emphasis on revenue derived from sales taxation and more emphasis on user charges and miscellaneous general revenue, the HHItown measure is calculated with greater consideration of the revenue sources actually used by town governments, as opposed to the HHI measures proposed by the extant literature for states and municipalities. Therefore, this new measure better captures the essence of revenue diversification strategies among unique town governments.

Conclusion
In this essay, we have sought to develop a greater understanding of revenue diversification among town governments by examining towns within five states: Connecticut, Maine, Minnesota, Vermont, and Wisconsin. These are the only states in which all towns maintain the traditional and unique governing structure of the town meeting, which is how we defined towns for purposes of analysis. Our study on town government revenue diversification contributes to local government research in two important ways. First, we were able to confirm that town governments tend to have less diversified revenue structures than what has been previously observed in states and municipalities. Second, revenue diversification among town governments is substantively different from other local governments and states. Town governments rely much less on sales taxation than states and municipalities, primarily because of their limited opportunities to do so. These findings led us to propose a new definition of revenue diversification, which is based on the Hirschman-Herfindahl Index, to more appropriately assess diversification strategies among town governments. Even with this new measurement, however, we continued to see less diversification among towns compared to states and municipalities because of a sustained reliance on property taxation over time.

We also sought to further understand the variation in town government revenue structures across states. Here, we found that state-imposed tax and expenditure limitations, as well as home rule provisions, affect levels of revenue diversification among towns. For example, towns in Wisconsin, which are restricted by TELs but do not have home rule status, maintained the highest levels of revenue diversification. Towns in states with home rule but no TELs (such as Connecticut and Maine) had the next highest HHI scores. The lowest levels of diversification were found among towns in states that had no home rule or TELs (Vermont and Minnesota). These findings provide evidence for the influence of both home rule status and TELs, but suggest that TELs present even greater motivation for towns to increase their levels of revenue diversification.

The findings from this research bring to light the implications for local governments of legislative differences among states. Through our analysis of town governments and the influence of state legislation we were able to uncover, we have a better understanding of revenue diversification among local governments. For towns, tax and expenditure limitations and home rule provisions matter to revenue diversification. It is plausible to expect these legislative differences to influence levels of diversification among other local governments as well. In addition, there undoubtedly are other factors that help to explain variation in revenue diversification among town governments. We encourage future research to develop a comprehensive model that determines the relative significance of these two factors along with other possible explanations.

Notes
1. The Hirschman-Herfindahl Index measure of revenue diversification

\[ 1 - \sum_{i=1}^{n} R_i^2 \]

is calculated as \[ 1 - \left(\frac{\text{HHI}}{100}\right)\], where \( R_i \) is the proportion of total revenue generated from each source and \( n \) represents the total number of revenue sources selected for measuring diversification. This calculation yields revenue diversification values ranging from 0 to 1, with higher values indicating greater levels of diversification.

2. It should be noted that not all citizens participate in town meetings. For further information, refer to Bryan’s (2004) recent work on Vermont town meetings.

3. For further information, see Fairlie (1906), Porter (1922), and Snider (1957).

4. For historical examples, see Fairlie (1906), Porter (1922), and Snider (1957).

5. For the purposes of this research, towns and townships are considered the same. Most of the towns in Midwestern states are unincorporated. Many of the towns and townships in New England are legally termed “municipal corporations,” and perform and deliver services in densely populated urban areas. However, like the unincorporated towns, their legal status is not based on their population size (e.g., Class A city, Class B city, etc.). Therefore, the reference to “towns” in this research includes both towns and townships counted by the U.S. Census Bureau in the Census of Governments.
6. According to the Census Bureau and several scholars, the following 20 states have town and township forms of government: Connecticut, Illinois, Indiana, Kansas, Maine, Massachusetts, Michigan, Minnesota, Missouri, Nebraska, New Hampshire, New Jersey, New York, North Dakota, Ohio, Pennsylvania, Rhode Island, South Dakota, Vermont, and Wisconsin. Scholarly work identifying the locations of towns and townships includes Sokolow (1988) and Abress (2000). For historical work on local governments, see Fairlie (1906), Porter (1922), and Snider (1957).

7. Maine’s municipal property tax increase is limited to a formula based on inflation, assessment growth, and income. However, it can be overridden by a local government as cited in MRSA 5721 (LD 1), making the limit relatively weak (Yuan et al. 2009).

8. As required by law under Title 13, U.S.C., Section 161, a census of all governments within the United States is conducted at five-year intervals (U.S. Census Bureau). The Census of Governments survey covers three major subject fields—government organization, public employment, and government finance. The Census Bureau also collects this information from a sample of governments in the years between each five-year census.

9. All data for this analysis were calculated using year 2000 constant dollars to adjust for inflation where necessary.

10. In 1986, data were available for 145 towns in Connecticut, 417 towns in Maine, 1,790 towns in Minnesota, 210 towns in Vermont, and 1,268 towns in Wisconsin.

11. Because 1997 was a census year, data were available for 149 towns in Connecticut, 467 towns in Maine, 1,794 towns in Minnesota, 237 towns in Vermont, and 1,266 towns in Wisconsin. Because of sampling in the noncensus years, annual data between 1993 and 1996 were available for 80 towns in Connecticut, 91 towns in Maine, 43 towns in Minnesota, 69 towns in Vermont, and 37 towns in Wisconsin.

12. Because 1997 was a census year, data were available for 149 towns in Connecticut, 467 towns in Maine, 1,794 towns in Minnesota, 237 towns in Vermont, and 1,266 towns in Wisconsin. Because of sampling in the noncensus years, data for 1996, 1998, and 1999 were available for 80 towns in Connecticut, 91 towns in Maine, 43 towns in Minnesota, 69 towns in Vermont, and 37 towns in Wisconsin. In 2000, data were available for 76 towns in Connecticut, 153 towns in Maine, 170 towns in Minnesota, 118 towns in Vermont, and 99 towns in Wisconsin.

13. Because 1992 and 1997 were census years, data were available for 149 towns in Connecticut, 467 towns in Maine, 1,794 towns in Minnesota, 237 towns in Vermont, and 1,266 towns in Wisconsin. Because of sampling in the noncensus years, data for 1993–1996 and 1998–1999 were available for 80 towns in Connecticut, 91 towns in Maine, 43 towns in Minnesota, 69 towns in Vermont, and 37 towns in Wisconsin. In 1990 and 1991, data were available for 141 towns in Connecticut, 219 towns in Maine, 125 towns in Minnesota, 125 towns in Vermont, and 1,267 towns in Wisconsin. In 2000, data were available for 76 towns in Connecticut, 153 towns in Maine, 170 towns in Minnesota, 118 towns in Vermont, and 99 towns in Wisconsin.

14. For the remainder of this analysis, we opted to analyze and report data pertaining to census years only because of the dramatic decline in the numbers of towns with available data in the noncensus years, which likely contributes to self-selection bias in the sample data for noncensus years. To avoid drawing conclusions from data that might not be representative of the population of towns in the states included in our study, we limited our analysis to census years in which data pertaining to all towns are available.

15. The Census Bureau defines general charges as “charges imposed for providing current services or for the sale of products in connection with general government activities.” The Census Bureau defines miscellaneous general revenue as “all other general revenue of governments from their own sources (i.e., other than liquor store, utility, and insurance trust revenue).” See http://www.census.gov/govs/www/class_ch7.html#S7.23 for definitions.

16. For further information on local options for sales taxes, refer to the state department of revenue.

17. The “other tax” category comprises all non–property tax revenue, including general and selective sales, personal and corporate income, license, and any other miscellaneous taxes. Towns within all five states in this study generate some amount of revenue from tax sources aggregated into the “other tax” category. Therefore, the four categories used to define and measure revenue diversification for this study are all available to the towns analyzed.

18. In addition to the presence of tax and expenditure limitations, revenue diversification might also be affected by the level of tax and expenditure limitations imposed upon each revenue category used to define and measure diversification. This information is not included in our analysis, and we recognize this as a limitation of our study. We invite future research to explore this issue further.

References


