1976

The Outlook for State and Local Government Finances

Roy W. Bahl
Georgia State University, rbahl@gsu.edu

Recommended Citation
Bahl, Roy. 1976. "The Outlook for State and Local Government Finances." Public Administration Review 36 (6): 683–87. https://doi.org/10.2307/975064.

The Outlook for State and Local Government Finances
Author(s): Roy Bahl
Source: *Public Administration Review*, Vol. 36, No. 6 (Nov. - Dec., 1976), pp. 683-687
Published by: Wiley on behalf of the American Society for Public Administration
Stable URL: https://www.jstor.org/stable/975064
Accessed: 23-11-2022 14:30 UTC

City? (Washington, D.C.: The Urban Institute, October 1972).
10. Leona Vogt, et al., *Health Start: Final Report of the Evaluation of the Second Year Program* (Washington, D.C.: The Urban Institute, December 1973).
11. Bayla White, et al., *The Atlanta Project: How One Large School System Responded to Performance Information* (Washington, D.C.: The Urban Institute, March 1974).
12. John Waller, et al., *Monitoring for Criminal Justice Planning Agencies* (Washington, D.C.: The Urban Institute, August 1974, and U.S. Government Printing Office, March 1975), revised and reprinted as *Monitoring for Government Agencies* (Washington, D.C.: The Urban Institute, February 1976).
13. See Richard Schmidt, et al., *The Market for Evaluation Services in the Department of Health, Education, and Welfare* (Washington, D.C.: The Urban Institute May 1974).
14. John W. Scanlon, *Urban Institute Program Evaluation Staff Self Assessment*, Urban Institute working paper, June 1973 (unpublished manuscript, in draft).

THE OUTLOOK FOR STATE AND LOCAL GOVERNMENT FINANCES

Roy Bahl
Syracuse University

Editor's note: This information was presented to the National Academy of Public Administration at its meeting on May 20, 1976.

The continuing New York City fiscal crisis has vividly brought to national attention a state and local government financing problem of potentially enormous dimensions. It has also raised an important set of issues about the nature of the problem and the appropriateness of the remedial policies being suggested. Disagreement is widespread, not only about the policy response, but also about the underlying causes of the urban fiscal problem, whether the problem extends to state governments, and, in any case, whether it is indeed a national problem. Among the important points of disagreement are:

- Will the state-local sector in aggregate face a large deficit and require a massive federal bailout?
- Is this fiscal problem mostly a result of the poor performance of the economy and, therefore, one which will tend to disappear during recovery?
- Is this fiscal problem the result of the high inflation rates of recent years and will it therefore disappear as inflation moderates?
- Is there a healthy fiscal position for the state-local sector in general but financially troubled pockets within the sector (e.g., large Northeastern cities)?
- Was the New York City debacle mostly a result of years of bad management and, therefore, not a transferable experience of forewarning to other cities?

Our reading of the evidence suggests that, while the fiscal troubles of only a few urban governments have been publicized so far, the list of potential candidates for trouble in the near future is sufficiently large to imply that the aggregate state-local sector may be approaching a grim, if not crisis, situation; that economic recovery in the next five years is not likely to resolve the problem—although such a generally welcome event would certainly mitigate the stress; and that the fundamental New York City crisis was no more the result of financial mismanagement than it was the inevitable outcome of a deep-seated economic base deterioration which is also taking hold in many other large American cities.

The Aggregate Outlook

The President's *Economic Report* for 1976 devotes only a few pages to the state-local sector, and generally sees a healthy position by 1980. They cite declining demand for services and economic recovery as major contributing factors and are silent on the public employment and compensation issues. Lest this be quickly dismissed as a political document in an election year, it should be

This article reports the results of several years of research in the Metropolitan Studies Program, and any credits must be shared with my coauthors, Alan Campbell, David Greytak, Bernard Jump, and David Puryear. A more detailed version of these remarks is reported in our testimony before the Joint Economic Committee on January 22, 1976.

Roy Bahl is director of the Metropolitan Studies Program, The Maxwell School, Syracuse University.

noted that roughly the same conclusions have been reached, after more thoughtful analysis, by the Tax Foundation and the American Enterprise Institute. The clear implication of these findings (actually stated in the AEI volume) is that state-local tax rate cuts are in the offing.

Such a statistical result and optimistic outlook simply does not square with what one observes in the state-local government sector; declining levels of public services, union pressures for cost-of-living adjustments in the face of continued inflation, taxpayer resistance, the likelihood that the black population will not share equally in the recovery, many costly programs of relief now in Congress, discussion of a pending capital shortage, and a great squabble over General Revenue Sharing which constitutes less than four per cent of total state-local sector spending.

The question of the gap between these optimistic forecasts and these casual observations is one which is in need of some careful consideration. Though we do not have an alternative econometric model to offer, we would like to raise several objections to the optimism of these studies. The reasoning behind these projected surpluses in the state-local sector fiscal position includes (a) an assumption that the level of expenditures will be able to adjust to the level of automatic revenue growth because of a reduction in the growth rate of population and hence in service level demands, particularly for education; (b) increased federal government involvement in capital facility financing or simply inactivity in this area at the state-local level; and (c) the possibility that pressures will not be so great from public employee unions because a "catch-up" has already occurred.[1] Unfortunately, our reading of the evidence does not lead to such optimistic assumptions.

Our basic argument is that the growth in state and local government expenditures in recent years and that expected in the foreseeable future is not *primarily* a response to increased service demands on the part of the population. It is, rather, a combination of the responses to increased service demands, rising employee and material costs, and inflation. Apart from transfer payments, the dampening expenditure effects of declining population will come about primarily through government employment reductions. These cost "savings" tend to be offset by wage rate increases, cost increases for materials, rising capital costs, etc. We think there is a strong argument to be made that a catch-up, which would alleviate public employee pressures for wage increases, has not occurred. Accordingly, we are prepared to argue that the slowdown of national population growth will not be sufficient to bring about a balance in the aggregate state and local financial position.

In any case, the net aggregate surplus or deficit may indeed be the wrong issue to raise. The fact that energy producing states can generate large surpluses is of little consolation to the fiscally troubled Northeastern states. Not only does the United States intergovernmental mechanism not provide for budget-balancing transfers between states, but the federal grant system, with its built-in "sunbelt" effects, likely accentuates the problem.

But perhaps more fundamental to our criticism of these projected supluses in the state and local sector is the extent to which these models have ignored the interdependency between state and local governments.

It seems virtually certain that states cannot long remain aloof and insulated from the problems of their local governments. Sooner or later, the result of local stress must be adverse fiscal consequences for the relevant states. And one form that such fiscal consequences will likely take is state assumption of some of the costly financial responsibilities formerly borne by the cities. In Table 1, we show that a sample of states containing large cities with declining populations[2] accounts for 49.7 per cent of aggregate state and local government expenditures. Even without taking account of other states which contain economically troubled cities, it is difficult to be entirely sanguine about the prospects for an aggregate budget surplus in the immediate offing in the state-local sector.

With the point made that one cannot properly separate urban from state fiscal problems, we would propose to turn to the very serious and important issue of the factors which underlie the city fiscal problems. The current New York City debacle has brought renewed attention to the serious financial problems of American cities in general and to metropolitan central cities in particular. And as bad as the consequences of the New York City collapse are for its residents, the whole experience holds an important lesson for financial planners in other cities and for federal government policy makers. Unfortunately, the tone of present federal policy gives every indication that this lesson will be lost, at least so far as federal help to the cities is concerned. For this reason, we emphasize here the possible parallels

TABLE 1

TOTAL EXPENDITURES OF STATE AND LOCAL GOVERNMENTS IN STATES WITH DECLINING MAJOR CITIES (1973-1974)

State	Cities	Total General Expenditure (millions of dollars)
California	Oakland San Francisco	$ 23,392.2
Maryland	Baltimore	4,319.2
Massachusetts	Boston	6,137.0
Michigan	Detroit Flint	9,375.0
Missouri	St. Louis	3,447.1
New Jersey	Jersey City Newark	7,172.0
New York	Buffalo Rochester Syracuse	26,228.4
Ohio	Akron Cincinnati Cleveland Dayton	8,090.5
Pennsylvania	Philadelphia Pittsburgh	10,474.3
Total		98,635.7
Total for 50 states		198,618.2
Percentage		49.7

Source: *1970 Census of Population, General Population Characteristics, Governmental Finances in 1973-1974.*

between the problems facing New York City and those which may be ahead for other large cities.

Four important dimensions of the urban fiscal problem must be considered to understand why many large central cities are encountering severe fiscal problems as well as to arrive at a realistic program to strengthen their financial viability. These four interrelated elements of the program are (1) the declining economic base of metropolitan central cities, (2) the effects of inflation on public expenditures and revenues, (3) the rising cost of public service delivery, and (4) the more purely financial management problems of cities.

To judge from the New York City case, however, it appears that the Administration places undue emphasis on financial management issues and largely ignores the matter of a declining economy. We would like to argue that an equivalent amount of emphasis must be placed on issues other than financial management. There may be few other cities which are soon to be candidates for default in the sense that they are unable to pay debt service obligations or other charges on time, but it is important to recognize that a city which is forced by a shrinking economic base to cut essential services far below minimally acceptable levels is no less in default on its obligation to residents dependent on such services.

The Nature of Reform

If our view of the state of state-local finances is correct, there is need to seriously rethink the piecemeal set of federal-state-local reforms which have been proposed.

No-Growth City Budgets

To the extent that central city fiscal problems stem from the process of economic decline, cities are suffering from problems that afflict all "mature" economics, and the best solution may be simply to concentrate on the problems of adjusting to the new reality of a slower growth. Recent trends in population growth in the United States suggest that employment growth will be slowing throughout the country and that the national economy will have to adjust to this slower rate of growth. In that core cities are growing slower even than the national economy, they are doubly damned in that their budgets will have to reflect an even more stringent measure of control than those of governments in other parts of the country.

The primary form which this adjustment will take is likely to involve changes in the level and mix of public expenditures. Planning for future growth will be replaced by planning for the conversion to a stable or very slow growing economy. The first place this retrenchment will be felt is in the area of capital spending, where cities will have to postpone those kinds of capital expenditures which are effectively luxuries—e.g., municipal recreation or auditorium facilities, widening of certain streets, municipal public buildings. The curtailing of other kinds of capital projects, improvements to sewer systems, delaying the construction or major repair of school buildings, etc., will no doubt also be called for. Together, these kinds of actions will reduce the debt service costs of city governments which, given present and prospective borrowing costs, will be a substantial saving.

The other element of no-growth planning has to do with the negotiation by the city government with public employee unions. In the long run, central city governments simply cannot afford to continue granting the kind of wage rate and fringe benefits increments which they have in the past—no matter how fair or unfair such increments may be. However, the overall slowdown in the national economy may suggest that, even with slower rates of increment in public employee compensation, parity with the private sector may be maintained. At any rate, it would appear that there is need to centralize the collective bargaining process at the state level, and to create some form of wage and benefit guidelines for public sector employees. Short of such policy, increasingly larger federal and state subsidies will be required to prop up local government budgets.

This economic and fiscal retrenchment has potential dangers because too severe a curtailment of public sector activities may well exacerbate the growth problem. However, there are some potential advantages to the slowdown if the state is able to mobilize its resources to take advantage of the opportunities. The problems of traffic congestion, environmental decay, and housing shortages are three examples of areas in which a period of slow growth, once the state and local economy has adjusted to it, can provide a necessary breathing space. However, the backlog of problems faced by states and local governments in areas such as these remains very large and will not be eliminated overnight.

State Government Subsidy

A second element in dealing with the longer term needs of central cities involves increases in state subsidies to city governments. Assuming that New York City brings its financial operation under control, it seems obvious already that it will still be faced with the inability to finance all of its social service responsibilites. The same problem is beginning to emerge elsewhere as is evidenced by the many announcements of public employee layoffs, budget reduction, and service curtailment. To the extent that such reductions in the delivery of basic services are deemed socially undesirable, the most apparent reform may be increased participation by state governments in the delivery of urban public services. In extreme cases, the best solution may be to turn the city into one which has a minimal responsiblity for delivery of social services. However, state assumption of functions such as education and health care (and federal assumption of welfare) brings to the forefront a new set of financing and equity issues. First of all, it means that state governments will have to search for new resources since state assumption inevitably would involve additional costs at the state level. As some of our recent work has shown, unless the proper choice of tax instruments is made, such state assumption may be accompanied by unfavorable income distribution consequences, i.e., if sales taxes are chosen as the financing mechanism over the income tax alternative, tax burdens on the urban poor may rise as a result of state assumption.

A second problem is the possibility that state governments may not adequately recognize the particular social service needs of the urban poor who tend to be clustered in the central city. In state legislatures where the suburban-rural dominance is important, this problem may loom very important.

Over and above these issues is the financial difficulty in which state governments are increasingly finding themselves. For inflation, rising public employee costs, and increased service demands are all factors which have affected state as well as city governments. Again, in the highly urbanized Northeastern states where the economic base has grown slowly relative to the rest of the nation, and where tax effort is already high in most cases, it is not clear that such expansion in government resources is either feasible or desirable. In these cases, the no-growth budget policy again becomes a real possibility. Certainly state government capital expenditures would have to be curtailed under these circumstances and it is likely that stringent controls over public employment costs will have to be maintained. With such financial pressure on state government budgets, the assumption of social service financial responsibilities from cities will not be made with great enthusiasm and the maintenance of social services at adequate levels in central cities is doubtful.

The Need for a New Federalism

What the above suggests is that, with a slowdown of the growth in the national economy, there also will be a slowdown in the growth of the state-local sector. An important implication of this pattern is the possible curtailment of social services in the central cities, a restriction on public employment compensation growth, and likely increased tax burdens on the urban poor. Even so, state and local governments will be strained to remain financially viable These factors together suggest the need for a realistic new federalism, not one that focuses on improving the efficiency of federal aids by consolidation or amalgamation, but one which recognizes the serious income distribution consequences of what lies ahead for the nation's cities. Full federal assumption of welfare costs would be a first step in this direction. An increased and realistic allotment of revenue sharing monies, in amount and under a formula which recognizes the particular problems of central cities, would be a second element of such a federalism. At best the next few years are going to be very difficult for many cities and states; for sure, there will be service level defaults; and at worst we are going to see many more New York City debacles.

Notes

1. There are, in addition, a number of data considerations on which we differ—particularly the treatment of the trust funds.
2. In the absence of employment or other more directly economic indicators of cities' conditions, declining population will serve adequately as a proxy. See also Thomas Muller, *Growing and Declining Urban Areas: A Fiscal Comparison* (Washington, D.C.: The Urban Institute, revised November 1975).

The Marshall E. Dimock Award on the Theme of Innovative Solutions for the Seventies

Four awards, each of $500, were provided for by a gift of $2,000 from Marshall E. Dimock. These awards go to the author, or authors, of the best article published in the *Review* on the above theme in a given year. The Society deems it appropriate to refer to the award as the Marshall E. Dimock Award, though this designation was neither requested nor intended by the donor.

Decisions on the awards are made by a committee appointed by the president of ASPA. The committee will have the right not to make an award in any given year, if they judge this appropriate; but the competition will continue until four awards of $500 have been made. (The first award was made for 1974.) Decisions of the Committee will be final.

The donor set forth his considerations in the following language. The awards committee will be guided, but not strictly limited, by this language:

> "Public administration should be one of the most innovative fields in the whole of academic and professional life. The reason is that, at its best, public administration is largely problem solving in its outlook and intent. Public administrators are relied upon for policies and also for operational know-how in solving society's most pressing problems. The need for innovative public administration is particularly urgent today, and from all indications, will continue to be so for some time to come. The committee's decisions should therefore be based upon considerations of practical imagination and creative instrumentation. The committee should look for innovation in management policy above innovation merely in the technique of management. The underlying assumption is that public administrators must be the principal innovators of solutions for the problems of the '70s and should be encouraged to stress this leadership role whether they are technically 'policy' officials or managers at a lower level of performance."