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Effects of Regional Shifts in Population and Economic Activity on the Finances of State and Local Governments: Implications for Public Policy

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

Alternatives to Confrontation

A National Policy toward Regional Change

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Victor L. Arnold
The University of Texas

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Roy Bahl

Introduction

The shift in economic activity from the Northeastern and Midwestern industrial regions has by now been thoroughly documented.[1] The numerous empirical examinations of this shift have been revealing in describing what has happened and in offering hypotheses about why it happened. Over the same period there has been an outpouring of literature on the financial problems of state and local governments.[2] The relationship between the declining economy and the declining fisc, however, has not been adequately studied,[3] or if it has, public policymakers have not understood the linkage. Perhaps it is because the relationship between the economy and the fisc is so difficult to formulate and because state and local governments have so little control over the performance of the state/local economy that policy analysts have turned in other directions to grapple with fiscal problems. There is probably no more glaring example of this misunderstanding than the proposed solutions to the fiscal problems of the New York City government. Indeed, at least in the early stages much more attention was focused on the financial management issues which surrounded the New York City and State near financial disasters than on the fiscal implications of the economic decline which was taking place. As a result, it would be no great surprise if the remedial management policies implemented do little to deal with the city's long-term fiscal problems.

The objective of this chapter is to analyze the linkage between regional shifts in economic activity and state and local government finances in the growing and declining regions of the United States. An initial assumption of this chapter is that regional shifts in population and employment are not undesirable per se and therefore should not be the object of remedial public policy. Nor is a trend toward interregional income equality or a growing homogeneity in the provision of public services across geographic areas

detrimental to the public welfare. What is harmful about regional shifts and what ought to be at the center of concern about public policy to deal with such shifts are the effects on unemployment, poverty, and the fiscal position of state and local governments. In a sense all three of these concerns can be translated into a more general concern for the distribution of income, more specifically to a concern for the share of purchasing power or public services accruing to low-income families. In this context, the problems of decline, those faced by the industrial Northeast and Midwest, would appear more difficult to resolve than the problems of growth, those experienced by the Southern tier states. Certainly there are migration barriers which would cause one to expect a holding of the jobless in central cities in declining regions, and there are institutional barriers which would cause one to expect a worsening fiscal position for jurisdictions in the declining region. This is not to say that there are not severe fiscal and poverty problems in the Southern region, but rather that the adjustment problems associated with regional *shifts* are likely to be more severe in the Northeast.

In any case, this crude statement of the problem suggests that an understanding of the linkages among regional shifts in employment and population, the unemployment problems particularly of large cities and the fiscal problems of state and local governments, is essential to formulating a remedial public policy. This chapter is a modest attempt to deal with one dimension of this linkage, the relationship between regional shifts and state-local finances.

The thesis here is straightforward. The fiscal adjustments to growth in service demands and factor costs in the Southern tier, on the one hand, while painful, as are all fiscal adjustments, could be absorbed in an expanding public sector which had a growing capacity to finance and a governmental structure and tax system more amenable to absorbing such decline. The decline in financial capacity in the Northern tier, on the other hand, did not induce a commensurate contraction in the public sector, partly because service demands did not decline as rapidly as taxable capacity and partly because there are formidable barriers to cutting public service costs (unions and inflation). The result is a narrowing of public service levels on a nationwide basis, but a higher tax burden in the declining region and a more limited ability of governments to deal with public servicing needs in that region. Moreover, there is a real possibility that governments in the declining region will adjust by cutting social service expenditures and service delivery employees. In such a case, the low-income families in the declining sector may suffer disproportionately during the period of decline.

The fiscal implications of a deteriorating economic base for a state which has a highly developed public sector are particularly serious because of the difficulties of downward expenditure adjustment. This is well illustrated by the case of New York State. Public service levels in New York,

while not adequate by absolute standards in every area, are supported by a high level of expenditure. Public employee compensation, debt service, and certain nonlabor costs (for example, energy-related costs) are not easily controllable, much less reversible; hence, in the face of economic decline, it is not likely that large cutbacks in spending can easily be effected. To the extent that much of New York State's expenditure increase is due to rising compensation rates, the ability to slow down the rate of growth in spending is limited, particularly in a period of inflation. On the other hand, revenues respond dramatically to a slowdown in the rate of economic growth; hence, the resources to finance rising expenditure requirements do not materialize. The result of all this is a cutback in the level of public services and an increase in taxes, which are already thought to be too high. The objectives of this presentation are to support this thesis by quantifying and analyzing the fiscal adjustments actually made in the growing and declining regions and suggesting an appropriate public policy response.

The analysis here is necessarily concerned with regional variations, more specifically with the variation in finances of jurisdictions, state and local, in growing and declining regions. If any regularities are to be ferreted out, some form of aggregation of these jurisdictions must be used. Since the concern here is with how the fisc has been compromised by regional movements in population, jobs, and income, the financing jurisdictions are aggregated here by state and region. In the latter case we follow the general pattern of labeling "Northern tier" the aggregate of the East North Central, Mid-Atlantic, and New England Census regions and "Southern tier" the South Atlantic,[4] East South Central, and West South Central regions.[5]

The danger with such aggregation is that there might remain very wide differences in fiscal structure and performance across states in a region and even across local jurisdictions within a state. For example, in fiscal structure, Texas is more like Ohio than West Virginia, and in terms of economic and population expansion, the city of Atlanta is more like Syracuse than Houston. The reader should remain cognizant of such variations, especially when this analysis is overenthusiastic in identifying "clear" regional variations.

Existing Pattern of Regional Variations

Several characteristics of state fiscal systems are crucial both to an understanding of variations among regions in state/local revenue and expenditure patterns and to an explanation of how these variations have been affected by regional shifts. The most important characteristics would include:

1. The assignment of expenditure and financing responsibility between the state and its local governments
2. The structure of local government and the potential for regionwide service delivery or financing
3. The level and functional composition of expenditures
4. The level of public employee compensation, public employment, and the importance of public employee unions
5. The level of taxation and its composition by major sources
6. The relative use of debt and reliance on federal grants as financing sources
7. Central city/outside central city disparities in local government revenues and expenditures

While these patterns are compared among states and regions below, the existence of substantial intrastate heterogeneity should be kept in mind.

Revenue and Expenditure Assignment

There are two approaches to identifying regional variations in the relative importance of state and local governments. One is to study the characteristics of Southern and Northern states and present whatever pattern emerges. The other is to devise an objective system for classifying all states and examine the results for the two regions. The latter approach was taken in a recent attempt to classify state fiscal systems.[6]

To develop a state fiscal classification scheme, expenditure and financing data were gathered for total state and local expenditures and four specific expenditure functions: education, highways, public welfare, and health and hospitals for 1967 and 1972. From these data, nine specific fiscal characteristics were derived. The first three—*percentage of state and local government expenditures financed by federal, state, and local sectors, respectively*—represent the relative financing responsibilities of the three government levels. The second group of fiscal characteristics—*state and local direct expenditure shares*—describes final spending responsibilities rather than the original source of financing of state and local governments. The sixth characteristic, *per capita expenditures*, is included to capture the scope rather than the division of fiscal responsibilities among the states. The seventh variable is *state grants to local governments as a percentage of total state government expenditure*, and it is geared to separate state governments that dominate financing into two groups: those that retain heavy direct expenditure responsibility and those that pass expenditure responsibility to localities via grant systems. An eighth indicator is revenue effort, defined as *state plus locally financed expenditure expressed as a percentage of state*

personal income. Finally, the *share of state and local government revenues accounted for by the individual income tax* is designed to roughly approximate the progressivity of state taxation systems.

The fifty state fiscal systems described by these nine characteristics exhibit many varied and distinctive combinations of intergovernmental relationships. Some general patterns, however, also emerge which indicate that although each state may be unique, certain common types of state and local fiscal relationships exist nonetheless.

Based on this analysis, the fifty states were grouped into categories of high, moderate, and low financing responsibilities, expenditure shares, and per capita spending levels. These groupings were used to cross-classify state and local fiscal systems as one of three major types: state-government-dominated in terms of both expenditure responsibility and origin of financing; local-government-dominated; and mixed systems. These results are described in table 5-1.

Although no systematic relationship could be found between Census region and these cross-classifications, it may be noted that nine of the sixteen Southern tier states exhibit a high state financing responsibility and a moderate to a high state expenditure responsibility. Only one Southern state, Texas, is to be found in the locally dominated group. By contrast, only two of the fourteen Northern tier states may be classified as state-dominated—Rhode Island and Vermont—while seven of the fourteen Northern tier states may be classified as locally dominated.

A correlation analysis tends to confirm the argument that Southern states in general tend to have more state-dominated fiscal systems. As may be seen in table 5-2, those states which have a heavier financing and direct expenditure shares tend to be lower income, less urban, and less populous.

Local Government Structure

A second important difference between Northern and Southern tier states is the structure of local government in metropolitan areas. The stereotype difference would be Northern central cities with heavy concentrations of the poor, an antiquated, dilapidated infrastructure surrounded by more affluent suburbs, and with little hope of annexation or consolidation. Many, if not most, Northeastern metropolitan areas would fit this stereotype. The Southern tier cities might be painted as newer, subject to less city and suburb wealth difference, and having been more successful at annexation and consolidation. The examples of Jacksonville, Miami, Nashville, Houston, and Baton Rouge come quickly to mind.

Table 5-1
Classification of State Fiscal Systems: Nonwelfare Expenditures of State and Local Governments, 1972

	High State Expenditure Responsibility	*Moderate State Expenditure Responsibility*	*Low State Expenditure Responsibility*[a]
High State Financing Responsibility			
High expenditure per capita	Alaska Delaware Hawaii Vermont		
Moderate expenditure per capita	Idaho Utah West Virginia	Louisiana New Mexico	
Low expenditure per capita	Kentucky South Carolina	Arkansas Mississippi North Carolina Oklahoma	
Moderate State Financing Responsibility			
High expenditure per capita	Montana Wyoming	Arizona Maryland Oregon Washington	Minnesota Wisconsin
Moderate expenditure per capita	North Dakota New Hampshire	Connecticut Pennsylvania	Florida
Low expenditure per capita	Maine Rhode Island	Alabama Georgia Tennessee Virgina	Iowa
Low State Financing Responsibility			
High expenditure per capita			California Nevada New York
Moderate expenditure per capita		Colorado Kansas Nebraska South Dakota	Illinois Indiana Massachusetts Michigan Missouri New Jersey
Low expenditure per capita			Ohio Texas

Source: Advisory Commission on Intergovernmental Relations, *Federal Grants: Their Effects on State-Local Expenditures, Employment Levels, Wage Rates* (Washington, February 1977).

[a]High, moderate, and low designations for each category relate to whether the state placed in the top fifteen, middle twenty, or bottom fifteen among states. State expenditure responsibility is the state share of total state and local direct expenditures. State financial responsibility is the share of total state and local expenditures financed by the state. Per capita expenditures is total state and local expenditures per capita.

Table 5-2
Correlations between Fiscal Characteristics of States and Social and Economic Variables, 1972

	Per Capita Income	*Percentage Urban*	*State Population*
Federal financing share	−.654*	−.466*	−.382*
State financing share	−.122	−.247	−.327*
Local financing share	.463*	.451*	.461*
State direct-expenditure share	−.340*	−.457*	−.595*
Local direct-expenditure share	.340*	.457*	.595*
Per capita expenditures ($)	.551	.119*	.014
Grants as share of state expenditure	−.189	−.334*	−.583*

Source: Advisory Commission on Intergovernmental Relations, *Federal Grants: Their Effects on State-Local Expenditures, Employment Levels, Wage Rates* (Washington, February 1977).
*Statistically significant at the 5 percent level.

There is more than impressionistic evidence to support this stereotype. Sacks finds striking differences between regions in the percentage of metropolitan area populations residing within the central city. As may be seen in table 5-3, he found an average of 61 percent of metropolitan population residing inside central cities in the South as compared to 34 and 45 percent, respectively, in the East and Midwest.[7] Moreover, he shows that between 1960 and 1973 this percentage increased slightly in the Southern metropolitan areas but declined in all other regions. This in no way allows a conclusion to be drawn that the structure of government in the South is less complicated, but it does show that central cities in the South are a more dominant force in their respective metropolitan areas. In addition to this population advantage, it can be shown that the central cities are both fiscally and economically better off in the Southern tier than in the Northern tier states. Much of this advantaged position of Southern central cities must be ascribed to the greater success of the South in consolidation attempts and/or in using more areawide financing mechanisms. Marando argues that consolidation is essentially a Southern regional phenomenon and that annexation has occurred extensively throughout the United States with the exception of the Northeastern region.[8]

Expenditure Level and Structure

There are wide variations between the Northern and Southern tier states in the level and functional distribution of expenditures. The Northern states spend substantially more—25 percent—on a per capita basis than do the Southern tier states (see table 5-4). This difference holds generally across

Table 5-3
Central-City Population as a Proportion of SMSA Population: 1960 and 1973[a]

	Number of Observations	*Mean Value (Percent) of*	
		1960	*1973*
East	18	41	34
Midwest	22	52	45
South	27	59	61
West	18	49	44
Total	85	51	47

Source: Advisory Commission on Intergovernmental Relations, *Trends in Metropolitan America* (Washington, 1977), table 2.

[a]For the eighty-five largest SMSAs.

states within the two regions. Only one Northern tier state (Indiana) spends less than the Southern mean, and only two Southern tier states (Delaware and Maryland) spend above the Northern mean. Only two Southern tier states, again Delaware and Maryland, spend above the national median. This low expenditure level in the South, even in the midst of an increased flow of resources to that region, is important in understanding the possibilities for fiscal adjustment.

In terms of expenditure distribution, the Southern states allocate a slightly greater share of total public resources to education. The same holds true for health and hospitals, but there is much greater variation among states within the two regions. But perhaps the major regional difference in expenditure structure is that the Northern states spend proportionately more for public welfare. No Northern state allocates as little to public welfare as the Southern mean of 11.7 percent.

Public Employment and Wage Levels

On average, there appears to be a greater level of state and local government employment, relative to population, in the South (see table 5-4). Nine of the sixteen states in the Southern tier are above the U.S. median of 476 employees per 10,000 population while only two of the fourteen Northern states are above this median. In general, however, there is much variation among states in both groups, making it difficult to draw a firm conclusion. The variations among the Northern states range from Pennsylvania's 401 state and local government employees per 10,000 population to New York's 563; in the South, the spread is not as great, ranging from Louisiana's 424 to Maryland's 532 employees per 10,000 population.

There is some evidence that an association exists between the level of local government employment and the rate of population growth. Muller compares twelve growing cities and fourteen declining cities on the basis of common function employment per 1,000 residents.[9] From this relatively small set of observations, he finds declining cities to have 12.1 workers per 1,000 residents as compared to 8.7 in the growing cities.[10] Perhaps even more interesting is his finding that the gap has widened between 1967 and 1972. No such relationship between the level of state and local employment and population growth or decline can be found among the Northern or Southern tier states examined here.

Average public employee wages are higher in the Northern tier (table 5-4). However, there are many problems inherent in a comparison of average wage levels across states. There are not good disaggregated data on the wage levels of public employees at various levels of seniority or in various occupations. The estimates presented in table 5-4 are of average payroll per full-time equivalent employee. Such a measure misses the wide variation in pay levels by class of employees, and since October payrolls are used, mixes nine-month employees (teachers) with twelve-month employees. Moreover, the inclusion of total payroll but only full-time *equivalent* employees introduces distortions created by payments to part-time employees. The variation in this distortion across states is unknown.

Even if payroll per full-time equivalent employee is a reasonable measure of interstate variations in the average wage, there remains the problem of measuring interstate variation in the level of pensions and fringe benefits. Again, there are inadequate data to make these cross-state comparisons, and one must be content to assume that interstate variations in the average wage, as measured above, accurately reflect interstate variations in total compensation. There is good reason to expect that it does not, since most benefits are tied to wage levels, for example, pensions and social security contributions. Hence, it is likely that the regional differences in total compensation are greater than those in average wages.

Finally, even if the payroll per full-time equivalent employee is a reasonable benchmark for comparison, there remains the problem of cost-of-living differentials which may tend to change this pattern of interstate differences. In an attempt to adjust the distribution of average wages for regional cost-of-living differences, we have applied the Department of Housing and Urban Development (HUD) estimated fair-market rent index.[11] When adjusted for living cost differentials in this manner, the advantage of Northern tier average public sector wages over Southern tier *falls* to an almost negligible 2 percent.[12]

If all these caveats are accepted, the greater average wage in the Northern tier suggests that a substantial part of the expenditure difference in the Northern and Southern states is due to public employee compensation dif-

Table 5-4
Expenditure and Employment Characteristics of State and Local Governments by Region, 1975

State and Region	Per Capita Expenditures	Percentage of Current Expenditures			State and Local Government Employees	
		Education	Welfare	Health and Hospitals	Per 10,000 Population[a]	Average Wage[b]
Northern Tier	$1,080[c]	41.1	15.9	7.8	454	$ 780
East North Central	1,000	44.8	14.6	8.0	445	775
Illinois	1,066	43.4	16.1	7.0	446	878
Indiania	827	50.9	10.0	10.2	434	652
Michigan	1,120	42.7	17.7	8.3	470	879
Ohio	894	42.2	13.3	8.1	410	734
Wisconsin	1,091	44.7	16.0	6.5	463	732
Middle Atlantic	1,275	37.7	16.2	8.8	473	901
New Jersey	1,107	40.9	14.5	6.0	456	883
New York	1,611	32.5	17.0	12.8	563	1,004
Pennsylvania	1,007	39.8	17.1	7.6	401	818
New England	1,050	39.6	16.7	7.1	452	723
Connecticut	1,059	40.0	13.2	6.4	417	837
Maine	938	39.4	17.4	4.2	446	610
Massachusetts	1,182	34.3	20.8	11.9	457	829
New Hamsphire	924	43.1	14.7	5.4	452	601
Rhode Island	1,044	38.7	19.4	8.3	456	839
Vermont	1,152	42.2	14.9	6.1	486	621

Southern Tier	863	44.0	11.7	10.2	477	678
South Atlantic	983	44.6	10.5	10.0	489	719
Delaware	1,187	47.7	10.1	6.3	532	764
Maryland	1,243	42.4	11.6	8.0	496	910
North Carolina	826	49.8	10.3	8.9	443	682
Virginia	974	45.4	11.8	7.4	487	732
South Carolina	873	45.2	8.7	13.3	473	602
Georgia	925	38.8	13.6	16.6	523	656
Florida	944	43.6	7.5	11.4	485	774
West Virginia	892	44.0	10.7	8.2	478	637
East South Central	839	43.7	12.6	10.8	456	631
Alabama	827	44.4	12.6	12.4	450	660
Kentucky	838	45.2	14.7	7.0	432	645
Mississippi	833	43.0	11.9	11.7	468	565
Tennessee	859	42.3	11.0	12.2	475	658
West South Central	648	43.2	13.1	9.9	474	640
Arkansas	726	43.3	14.1	10.7	424	582
Louisiana	946	40.8	11.4	11.2	517	645
Oklahoma	873	41.0	15.7	8.6	480	610
Texas	838	47.5	11.0	9.2	476	727
U.S. Median	1,008				476	

Source: U.S Bureau of the Census, *Governmental Finances in 1974-75, Series G-F 75*, 5 (Washington: Government Printing Office, 1976).

[a]Full-time equivalent employment.

[b]October payroll divided by full-time equivalent employment.

[c]Unless otherwise noted, the regional and tier averages are simple unweighted means over states in the respective group.

ferences. If one accepts a notion that differentials in average wages across regions are not commensurate with productivity differentials in the public sector, then the higher level of per capita spending in the Northern states substantially overstates the difference in the quality of services provided between the two regions. Muller has studied wage variations among local governments using his growth/decline dichotomy and for his sample has determined that average wage levels tend to be higher in older and declining cities. His plausible explanation of this difference is the greater ability of municipal employee associations in older cities to press for more favorable contract terms, coupled with cost-of-living differences and perhaps a necessary premium for what is perceived as a lower quality of life in the older, more congested cities of the Northeast and industrial Midwest.

Sources of Finance

Three aspects of the financing of state and local government expenditures are important in describing regional variations in fiscal systems: reliance on debt, the structure of taxes raised, and the level of revenue effort exerted. With respect to borrowing, the level of general obligation debt in the Northern tier is substantially higher both on a per capita basis and as a percentage of personal income than in the South (see table 5-5). This higher level of per capita debt in the Northern tier suggests a greater fixed commitment for debt service in the annual budget of the states. It is interesting to note that the highest per capita levels of debt, and generally the highest levels of debt as a percentage of personal income, are observed for those states thought to be facing the most serious fiscal crisis, that is, New Jersey, New York, Pennsylvania, and Massachusetts.

To give some rough idea of how the market perceives the quality of this debt, Standard & Poor's ratings of the general obligation bonds of each state are shown in table 5-5. No consistent pattern emerges with respect to variations between regions. From the ratings one might draw the conclusion that the market does not weight the regional shift in economic activity and employment very heavily in gauging the long-term repayment potential of state government. For example, declining New York and growing Florida are both seen as AA credits, while declining New Jersey and growing Texas are both seen as AAA credits.

In terms of revenue structure there are distinct differences between the regions. Southern states are more heavily reliant on sales taxes and Northern states on property taxes (see table 5-6). This difference is largely a reflection of the division of financial responsibility for services between the state and local levels. Where local government involvement in the delivery of ser-

Table 5-5
Debt Levels by Region, 1975

State and Region	Long-Term Debt Outstanding: Per Capita	Long-Term Debt Outstanding: As a Percentage of Personal Income	Bond Rating
Northern Tier	$1,080	17.9	
East North Central	758	12.3	
Illinois	922	12.7	AAA
Indiana	501	8.9	—
Michigan	926	15.0	AA
Ohio	755	13.0	AAA
Wisconsin	684	12.1	AAA
Middle Atlantic	1,547	24.0	
New Jersey	1,208	18.0	AAA
New York	2,194	33.4	AA
Pennsylvania	1,238	20.8	AA
New England	1,117	19.6	
Connecticut	1,566	22.5	AA
Maine	742	15.5	AAA
Massachusetts	1,321	21.7	AA
New Hampshire	743	14.0	—
Rhode Island	994	17.0	AA
Vermont	1,334	26.9	—
Southern Tier	873	16.4	
South Atlantic	897	15.3	
Delaware	1,680	20.7	A
Maryland	1,239	19.1	AAA
North Carolina	427	8.6	AAA
Virginia	737	12.7	AAA
South Carolina	670	14.5	AAA
Georgia	764	15.0	AA
Florida	784	13.9	AA
West Virginia	872	17.7	AA
East South Central	868	18.6	
Alabama	787	17.0	AA
Kentucky	1,135	23.3	AA
Mississippi	647	16.0	A
Tennessee	902	18.4	AA
West South Central	831	16.2	
Arkansas	514	11.1	—
Louisiana	1,054	21.5	AA
Oklahoma	842	16.0	AA
Texas	916	16.3	AAA
U.S. Median	902		

Source: U.S. Bureau of the Census, *Governmental Finances in 1974-75, Series G-F 75,* 5 (Washington: Government Printing Office, 1976); and Standard and Poors Corporation, *Municipal Bond Selector* (New York, 1975).

Table 5-6
Revenue Structure by Region, 1975

State and Region	Percentage of Own-Source Revenues Raised from: Property Taxes	Sales Taxes	Income Taxes	Per Capita Federal Aid	Federal Aid as a Percentage of Total General Revenue
Northern Tier	34.8	12.8	14.8	$218	20.5
East North Central	30.6	15.7	16.5	186	18.1
Illinois	31.9	18.5	14.7	196	18.2
Indiana	30.0	20.7	12.2	139	15.3
Michigan	32.5	14.3	14.8	232	20.1
Ohio	28.6	13.0	16.1	164	18.8
Wisconsin	30.1	12.3	24.7	200	18.1
Middle Atlantic	32.2	13.6	16.6	223	18.7
New Jersey	46.3	11.8	3.8	191	17.7
New York	29.2	15.2	23.8	276	18.0
Pennsylvania	21.1	13.9	22.2	201	20.6
New England	39.5	10.1	12.6	242	23.2
Connecticut	42.8	16.8	6.1	190	18.8
Maine	33.4	18.8	8.8	256	27.0
Massachusetts	45.4	4.6	22.7	223	19.0
New Hampshire	47.5	0	6.4	200	23.1
Rhode Island	34.3	14.2	15.9	249	24.0
Vermont	34.1	6.4	15.7	336	27.6
Southern Tier	17.7	18.0	13.9	218	24.1
South Atlantic	19.2	15.8	17.8	217	22.8
Delaware	13.1	0	29.0	225	18.8
Maryland	23.0	10.4	28.4	219	19.1
North Carolina	19.0	16.0	21.2	223	26.4
Virginia	21.6	13.4	18.4	200	21.6
South Carolina	16.1	19.2	16.7	198	24.0
Georgia	23.0	17.7	14.2	232	24.7
Florida	22.6	20.0	3.0	159	18.1
West Virginia	15.3	30.4	11.7	280	29.9
East South Central	14.5	22.4	11.6	225	26.4
Alabama	8.8	21.3	12.2	224	27.0
Kentucky	14.3	16.5	19.8	229	25.6
Mississippi	15.9	27.0	8.8	245	28.7
Tennessee	19.0	25.0	5.7	200	24.6
West South Central	18.2	17.7	8.3	214	24.2
Arkansas	16.6	18.6	15.8	221	29.0
Louisiana	11.1	21.1	6.4	224	22.5
Oklahoma	17.3	13.6	11.2	231	25.5
Texas	27.9	17.8	0	180	20.1

Source: U.S. Bureau of the Census, *Governmental Finances in 1974-75, Series G-F 75, 5* (Washington: Government Printing Office, 1976).

vices is strong, there tends to be much heavier use of the property tax. But, as shown above, the Southern states tend to be more state-government-dominant; hence there is heavier *reliance* on nonproperty taxation.

The importance of this difference lies with the potential response of the fisc to growth or decline in the economic base. In the South, where there is heavy reliance on sales and income taxes, a combination of real growth and inflation will automatically generate substantial new revenue for expansion of the public sector. In the Northern tier, where reliance is greater on property taxation, even the tax-base growth generated by inflationary increase in income will not be fully or easily captured.[13] Another advantage of such centralization is the controllability of the overall level of state and local government taxation and spending. It is difficult to formulate a long-term state fiscal plan where one-half of all spending and taxing decisions are made by local governments. In terms of the controversial issue of the regional distribution of federal aid, both regions receive about the same per capita amount, but Southern states, because of their lower level of fiscal activity, are more dependent on federal aid as a revenue source.

Local Fiscal Problems

State-to-state variations in fiscal structure and performance mask the differences between regions in the problems facing the largest local governments within the regions. Indeed, the standard stereotype would have central cities in a substantially worse position than their suburbs in terms of income level, public service levels, and concentration of the poor.

Nathan and Dommel have developed a "hardship index" which compares the socioeconomic conditions of fifty-five of the nation's largest central cities with the same conditions both for their surrounding suburban area and with each other.[14] Of the fourteen cities scoring poorest on this hardship index, eleven are in the Northern tier of states while only two, Atlanta and Richmond, are in the South. Of the ten cities found better off, five were in the Southern tier and none were in the North.

Sacks, in his latest compendium of metropolitan fiscal disparities, also supports the stereotype. As may be seen from the data in table 5-7, the Southern cities are more densely populated and wealthier relative to their own suburbs, but are less densely populated and poorer relative to Northern cities. The fiscal disparities which grow out of this socioeconomic disparity are predictable: central cities in the Northeast have greater average tax burdens than their suburbs and apparently provide a lower level of public services.

Table 5-7
City-Suburb Disparities

	Mean Values in 1973		
		Per Capita Income	
	Population Density in Central City (Persons per Acre)	*City*	*Ratio of City to Suburb*
East	16.4	$3,727	0.83
Midwest	8.4	3,756	0.89
South	4.7	3,644	1.06
West	6.3	4,088	1.04
Eighty-five SMSAs	8.5	3,784	0.96

Source: Advisory Commission on Intergovernmental Relations, *Trends in Metropolitan America* (Washington, 1977), tables 4 and 10.

Summary: Regional Variations in State-Local Finances

These data show certain clear differences in fiscal structure and performance between the Northern and Southern tier states. While there certainly are exceptions to this pattern, the general differences observed would appear to hold for most jurisdictions in the two regions. First, the Southern tier states have more state-dominated fiscal systems. This means that they have heavier state government responsibility for both financing and direct expenditures, which in turn means that the growth and distribution of total state and local expenditures are more controllable and that the growth in expenditures is financed with a more elastic revenue source. In the case of the Southern tier states, the sales tax is relied on to a much greater extent than in the North. The Northeastern and Midwestern states, on the other hand, tend to have more local-government-dominated systems. As a result, there is a potential for much greater disparity in public spending levels among jurisdictions within the state, and there is much heavier reliance on the local property tax than in the Southern tier states.

With respect to the level of spending, per capita expenditures are some 25 percent lower in the Southern states than in the Northern states. However, a part of this difference is due to the higher level of welfare expenditures in the Northern tier states. Moreover, since these differences are not adjusted for regional variations in prices, and average public employee wages are much higher in the North, the difference in public service levels may be considerably less than 25 percent. Public employment levels per 10,000 population are greater on average in the Southern states and do not vary systematically with the rate of population growth of a state. Adjustment of average wage differences for differences in the cost of living may all but eliminate the gap in wages between regions.

There is a major difference between the two regions with respect to the fiscal health of their largest local governments. The Northeast and industrial Midwest regions seem to fit the stereotype of declining and poor central cities surrounded by relatively wealthy and fiscally sound suburbs. The reverse tends to be true in the South, where the per capita income level in the central city is greater than that in the suburbs. This advantaged position of Southern central cities can be attributed in part to the newness of the cities and their resulting local government structure which often tends to encompass growing suburban areas. There would appear to be much less jurisdictional fragmentation in the South, largely because of the greater potential for annexation and consolidation during the rapid growth period of the past two decades. To the contrary, Northern cities which are surrounded by older incorporated jurisdictions find it all but impossible to expand jurisdictional boundaries.

Comparative Fiscal and Economic Growth

An understanding of the fiscal problems resulting from the movement of population and economic activity to the South requires analysis of the structure of the state and local government expenditure and revenue responses to this movement, in both the growing and the declining regions. In the discussion below, we look successively at the growth in the capacity to finance public services and the demand for expansion of public services as measured by the growth in the economic and demographic base of the regions, the expenditure response and the extent to which it was demand- or supply-induced, and the revenue response in terms of its composition by type of tax and changes in the level of tax effort.[15] The results of this analysis suggest that fiscal activity in the South expanded in response to an increase level of population, a demand consideration, and was supported by an increased capacity to finance such activity. In the North, fiscal activity also continued to expand even in the face of a relatively slower-growing, or in some cases a declining, economic base. The expansion of fiscal activity may be attributed to increases in state and local government employment and increases in the average compensation of these employees, demand and supply considerations, respectively.

Growth in the Economic and Poulation Base

The shift in economic activity from the Northern to the Southern states has been well documented in the literature. Jusenius and Ledebur have described this shift in terms of population movement, disaggregating changes into

natural increase and inmigration.[16] Greenberg and Valente[17] and Garnick[18] have studied the trends in employment, and the Congressional Budget Office has described the pattern of growth in earnings and personal income.[19] For the purposes of this chapter it is necessary to examine these trends in order to determine their potential effects on the taxable capacity and public servicing requirements of states in each region. Unfortunately, none of these indicators of economic expansion or contraction is an adequate measure of taxable capacity, partly because the tax structures of the fifty states vary so widely. Nevertheless, population movement, employment, and growth in earnings and personal income give some notion of how regional shifts in economic activity enhance or compromise the ability of state and local governments to finance public services.

Per capita income is a composite measure which more than anything else indicates the average level of well-being of citizens in a region. Since per capita income is influenced by changes in population size, it may or may not provide a proxy measure of changes in the capacity to finance. As may be seen in table 5-8, the per capita income growth in the Southern tier was substantially greater than in the North for all three periods considered here. It is interesting to note, however, that the disparity in the rate of growth in per capita personal income was reduced somewhat in the past three years. Between 1962 and 1972, per capita income in the Southern tier was growing about 25 percent faster, but the differential fell to about 14 percent between 1972 and 1975. This narrowing in per capita income growth is due primarily to a relatively heavy loss of population in the Northern tier states and a continued rapid growth of population in the Southern tier states. Hence, as the population shift has continued, there has been a slackening of the rate at which average income levels in the growing and declining region are converging.

The aggregate personal income trends which lie behind these per capita amounts give perhaps a clearer picture of the implications for the capacity to finance. Between 1962 and 1975, there were substantial increases in money income in both regions, but there was relatively little shift in the composition of income. Income originating in manufacturing in Northern states fell from 25 to 21 percent, while income originating in the services rose by about 4 percent. Otherwise, things stayed much the same. Most importantly, the share of income accounted for by all transfer payments—which may provide less taxable capacity than earnings from goods and service production—remained about the same in both regions. These data offer scant evidence that changes in the composition of income have compromised the tax base during the period studied.

However, in the case of local governments, particularly large central-city governments, changes in the composition of personal income may well have had a dampening effect on potential revenue growth. To the extent that local property tax systems include industrial machinery, equipment, and so on, the shift of income composition from manufacturing to services

Table 5-8
Percentage Increase in per Capita Personal Income by Region for Selected Periods

State and Region	*1962-1967*	*1967-1972*	*1972-1975*	*1975 Level*
Northern Tier	34.1	39.3	28.5	$6,232
East North Central	33.6	39.8	29.1	6,121
Illinois	31.5	38.0	32.3	6,789
Indiana	33.4	38.6	29.4	5,653
Michigan	38.3	43.3	24.7	6,173
Ohio	32.8	40.0	27.2	5,810
Wisconsin	31.8	39.2	32.1	5,669
Middle Atlantic	30.4	39.5	27.7	6,398
New Jersey	29.6	40.4	26.8	6,722
New York	31.0	37.2	25.1	6,564
Pennsylvania	30.5	41.0	31.2	5,943
New England	36.5	38.7	27.8	6,098
Connecticut	31.6	33.5	29.6	6,973
Maine	48.8	43.0	29.6	4,786
Massachusetts	30.2	40.9	26.0	6,114
New Hampshire	32.0	38.1	27.1	5,315
Rhode Island	36.5	36.7	29.5	5,841
Vermont	40.0	40.1	27.7	4,960
Southern Tier	40.3	49.7	30.2	5,292
South Atlantic	39.0	51.0	30.1	5,510
Delaware	27.9	39.8	29.2	6,748
Maryland	30.6	48.6	30.3	6,474
North Carolina	42.8	53.1	28.5	4,952
Virginia	41.0	52.8	31.5	5,785
South Carolina	46.7	52.9	31.7	4,618
Georgia	45.5	52.3	28.2	5,086
Florida	38.5	60.2	25.0	5,638
West Virginia	39.2	48.4	36.5	4,918
East South Central	42.1	52.8	32.0	4,676
Alabama	39.4	53.6	33.7	4,643
Kentucky	38.2	47.4	35.0	4,871
Mississippi	49.9	58.4	27.2	4,052
Tennessee	41.1	51.8	32.0	4,895
West South Central	40.9	44.0	37.4	5,347
Arkansas	42.9	50.3	38.2	4,620
Louisiana	42.7	40.3	37.3	4,904
Oklahoma	39.2	41.4	36.9	5,250
Texas	38.9	44.0	37.3	5,631

Source: Bureau of Economic Analysis, U.S. Department of Commerce, *Survey of Current Business* 56, no. 8 (Washington: Government Printing Office, 1976).

may have depressed the level of property tax revenues. Similarly, the very rapid growth in income generated in the state/local sector in large central cities may not have offset the revenue losses resulting from the outmovement of manufacturing. This is in part due to the exemption of state and

local government properties from the real estate tax and the fact that they are not included in the business income tax base.[20]

In terms of changes in the level of employment, the Southern tier states have been growing more rapidly for all three periods considered (see table 5-9). Even though the rate of employment growth has slowed in the Southern states, it still remains considerably higher than that in the North. Perhaps even more important in the context of this analysis is the fact that the relatively low rate of employment growth in the Northern tier between 1967 and 1972 turned to literally no growth and in some cases decline between 1972 and 1975. In the Southern tier, on the other hand, while the growth rate slowed between 1972 and 1975, only one state (Delaware) showed an absolute job loss. Garnick argues that the relative shifts in employment are primarily a Northern central-city phenomenon with central-city counties of the large SMSAs in particular having been subject to absolute declines in employment (especially manufacturing) at least since 1960.[21] When the 1965-1972 pattern of employment growth in metropolitan central cities is examined in the ten largest city counties, declines were registered in New York, Philadelphia, and St. Louis, with only a modest increment in Baltimore. The largest percentage increases in employment were in Denver, Indianapolis, Jacksonville, Nashville, and New Orleans.[22]

Yet a third way to measure the change in economic activity in the two regions is to examine the pattern and trend of population growth. On the revenue side, a declining population may mean a diminishing capacity to finance public services if the population losses are higher-income-earning families. If outmigration is primarily of low-income families, service requirements may be reduced by more than taxable capacity, thereby enhancing the government's fiscal position.

The North-South differentials in population growth rates are predictable. The growth in the Northern tier has slowed steadily since 1962 and was negligible over the 1972-1975 period. Among the Southern states the rate of population growth also slowed but remained well above the Northern rate even during the 1972-1975 period. No state in the Southern tier showed a population decline over the 1972-1975 period while five Northern states (Illinois, New Jersey, New York, Pennsylvania, and Rhode Island) lost population (see table 5-10). With respect to the composition of population change, little data are available by way of the income level and employment characteristics (that is, occupation, industry) of migrants. However, it is known that because of higher fertility rates the Southern tier would have grown faster than the Northern tier even in the absence of migration between the regions.[23]

In terms of population change within metropolitan areas, some evidence is available on the changes by central city/outside central city and by race. These data show that Southern cities tended to increase their share

of metropolitan area population while Northern cities generally tended to decline as a percentage of metropolitan area population. Sacks has shown that the population decline in the major cities of the East between 1960 and 1970 was predominantly an exodus of white population—no major central city in the East showed a gain of white population between 1960 and 1970.

The inference one might draw from these trends is that the declining population in the North likely reduced certain servicing needs, but these reductions may have been offset by increasing concentrations of the poor, particularly in central cities.

Expenditure Growth

Given the relatively slower growth in financial capacity in the Northern states, a slower growth in fiscal activity might have been expected. In fact, expenditure growth in the Northern tier states was not noticeably below that in the Southern states (see table 5-11). Indeed, expenditures grew at a rate approximately 20 to 30 percent higher than personal income in both regions in all three periods considered, except for the 1967-1972 period, when per capita expenditures in the Northern tier grew 87 percent faster than per capita income (see table 5-12). Even in the 1972-1975 period, when total employment increased by about 7 percent in the South and less than 1 percent in the North, per capita expenditures grew by about the same percentage in both regions. From this evidence, one might conclude that there was not a strong relationship between the growth in public expenditures in the two regions and the capacity to finance that growth.

If the growth or decline in taxable capacity does not explain growth of the state and local government sector, then attention might be turned to two other possible explanations: (1) on the demand side, growing requirements for services resulted primarily in increased numbers of public employees and thereby exerted an upward pressure on expenditures; (2) on the supply side, increased public employee compensation resulted from union pressures and inflation and forced up expenditure levels. Either explanation would be consistent with the observed absence of relationship between economic base and public expenditure growth.

There is a wealth of literature on expenditure determinants which attests to the difficulties of separating demand from supply influences to explain expenditure growth and variations.[24] Those difficulties notwithstanding, we proxy the growth in service demand here with three variables: population growth (table 5-10), increase in Aid for Dependent Children (AFDC) recipients (table 5-13), and increase in primary and secondary school enrollments (table 5-14). To the extent that these factors increased over the three periods studied, an increase in state and local government employment levels might

Table 5-9
Growth in Employment by Region

State and Region	1962-1967 Change (000s)	1962-1967 Percentage Change	1967-1972 Change (000s)	1967-1972 Percentage Change	1972-1975 Change (000s)	1972-1975 Percentage Change
Northern Tier	4,192.7	15.2	1,835.3	5.8	200.8	0.6
East North Central	2,261.5	19.4	944.3	6.4	294.4	2.0
Illinois	634.9	17.8	117.6	2.8	115.4	2.7
Indiana	315.7	21.6	145.0	8.2	8.4	0.4
Michigan	566.8	24.3	212.9	7.3	10.3	0.3
Ohio	520.6	16.8	318.5	8.8	71.2	1.8
Wisconsin	223.3	18.5	150.3	10.5	89.1	5.6
Middle Atlantic	1,395.8	11.5	632.9	4.7	−204.4	−1.5
New Jersey	324.8	13.4	252.8	10.4	−5.8	0.0
New York	597.0	9.5	171.9	2.5	−239.1	−3.4
Pennsylvania	474.8	12.9	208.2	5.0	40.5	0.9
New England	535.4	14.0	258.1	6.0	110.8	2.4
Connecticut	180.3	19.0	59.5	5.3	30.8	2.6
Maine	37.4	13.4	27.1	8.6	12.1	3.5
Massachusetts	215.8	11.1	98.7	4.6	63.8	2.8
New Hampshire	36.1	17.4	35.7	14.6	13.5	4.8
Rhode Island	40.0	13.4	19.8	5.9	−15.1	−4.2
Vermont	25.8	23.3	17.3	12.7	5.7	3.7

Southern Tier	3,468.0	24.3	3,610.0	20.3	1,498.0	7.0
South Atlantic	1,766.0	25.2	2,016.0	23.0	599.0	5.5
Delaware	41.2	26.9	32.7	16.6	−3.4	−1.5
Maryland	232.9	24.5	175.7	14.9	66.9	4.9
North Carolina	342.4	27.2	323.2	20.2	71.2	3.7
Virginia	248.4	23.0	313.3	23.6	111.5	6.8
South Carolina	144.6	23.7	165.9	22.0	57.5	6.2
Georgia	302.0	27.6	310.3	22.2	19.8	1.2
Florida	428.6	30.9	658.2	36.2	254.9	10.3
West Virginia	56.1	12.5	36.9	7.3	20.6	3.8
East South Central	677.0	23.7	611.0	17.3	206.7	5.0
Alabama	160.0	20.2	120.5	12.7	77.5	7.2
Kentucky	160.9	23.9	152.5	18.3	54.1	5.5
Mississippi	106.2	24.9	106.3	20.0	29.1	4.6
Tennessee	249.4	25.7	196.5	16.1	46.0	3.2
West South Central	1,025.0	23.2	983.0	18.1	693.0	10.8
Arkansas	101.1	25.5	87.5	17.6	34.6	5.9
Louisiana	209.8	26.4	131.5	13.1	62.9	5.5
Oklahoma	104.8	17.4	107.9	15.3	73.2	9.0
Texas	626.9	23.9	638.5	19.6	622.9	16.0

Source: Bureau of Labor Statistics, U.S. Department of Labor, *Employment and Earnings, States and Areas, 1939-75*, Bulletin 1370-12 (Washington: Government Printing Office, 1977).

Table 5-10
Population Level and Growth by Region, 1962, 1967, 1972, and 1975

State and Region	Population (000s)				Percentage Increase		
	1962	1967	1972	1975	1962-1967	1967-1972	1972-1975
Northern Tier	82,785	87,414	90,519	90,362	5.6	3.6	0.2
East North Central	36,874	39,124	40,793	40,901	6.1	4.3	0.3
Illinois	10,260	10,893	11,244	11,160	6.2	3.2	−0.8
Indiana	4,725	5,000	5,287	5,313	5.8	5.7	0.5
Michigan	7,923	8,584	9,014	9,117	8.3	5.0	1.1
Ohio	9,952	10,458	10,722	10,745	5.1	2.5	0.2
Wisconsin	4,014	4,189	4,526	4,566	4.4	8.0	0.9
Middle Atlantic	35,185	36,968	37,621	37,263	5.1	1.8	−1.0
New Jersey	6,385	7,003	7,349	7,316	9.7	4.9	−0.5
New York	17,464	18,336	18,367	18,120	5.0	0.2	−1.4
Pennsylvania	11,336	11,629	11,905	11,827	2.6	2.4	−0.7
New England	10,726	11,322	12,105	12,198	5.6	6.9	0.8
Connecticut	2,640	2,925	3,080	3,095	10.8	5.3	0.5
Maine	990	973	1,026	1,059	−1.7	5.4	3.2
Massachusetts	5,201	5,421	5,796	5,828	4.2	6.9	0.6
New Hampshire	630	686	774	818	8.9	12.8	5.7
Rhode Island	872	900	969	927	3.2	7.7	−4.3
Vermont	393	417	460	471	6.1	10.3	2.4

Southern Tier	56,599	60,634	64,306	67,399	7.1	6.1	4.8
South Atlantic	26,387	28,671	31,168	32,999	8.7	8.7	5.8
Delaware	446	523	571	579	12.2	9.2	1.4
Maryland	3,245	3,682	4,048	4,098	13.5	9.9	1.2
North Carolina	4,736	5,029	5,221	5,451	6.2	3.8	4.4
Virginia	4,187	4,536	4,765	4,967	8.3	5.0	4.2
South Carolina	2,450	2,599	2,688	2,818	6.1	3.4	4.8
Georgia	4,108	4,509	4,733	4,926	9.8	5.0	4.1
Florida	5,392	5,995	7,347	8,357	11.2	22.6	13.7
West Virginia	1,823	1,798	1,795	1,803	−6.5	−0.2	0.4
East South Central	12,407	12,969	13,155	13,544	4.5	1.4	3.0
Alabama	3,342	3,540	3,521	3,614	5.9	−0.5	2.6
Kentucky	3,099	3,189	3,306	3,396	2.9	3.7	2.7
Mississippi	2,276	2,348	2,256	2,346	3.2	−3.9	4.0
Tennessee	3,690	3,892	4,072	4,188	5.5	4.6	2.8
West South Central	17,805	18,994	19,983	20,856	6.7	5.2	4.4
Arkansas	1,875	1,968	2,008	2,116	5.0	2.0	5.4
Louisiana	3,371	3,662	3,738	3,791	8.6	2.1	1.4
Oklahoma	2,435	2,495	2,633	2,712	2.5	5.5	3.0
Texas	10,124	10,869	11,604	12,237	7.4	6.8	5.5

Source: Bureau of the Census, *Current Population Reports, Series P-25*, various issues.

Table 5-11
Indicators of Fiscal Expansion by Region

State and Region	Increases in per Capita General Expenditures (dollars)			Percentage Increases in per Capita General Expenditures		
	1962-1967	*1967-1972*	*1972-1975*	*1962-1967*	*1967-1972*	*1972-1975*
Northern Tier	138	342	274	42.8	73.4	34.4
East North Central	132	305	259	40.9	67.8	34.2
Illinois	102	377	271	32.5	90.2	34.2
Indiana	122	242	174	41.9	58.7	26.6
Michigan	162	349	332	46.7	68.5	38.7
Ohio	103	244	258	35.3	62.0	40.4
Wisconsin	169	311	260	48.3	59.8	31.3
Middle Atlantic	157	449	314	47.8	91.4	34.7
New Jersey	115	385	304	38.2	92.5	37.9
New York	216	624	372	54.3	101.5	30.1
Pennsylvania	139	339	267	51.0	80.2	36.0
New England	135	320	267	41.8	69.1	34.5
Connecticut	105	354	233	28.6	74.9	28.2
Maine	122	270	254	41.8	65.3	37.1
Massachusetts	123	426	290	35.8	91.5	32.5
New Hampshire	104	276	241	34.4	68.0	35.3
Rhode Island	202	228	321	68.9	46.0	44.5
Vermont	154	364	262	41.3	69.1	29.4

Southern Tier	145	257	248	52.1	64.2	35.9
South Atlantic	162	289	277	56.1	70.3	36.4
Delaware	371	403	177	80.9	66.4	17.6
Maryland	155	363	408	48.6	76.8	12.9
North Carolina	113	201	262	49.5	58.5	46.5
Virginia	130	258	337	45.5	68.0	52.8
South Carolina	103	262	305	64.5	86.0	53.8
Georgia	118	302	247	46.1	80.6	36.5
Florida	153	222	286	54.0	51.0	43.6
West Virginia	150	301	190	59.6	75.2	27.1
East South Central	119	240	224	47.0	64.6	36.4
Alabama	115	240	228	47.0	66.6	38.0
Kentucky	117	215	212	40.0	52.4	34.0
Mississippi	98	284	202	39.3	82.0	32.1
Tennessee	147	221	252	61.7	57.2	41.5
West South Central	138	214	214	49.6	51.5	34.4
Arkansas	118	174	215	53.3	51.2	42.0
Louisiana	152	239	223	45.8	49.0	30.8
Oklahoma	167	205	202	56.2	44.1	30.1
Texas	116	237	216	43.1	61.5	34.7

Source: U.S. Bureau of the Census, *Governmental Finances in 1974-75 (1961-62, 1966-67, 1971-72), Series G-F 75*, 5 (Washington: Government Printing Office, 1976).

Table 5-12
Per Capita Income Elasticity[a] of State and Local Government Expenditures by Region

	Northern Tier	*Southern Tier*
1962-1967	1.26	1.20
1967-1972	1.87	1.29
1972-1975	1.21	1.19

Source: Computed from tables 5-8 and 5-11.

[a]Percentage increase in per capita expenditure divided by percent income in per capita income.

have been expected. When the states are aggregated by region, it may be seen that the number of AFDC recipients increased at a greater rate in the North than in the South in all years considered, while the reverse was true for total increases in population (table 5-15). Primary and secondary school enrollments increased at a more rapid rate in the North over the 1962-1972 period, but actually declined over the 1972-1975 period. From these aggregates, one might again infer an increasing concentration of high-cost citizens in the North and a considerably greater demand for increased numbers of school personnel, at least during the 1962-1972 period.

In fact, public employment did increase rapidly between 1962 and 1967 in response to relatively high population and school enrollment growth. Between 1967 and 1972, public employment grew at a relatively slow rate, even though the concentration of the poor appeared to increase dramatically in both regions. However, the much greater increase in per capita spending in the 1967-1972 period can be at least partially attributed to the increment in transfer payments necessitated by the growth in AFDC recipients. The 1972-1975 period does not support the demand explanation. While the growth in all three service requirement indicators was relatively low, there was a greater percentage increment in public employment. Although these results do not appear to provide strong support for a demand thesis, it is important to emphasize the very great diversity across states which is disguised in such an aggregate analysis. Particularly in the case of the rate of increase in AFDC recipients, there is great diversity within each region.

These results suggest that the explanations for expenditure increases in the two regions are at least partially to be found on the supply side, that is, in terms of increases in the level of public employee compensation. As may be seen in table 5-16, the percentage increase in payroll per employee was higher in the Northern than in the Southern states over the 1962-1972 period—despite the fact that the capacity to finance such increases in Northern states was declining. By the 1972-1975 period, the rate of increase in average wages in the North had fallen below that in the South.[25] The rates of wage increase observed during these periods tend to support the thesis

that increases in expenditures closely parallel increases in public employee compensation rates.

Revenue Growth

According to the scenario above, the fisc in the Northern states has expanded at about the same rate as that in the Southern states despite very great differences in the growth of their respective economic and demographic bases. As a consequence, revenue effort in the Northern tier states must have increased more rapidly, or the flow of federal aid to the Northern states must have increased. The reality of an increase in revenue effort is borne out by a recent Advisory Commission on Intergovernmental Relations (ACIR) publication which attempts to classify states with reference to both the level and the direction of tax effort.[26] Of the states classified as having high and rising levels of tax effort, nine are in the Northern tier and three are in the South. Similar findings may be found in tables 5-17 and 5-18, where both per capita revenues from own sources and own-source revenues per $1,000 are significantly higher in the Northern tier than in the South.

A comparison of the growth in own-source revenues to the growth in personal income, employment, and population shows a greater revenue-income elasticity in the North in every period (see table 5-18).[27] This means that, on average, the tax on each increment to income was greater in the North, or that the tax reduction of disposable income was largest in the North.

The presentation in table 5-19 disaggregates increases in state and local government revenue by source of increase. The results are helpful in understanding the mechanics of the fiscal response over the period in question. Between 1962 and 1967, Southern states financed expenditure increases through the use of sales and income taxes and through substantial increments in federal aid. In the North, where income and employment growth was slower, the increments were derived relatively more from property taxation and relatively less from federal aid. About the same pattern was observed between 1967 and 1972, when expenditure increases in the North were highest for the period under consideration. Between 1972 and 1975, when the rate of expenditure growth slowed in both regions, essentially the same pattern was observed for the Southern states—heavy reliance on sales and income taxes and relatively little on the property tax as a course of increased revenue. In the North, even though relatively more of the increment was financed from sales and income taxes, the relative use of property taxation remained much greater than in the South. Also noteworthy within the 1972-1975 period was the substantial increase in the reliance on federal grants to finance expenditure increments in the Northern tier. As may be seen in table 5-19, the pattern described above holds true for most states in the two regions.

Table 5-13
AFDC Recipients by Region

State and Region	Level (000s)				Percentage Increase		
	1962	1967	1972	1975	1962-1967	1967-1972	1972-1975
Northern Tier	1,602	2,282	4,986	5,288	42.4	118.5	6.1
East North Central	623	792	2,179	2,314	27.1	175.1	6.2
Illinois	265	275	773	783	3.8	181.1	1.3
Indiana	47	51	168	163	8.5	229.4	−3.0
Michigan	121	183	600	655	51.2	227.9	9.2
Ohio	147	222	497	552	51.0	123.9	11.1
Wisconsin	43	61	141	161	41.9	131.1	14.2
Middle Atlantic	815	1,222	2,216	2,307	49.9	81.3	4.1
New Jersey	83	145	420	444	74.7	189.7	5.7
New York	399	786	1,190	1,230	97.0	51.4	1.1
Pennsylvania	333	291	606	633	−12.6	108.2	4.5
New England	164	268	591	667	63.4	120.5	12.9
Connecticut	43	62	118	126	44.2	90.3	6.8
Maine	22	22	72	83	0.0	227.3	29.2
Massachusetts	70	138	309	356	97.1	123.9	15.2
New Hampshire	4	9	24	27	125.0	166.7	12.5
Rhode Island	20	29	48	53	45.0	65.5	10.4
Vermont	5	8	20	22	60.0	150.0	10.0

Southern Tier	1,159	1,418	2,941	2,988	22.3	107.4	1.6
South Atlantic	564	667	1,394	1,440	18.3	109.0	3.3
Delaware	7	17	29	33	142.9	70.6	13.8
Maryland	58	108	220	219	86.2	103.7	−0.5
North Carolina	115	107	151	177	−7.0	41.1	17.2
Virginia	44	58	165	177	31.8	184.5	7.3
South Carolina	34	28	121	138	−17.6	332.1	14.0
Georgia	64	105	341	358	64.1	224.8	5.0
Florida	103	148	300	264	43.7	102.7	−12.0
West Virginia	139	96	67	74	30.9	−30.2	10.4
East South Central	332	377	676	719	13.6	79.3	6.4
Alabama	90	75	150	163	16.7	100.0	8.7
Kentucky	81	106	153	162	30.9	44.3	5.9
Mississippi	79	99	183	187	25.3	84.8	2.2
Tennessee	82	97	190	207	18.3	95.9	8.9
West South Central	263	374	871	829	42.2	132.9	−4.8
Arkansas	25	39	91	103	56.0	133.3	14.3
Louisiana	94	124	250	235	31.9	100.8	−6.0
Oklahoma	71	90	91	100	26.8	1.1	9.9
Texas	73	121	439	391	65.8	262.8	−10.9

Source: U.S. Department of Health, Education, and Welfare, Social Security Administration, August 1975, vol. 38, no. 8: *Social Security Bulletin* (Washington: Government Printing Office, 1975), p. 65; and U.S. Bureau of the Census, *Statistical Abstract of the United States: 1963, 1968, 1973* (Washington, 1963, 1968, 1973), sec. 10

Table 5-14
Primary and Secondary School Enrollment by Region

State and Region	Level (000s)				Percentage Increase		
	1962	1968	1972	1974	1962-1968	1968-1972	1972-1974
Northern Tier	15,393	17,952	19,187	18,676	16.6	6.9	−2.7
East North Central	7,392	8,691	9,212	8,900	17.6	6.0	−3.4
Illinois	1,892	2,188	2,388	2,281	15.6	9.1	−4.5
Indiana	1,038	1,181	1,220	1,191	13.7	3.3	−2.4
Michigan	1,735	2,042	2,193	2,131	17.7	7.4	−2.8
Ohio	1,975	2,359	2,416	2,323	19.4	2.4	−3.8
Wisconsin	752	921	995	974	22.5	8.0	−2.1
Middle Atlantic	6,030	6,942	7,393	7,196	15.1	6.5	−2.7
New Jersey	1,141	1,368	1,514	1,470	19.9	10.7	−2.9
New York	2,856	3,318	3,511	3,426	16.2	5.8	−2.4
Pennsylvania	2,033	2,256	2,368	2,300	11.0	5.0	−2.9
New England	1,971	2,319	2,582	2,580	17.7	11.3	−0.1
Connecticut	516	610	674	660	18.2	10.5	−2.1
Maine	205	229	247	244	11.7	7.9	−1.2
Massachusetts	918	1,084	1,190	1,218	18.1	9.8	2.4
New Hampshire	114	138	168	174	21.1	21.7	3.6
Rhode Island	142	167	190	179	17.6	13.8	−5.8
Vermont	76	91	113	105	19.7	24.2	−7.1

Southern Tier	12,804	14,033	14,388	14,487	9.6	2.5	0.7
South Atlantic	5,961	6,609	6,858	6,960	10.9	3.8	1.5
Delaware	90	118	134	131	31.1	13.6	−2.2
Maryland	650	826	921	896	27.0	10.7	−2.7
North Carolina	1,142	1,193	1,159	1,178	4.5	−2.8	1.6
Virginia	900	1,017	1,069	1,093	13.0	5.1	2.2
South Carolina	631	644	640	606	2.1	−0.6	−5.3
Georgia	996	1,095	1,084	1,081	9.9	−1.1	−0.3
Florida	1,106	1,300	1,437	1,571	17.5	10.5	9.3
West Virginia	446	416	414	404	−6.7	−0.5	−2.4
East South Central	2,891	2,968	2,916	2,860	2.7	−1.8	−1.9
Alabama	807	831	783	764	3.0	6.3	−2.4
Kentucky	651	680	715	705	3.6	5.1	−1.4
Mississippi	585	583	526	513	−0.3	−9.8	−2.5
Tennessee	848	874	892	878	3.1	2.1	−1.6
West South Central	3,952	4,456	4,614	4,667	12.8	3.5	1.1
Arkansas	436	451	459	454	3.4	1.8	−1.1
Louisiana	733	840	847	842	14.6	0.8	−0.6
Oklahoma	557	593	614	591	6.5	3.5	−3.7
Texas	2,226	2,572	2,694	2,780	15.5	4.7	3.2

Source: U.S. Bureau of the Census, *Statistical Abstract of the United States: 1965* (Washington, 1965), sec. 4; and National Education Association, Division of Research, *Estimates of School Statistics, Research Report: 1967, 1972, 1975* (Washington, 1967, 1972, 1975).

Table 5-15
Indicators of Growth in Servicing Requirements

	Percentage Increases					
	1962-1967		*1967-1972*		*1972-1975*	
	North	*South*	*North*	*South*	*North*	*South*
AFDC	42.4	22.3	118.5	107.4	6.1	1.6
Population	5.6	7.1	3.6	6.1	0.2	4.8
Enrollment	16.6	9.6	6.9	2.5	−2.7	0.7
Public employees	24.4	31.5	20.3	24.7	33.9	30.6
Per capita expenditures	42.8	52.1	73.4	64.2	34.4	35.9

Source: Computed from tables 5-13, 5-9, 5-14, 5-15, and 5-4.

This pattern of revenue increase may reflect the greater automatic responsiveness of tax systems in the South which rely more on sales and less on property taxes. While detailed comparisons are not readily available, it would seem reasonable to assume that relatively more of the revenue increase in the North was the result of discretionary changes in the tax system.

Implications for Public Policy

It is important to separate the general fiscal problems of state and local governments from those which have been exacerbated by the regional shifts that lie at the heart of this discussion. It is particularly important to separate the fiscal problems and public service deficiencies which are primarily attributable to low income—the Southern problem.

The basic dilemma faced by several of the declining states in the Northeast is that their public sector has become overdeveloped relative to financial capacity. As a result, tax burdens are thought to be too high, there is little additional public money to be devoted to what are thought to be serious city fiscal problems, fixed debt and pension commitments are high, union compensation demands will likely parallel cost-of-living increments, and there seems to be no short-term reversal of existing economic trends. To be sure, this pattern does not fit all state and local governments in the Northeastern and Midwestern regions and likely describes some Southern metropolitan-area governments. But the pattern tends to hold for many governments in the Northern tier and tends not to hold for most in the Southern rim.

The strategies for dealing with these fiscal problems would seem to be of four types: reversal of the economic decline, in both the central cities and the region; assistance during the transition period; a strengthening of fiscal position of the poorest local jurisdictions through a grants program and federal welfare assumption; and fiscal planning in the declining region to

Table 5-16
Percentage Increase in State and Local Government Employment and Employee Wages by Region

State and Region	Total Employment 1962-1967	1967-1972	1972-1975
Northern Tier	24.4	20.3	33.9
East North Central	25.6	17.8	36.2
Illinois	27.1	20.4	32.6
Indiana	31.9	10.0	35.7
Michigan	26.3	16.3	37.0
Ohio	20.4	16.5	31.3
Wisconsin	22.3	26.0	44.5
Middle Atlantic	26.4	17.9	23.9
New Jersey	26.9	21.7	33.5
New York	25.2	17.1	14.1
Pennsylvania	27.1	14.8	24.1
New England	22.5	23.6	37.0
Connecticut	28.6	19.6	28.0
Maine	18.0	27.1	32.4
Massachusetts	16.9	20.3	26.9
New Hampshire	34.2	21.1	58.9
Rhode Island	23.6	22.1	23.5
Vermont	23.4	31.5	52.2
Southern Tier	31.5	24.7	30.6
South Atlantic	34.7	28.4	30.3
Delaware	36.9	39.8	17.9
Maryland	40.8	26.6	24.0
North Carolina	32.7	24.7	32.3
Virginia	36.8	25.4	39.1
South Carolina	31.2	31.1	40.3
Georgia	36.1	32.2	30.4
Florida	39.0	31.3	34.3
West Virginia	24.3	15.8	24.4
East South Central	29.2	22.6	28.3
Alabama	29.4	21.2	28.7
Kentucky	26.7	18.9	36.1
Mississippi	28.2	23.1	24.8
Tennessee	32.6	27.2	23.7
West South Central	27.5	19.3	33.6
Arkansas	27.5	21.2	37.3
Louisiana	25.0	16.2	27.6
Oklahoma	28.5	16.0	34.9
Texas	28.8	23.7	34.5
	Employment per 10,000 Population		
Northern Tier	18.1	15.3	9.4
East North Central	18.3	16.0	8.3
Illinois	17.8	16.5	8.3
Indiana	23.0	4.0	7.7
Michigan	18.1	29.9	12.8
Ohio	15.5	12.9	6.6
Wisconsin	17.3	16.8	6.3

Table 5-16 *(cont.)*

State and Region	Employment per 10,000 Population		
	1962-1967	1967-1972	1972-1975
Middle Atlantic	19.7	15.7	10.5
New Jersey	15.2	15.7	17.1
New York	19.4	19.4	7.8
Pennsylvania	24.4	11.9	6.5
New England	17.1	14.4	9.7
Connecticut	15.4	13.5	7.9
Maine	18.6	20.1	3.4
Massachusetts	11.9	12.7	6.1
New Hampshire	21.6	7.8	16.6
Rhode Island	20.5	13.6	13.1
Vermont	14.5	18.9	11.3
Southern Tier	22.6	19.4	8.6
South Atlantic	23.8	21.0	8.3
Delaware	22.2	29.4	0.9
Maryland	23.6	14.9	10.0
North Carolina	19.7	24.8	7.8
Virginia	28.0	19.4	14.3
South Carolina	23.5	27.9	10.4
Georgia	23.2	26.3	10.8
Florida	26.0	8.4	4.1
West Virginia	24.2	16.9	8.2
East South Central	23.0	20.6	8.2
Alabama	21.2	22.2	8.9
Kentucky	22.6	14.9	15.6
Mississippi	23.5	27.7	1.6
Tennessee	24.5	17.6	6.5
West South Central	20.1	15.1	9.8
Arkansas	19.3	20.6	8.7
Louisiana	15.1	14.4	10.4
Oklahoma	26.1	9.9	8.0
Texas	19.9	15.4	12.1
	Payroll per Employee		
Northern Tier	29.3	36.7	6.5
East North Central	26.4	38.2	5.7
Illinois	20.5	43.6	3.1
Indiana	25.8	24.9	3.0
Michigan	26.7	49.2	4.4
Ohio	28.0	37.1	8.9
Wisconsin	30.8	36.0	9.0
Middle Atlantic	29.6	39.6	7.7
New Jersey	26.1	37.8	6.3
New York	27.2	45.9	8.4
Pennsylvania	35.6	35.1	8.6
New England	31.6	34.1	6.5
Connecticut	30.5	38.4	3.2
Maine	31.6	30.2	1.7
Massachusetts	31.7	32.2	4.5
New Hampshire	29.3	34.0	9.2

Table 5-16 *(cont.)*

State and Region	Payroll per Employee		
	1962-1967	1967-1972	1972-1975
Rhode Island	33.1	37.4	9.0
Vermont	33.4	32.4	11.6
Southern Tier	28.1	33.4	10.6
South Atlantic	28.5	35.9	9.5
Delaware	23.9	39.0	9.2
Maryland	33.1	37.6	14.2
North Carolina	25.4	32.0	3.8
Virginia	30.0	37.1	7.3
South Carolina	28.7	38.1	4.1
Georgia	31.6	30.1	16.1
Florida	29.0	45.3	10.0
West Virginia	26.3	27.7	11.1
East South Central	28.3	33.2	11.5
Alabama	33.6	31.2	15.6
Kentucky	23.4	37.1	2.6
Mississippi	25.6	32.8	15.0
Tennessee	30.7	31.8	12.6
West South Central	27.0	28.7	12.0
Arkansas	33.0	24.4	14.8
Louisiana	24.9	31.0	10.4
Oklahoma	23.0	30.3	5.6
Texas	27.1	28.9	17.1

Source: U.S. Bureau of the Census, *Public Employment in 1975, Series GE 75*, 5 (Washington: Government Printing Office, 1976); U.S. Bureau of the Census, *Compendium of Public Employment in 1972 (1962, 1967)* 3, no. 2 (Washington: Government Printing Office, 1974).

bring about a better balance between the size of the public sector and the size of the economic base available to support that public sector.

An alternative strategy would be to take no action to correct the fiscal problems of governments in the declining region. The argument would go that market forces are already underway which are correcting regional disparities in income, employment, and population and that the regional disparities in public service levels also should narrow. Eventually, as the resource base continues to grow slowly, the public sector in the Northeast will also grow slowly. The problem with this line of reasoning is that shrinkage in the public sector in the Northeast will likely mean a cutting of service levels in those areas where expenditures are greatest—health, education, and welfare. This may imply that much of the painful burden of the transition to a lower level of public services will be borne by lower-income residents in the declining regions.

Given these strategies, there would seem to be five policy directions open: cut services, raise taxes, increase productivity, increase federal

Table 5-17
Levels of Revenue Effort: Selected Northern and Southern Tier States, 1975

State and Region	*Revenues from Own Sources per $1,000 of Personal Income*	*Per Capita Revenue from Own Sources*
Northern Tier	$153.98	$ 911.51
East North Central	148.95	826.69
Illinois	141.52	881.21
Indiana	148.19	770.98
Michigan	153.49	897.12
Ohio	128.24	706.15
Wisconsin	173.33	901.32
Middle Atlantic	163.14	1,021.48
New Jersey	142.28	890.48
New York	205.18	1,236.01
Pennsylvania	141.96	773.84
New England	153.58	859.33
Connecticut	127.47	821.03
Maine	152.50	692.10
Massachusetts	165.57	948.59
New Hampshire	135.85	663.46
Rhode Island	145.93	788.03
Vermont	194.17	878.51
Southern Tier	144.86	690.66
South Atlantic	146.40	721.41
Delaware	156.30	975.57
Maryland	156.07	926.55
North Carolina	135.26	620.77
Virginia	138.14	728.80
South Carolina	146.87	625.60
Georgia	149.82	705.47
Florida	137.31	719.93
West Virginia	151.46	657.66
East South Central	137.47	623.43
Alabama	99.45	603.53
Kentucky	151.40	664.81
Mississippi	162.19	611.08
Tennessee	136.85	613.97
West South Central	149.17	685.66
Arkansas	131.72	539.08
Louisiana	176.35	768.87
Oklahoma	147.58	675.25
Texas	141.00	687.53
U.S. Median	152.50	794.81

Source: U.S. Bureau of the Census, *Governmental Finances in 1974-75, Series G-F 75, 5* (Washington: Government Printing Office, 1976).

Table 5-18
Overall Responsiveness of Revenues to Economic Activity, 1963-1975

	Northern Tier			*Southern Tier*		
	1962-1967	*1967-1972*	*1972-1975*	*1962-1967*	*1967-1972*	*1972-1975*
Percentage increase in revenues from own sources	47.0	82.0	29.0	54.0	80.9	38.5
Percentage increase in personal income	40.0	44.2	27.8	49.4	61.2	38.6
Revenue-income elasticity	1.2	1.9	1.0	1.1	1.3	1.0
Percentage increase in total employment	15.2	5.8	0.6	24.3	20.3	7.0
Percentage increase in population	5.6	3.6	0.2	7.1	6.1	4.8

Source: Computed from tables 5-8, 5-9, 5-10, and 5-19.

assistance, or improve the local economy. The first three are options for state and local government action while the last two require federal action.

State and Local Government Options

Increased productivity in the public sector is a favorite policy recommendation in that it solves fiscal problems without requiring governments to either raise taxes or cut services. While there is clearly room for improved management at the local government level, large savings (relative to projected deficits) from increased productivity in the public sector is not a realistic expectation.[28]

Revenues might be increased through further increase in the effective tax rate. The argument against this is the possible retarding effect on economic development. State and local government revenue effort in the Northeastern and Midwestern regions is already high relative to the South, a difference that would reinforce the argument to lower rather than raise taxes for competitive reasons. While this pattern certainly does not hold for all states in the declining region—Connecticut and Ohio have revenue efforts among the lowest in the United States—it fits many of the large industrial states. Service level-reductions are the most likely route. While there will continue to be absolute cutbacks in some areas and reductions in the scope of some services, this will mostly take the form of services not expanding to accommodate increasing needs and increasing unit cost of provision. This does not mean that expenditures will decline. Increasing wages and benefits can drive up expenditures by a significant amount, without raising service levels.

Table 5-19
Increases in General Revenues of State and Local Governments

	1962-1967			1967-1972			1972-1975		
	Percentage of Increase due to			Percentage of Increase due to			Percentage of Increase due to		
	Sales and Income Taxes	Property Taxes	Federal Aid	Sales and Income Taxes	Property Taxes	Federal Aid	Sales and Income Taxes	Property Taxes	Federal Aid
Northern Tier	21.0	23.1	19.5	22.7	29.5	20.0	28.7	16.7	31.0
East North Central	25.0	20.4	17.6	25.7	27.8	19.2	40.1	9.0	26.1
Illinois	21.2	21.4	19.3	28.4	23.1	32.3	40.8	15.6	12.5
Indiana	32.0	22.3	14.9	17.6	35.9	15.2	51.2	−1.4	20.4
Michigan	19.1	17.4	20.8	28.7	23.5	18.5	22.4	23.6	34.8
Ohio	13.4	29.3	18.8	24.8	21.6	15.4	40.0	7.4	29.9
Wisconsin	39.4	11.6	14.6	28.8	35.0	14.7	46.1	−0.5	33.1
Middle Atlantic	24.4	22.9	18.6	24.9	24.3	20.3	34.8	20.0	26.8
New Jersey	20.3	28.6	15.9	13.5	37.5	20.1	20.0	32.5	23.7
New York	31.6	20.6	17.6	30.8	21.2	22.6	42.7	19.0	22.5
Pennsylvania	21.3	19.5	22.4	30.3	14.1	18.4	41.8	8.7	34.2
New England	15.9	25.4	21.5	10.0	33.4	20.5	25.8	21.4	37.2
Connecticut	11.1	33.5	19.8	21.1	35.5	14.7	31.5	22.6	42.9
Maine	23.7	17.5	28.1	19.5	39.2	26.2	29.6	7.8	40.2
Massachusetts	25.0	20.3	20.2	22.1	35.3	21.8	33.6	35.6	22.9
New Hampshire	1.3	40.5	14.8	1.6	39.4	17.0	14.5	23.9	39.3
Rhode Island	15.5	21.8	29.9	31.5	22.2	21.6	27.1	22.8	34.9
Vermont	19.0	18.7	16.3	18.5	29.0	21.5	18.4	15.7	42.9

Southern Tier	21.3	13.8	26.4	25.4	12.1	23.4	31.2	9.7	28.7
South Atlantic	25.7	15.6	23.4	26.1	13.7	22.2	32.7	11.2	29.3
Delaware	15.4	9.6	17.9	18.8	8.9	23.6	36.8	10.2	20.9
Maryland	25.1	13.3	14.7	36.5	14.9	17.5	36.6	10.0	28.3
North Carolina	25.3	14.3	23.2	24.0	14.4	22.6	35.9	9.5	42.8
Virginia	34.1	14.3	23.1	26.2	17.0	19.2	29.0	13.9	27.2
South Carolina	58.4	24.3	21.8	27.8	15.6	24.0	32.2	9.1	29.1
Georgia	20.2	17.4	23.1	21.2	15.5	23.7	32.0	17.5	30.4
Florida	12.1	22.1	21.1	23.5	16.4	15.5	21.1	12.7	24.1
West Virginia	15.1	9.9	42.6	30.8	7.1	31.7	38.2	7.9	32.0
East South Central	21.0	9.2	31.1	27.1	8.6	26.0	31.2	7.7	28.5
Alabama	25.5	6.6	25.5	20.8	4.8	32.2	33.1	3.2	24.9
Kentucky	19.8	8.2	36.9	35.4	7.8	20.2	27.7	7.7	28.3
Mississippi	18.4	10.4	33.1	29.2	7.7	30.1	32.2	9.4	31.8
Tennessee	20.1	11.5	28.8	22.9	14.0	21.5	32.0	10.4	28.8
West South Central	12.9	14.6	27.8	22.3	12.4	23.3	28.0	8.6	27.7
Arkansas	15.2	11.2	33.4	20.9	10.4	27.8	38.6	8.7	32.1
Louisiana	19.8	8.5	24.0	26.9	11.5	20.2	26.2	0.0	27.4
Oklahoma	8.0	16.4	31.5	20.5	9.0	24.3	30.6	7.8	27.7
Texas	8.8	22.4	27.1	20.9	19.0	21.0	16.5	17.9	23.8

Source: U.S. Bureau of the Census, *Government Finances in 1972 (1962, 1967): Compendium of Government Finances* 4, no. 5 (Washington: Government Printing Office, 1974); and U.S. Bureau of the Census, *Governmental Finances in 1974-75, Series G-F 75*, 5 (Washington: Government Printing Office, 1976).

There is another type of reform which is highly desirable but politically difficult. If the tax base in the suburbs could be tapped more fully so as to balance needs for services with capacity to finance, the fiscal situation in central cities could be markedly improved. History has not shown this to be a viable alternative in the Northern industrial states.

Federal Options

The federal government could increase the flow of aid to the state to prop up the public sector during this period of decline. A program of increased aid during a transition period in which the state sought to balance its long-term spending expectations with its likely future economic growth would be a sane program. On the other hand, federal grants to maintain an overdeveloped public sector would only prolong the period of continuing annual fiscal crisis.

A number of federal policies might be undertaken during the fiscal adjustment period, that period when the public sector in the North is moving to a lower level which is commensurate with its capacity to finance. One element of such a program would be an expansion of the countercyclical revenue-sharing program and the temporary public sector job-related programs. But perhaps the most important ingredient of a fiscal reform would be a higher level of federal financing of public welfare. The removal of a substantial share of welfare costs from the declining states in the Northeast would free substantial resources for other uses. The net effect would be to allow governments in the declining states to maintain a higher level of fiscal activity with respect to other social services.

A similar position might be taken with respect to regional development subsidies. They only prolong the period of transition to a lower, but stable level of activity. The longer the period of this transition, the greater the uncertainty with respect to business investment and the greater the chance for a snowballing effect of the decline.

An often discussed approach to dealing with the problems of decline is the creation of a "Regional Energy and Development Corporation" that would finance regional development projects using federally guaranteed taxable bonds. It is hoped that such an activity would accelerate development of Eastern coal and result in substantial job generation. If regional subsidies worked, they could have a strong positive effect on the finances of governments in the declining region. There are two caveats, however, even to the potentially favorable government finance effects. One is that the fiscal problems in the declining region are very much the fiscal problems of the central cities in those regions. Historically, these cities have not always shared in the economic growth of the region, and therefore it is not clear

how much their fiscal positions would improve in the event the regional shifts slowed. A second, and related, caveat is that the states in the declining region tend to be more heavily dependent on local property taxation, which may make it difficult to fully capture increases in regional income and employment for the public sector. But the most important issue with respect to regional subsidies is whether they induce any *net* improvement in private sector economic activity.

Finally, it should be noted that a successful federal approach will not likely grow out of political compromise. The problems of state and local governments in the regions are sufficiently different that any remedial program which benefits all is not apt to substantially benefit any. Programs such as general revenue sharing, a formula-based program with something for everyone, is an almost classic case of the "compromise effect."

Improved Fiscal Balance

The fiscal problem of many Northern tier states is that their public sectors are overdeveloped. The state's resource bases will no longer support the high level of public services provided in the state, unless tax rates are continuously increased. While shifts in population and economic activity are tending toward equalizing income across the country, the states have retained dominance in their relative national role in state and local fiscal activity. This can no longer be done. A downward transition must be recognized, and policy should center on selecting priorities in the adjustment of public service levels. With appropriate federal aid, this need not mean severe service cutbacks in all areas, but rather a slow growth in services provided while the rest of the nation catches up.

Lessons for the Growing Region

It is likely that the rapid fiscal expansion in the state-local sector in the South has yet to come. Investments in public infrastructure and human capital often lag behind the growth in population and income level. It is noteworthy that this growth has been particularly rapid over the past five years.

If the Southern tier of states is about to enter a fiscal growth period similar to that experienced in the Northern tier in the 1960s, some of the painful fiscal lessons of that period might be well learned. Much of the problem facing the Northern tier states was not of their own making. The very rapid fiscal expansion in the mid- and late 1960s and early 1970s was to a large extent the result of union pressures for higher employee compensa-

tion, a demand that was abetted by a high rate of inflation, and a crowding of high-cost, low-income citizens into the central cities. Much of this expenditure increase would have been difficult to avoid. Other aspects of the expansion, however, were more discretionary—the making of substantial long-term fixed debt and pension commitments, the addition of substantial numbers to the public employee roles, and the buying into federal programs to expand the scope of services offered.

The growing states with rapidly developing public sectors could learn much from this experience. But the lesson is not that public employee unionization should be resisted or that public service levels should be kept at modest levels, but rather that the longer-term consequences of fiscal decisions should be continuously monitored. Moreover, there are conditions in the growing region which may make the growth experience much less painful than in the Northern tier. A more favorable local government structure and a more elastic tax mix that is less reliant on the property tax may allow big, newer cities in the growth region to avoid the central-city financial crisis which is so common in the Northern tier.

Notes

1. See, for example, William H. Miernyk, "The Northeast Isn't What It Used to Be," in *Balanced Growth for the Northeast* (New York State Senate, 1975); Christopher Carlaw, *Boston and the Flight to the Sunbelt* (Boston: Boston Development Authority, October 1976); and David Puryear and Roy Bahl, *Economic Problems of a Mature Economy*, Occasional Paper no. 27 (Metropolitan Studies Program, The Maxwell School, Syracuse University, April 1976).

2. See, for example, George E. Peterson, "Finance," in *The Urban Predicament*, eds. William Gorham and Nathan Glazer (Washington: The Urban Institute, 1976); and Roy Bahl, Alan Campbell, David Gretak, Bernard Jump, and David Puryear, "Impact of Economic Base Erosion, Inflation, and Retirement Costs on Local Governments," in *Fiscal Relations in the American Federal System, Hearings before a Subcommittee on the Committee on Governmental Operations* (Washington: Government Printing Office, July 1975).

3. Notable exceptions here are Richard P. Nathan and Paul R. Dommel, who in "Understanding Central City Hardship" [*Political Science Quarterly* 21, no. 1 (Spring 1976)] argue a relationship between regional shifts and urban fiscal problems, and Tom Muller, who argues that population decline is a reasonable proxy for fiscal distress in "The Declining and Growing Metropolis—A Fiscal Comparison" [in *Post-Industrial America: Metropolitan Decline and Regional Job Shifts*, eds. George Sternlieb and

James W. Hughes (New Brunswick, N.J.: Center for Urban Policy Research, State University of New Jersey, 1975), pp. 197-220].

4. Excluding the District of Columbia.

5. The states included in each region are enumerated in the tables which follow. Some authors have followed a procedure of excluding certain states in these regions on grounds that they are qualitatively different in terms of economic base. For example, Jusenius and Ledebur exclude Maine, Vermont, and New Hampshire because the industrial bases of these states differ in kind and degree from the rest of the major region. See C.L. Jusenius and L.C. Ledebur, *A Myth in the Making: The Southern Economic Challenge and the Northeast Economic Decline* (Washington: Economic Development Administration, U.S. Department of Commerce, November 1976), p. 2.

6. See David Puryear, Roy Bahl, and Seymour Sacks, *Federal Grants: Their Effect on State and Local Expenditures, Employment Levels, Wage Rates* (Washington: Advisory Commission on Intergovernmental Relations, February 1977), chapter 2.

7. Sack's East and Midwest regions correspond approximately to our Northern tier, and his Southern region to our Southern tier, with the following exceptions: in the Midwest he includes Des Moines, Wichita, Minneapolis, Kansas City, St. Louis, and Omaha; in the East he includes Washington, D.C. Advisory Commission on Intergovernmental Relations, *Trends in Metropolitan America* (Washington: Government Printing Office, 1977).

8. Vincent Marando, "The Politics of Metropolitan Reform," in *State and Local Government: The Political Economy of Reform*, eds. Alan Campbell and Roy Bahl (New York: The Free Press, 1976), pp. 24-49.

9. Common municipal functions exclude education, hospitals, and other variable functions as defined by the Census.

10. Muller, "The Declining and Growing Metropolis—A Fiscal Comparison," pp. 203-206.

11. The Department of Housing and Urban Development (HUD) has established fair-market rent levels for about 3,100 areas throughout the nation in conjunction with their Section Eight lease housing program. One might argue the use of the data to construct a cost-of-living index because (1) housing costs make up a large proportion of total consumption and (2) much of the variance in living costs might be attributed to housing. Following this procedure, we have taken the indices computed for 501 formula cities under the HUD community development block program, aggregated and averaged the indices by state, and then compared them to the U.S. average to develop an index. For a discussion of the potential use of the HUD index as a cost-of-living measure in another context, see the Controller-general of the United States, "Why the Formula for Allocating

Community Development Block Grant Funds Should Be Improved" (Washington: General Accounting Office, December 1976).

12. There are not adequate deflators for this purpose. The choices here were between the Bureau of Labor Statistics (BLS) levels of living for low-, intermediate-, and high-income families and the HUD index of rent. We chose the latter because the BLS data are available only for forty-one metropolitan areas and this would not seem to provide adequate regional coverage. See Bureau of Labor Statistics, "Autumn 1976 Urban Family Budgets and Comparative Indexes for Selected Urban Areas," *News* (Washington: Department of Labor, April 27, 1977), pp. 77-369.

13. David Greytak and Bernard Jump, "Inflation and Local Government Expenditures and Revenues: Method and Case Studies," *Public Finance Quarterly*, June 1977.

14. Richard P. Nathan and Paul R. Dommel, "The Strong Sunbelt Cities and the Weak Cold Belt Cities," Hearings before the Subcommittee on the City, of the House Committee on Banking, Finance and Urban Affairs, *Toward a National Urban Policy*, 95th Cong. (Washington: Government Printing Office, 1977), pp. 19-26; and "Understanding Central City Hardship," *Political Science Quarterly* 21, no. 1 (Spring 1976):61-62.

15. For a parallel analysis of the New York State economy and fisc, see Roy Bahl, "The Long Term Fiscal Outlook for New York State," in *The Decline of New York in the 1970's*, ed. Benjamin Chinitz (Binghamton, N.Y.: Center for Social Analysis, State University of New York at Binghamton, May 1977), pp. 95-142.

16. Jusenius and Ledebur, *A Myth in the Making*.

17. Michael R. Greenberg and Nicholas J. Valente, "Recent Economic Trends in the Major Northeastern Metropolises," in *Post-Industrial America: Metropolitan Decline and Inter-Regional Job Shifts*, eds. George Sternlieb and James Hughes (New Brunswick, N.J.: The Center for Urban Policy Research, Rutgers University, 1975), pp. 77-100.

18. Daniel Garnick, "The Northeast States in the Context of the Nation," in *The Decline of New York in the 1970's*, ed. Benjamin Chinitz (Binghamton, N.Y.: Center for Social Analysis, State University of New York at Binghamton, 1976).

19. Congressional Budget Office, "Troubled Local Economics and the Distribution of Federal Dollars" (Government Printing Office, August 1977).

20. These possibilities are examined for New York City in Roy Bahl and David Greytak, "The Response of City Government Revenues to Changes in Employment Structure," *Land Economics* 52, no. 4 (November 1976).

21. Garnick, "The Northeast States in the Context of the Nation," p. 188.

22. Puryear and Bahl, *Economic Problems of a Mature Economy*.

23. Jusenius and Ledebur, *A Myth in the Making*, pp. 1-5.

24. R.G. Ehrenberg, "The Demand for State and Local Government Employees," *American Economic Review* 63, no. 3 (June 1973):366-79; and T.E. Borcherding and R.T. Deacon, "The Demand for Services of Non-Federal Governments," *American Economic Review* 62, no. 5 (December 1972):891-901.

25. It is important to reemphasize that the rates of increase of average wages measure do not total compensation, but only direct wage and salary payments. To the extent there are regional differences in the pension and fringe-benefit component of compensation *increases*, these comparisons are distorted. One view would be that this distortion is in the direction of underestimating growth rates in compensation for employees of Northern states.

26. Advisory Commission on Intergovernmental Relations, *Measuring the Fiscal Blood Pressure of the States* (Washington: Government Printing Office, 1977).

27. Revenue-income elasticity is the percentage increase in revenue divided by the percentage increase in personal income. A more rigorous measure of the revenue-income elasticity would require adjusting the revenue data levels for discretionary changes in both the rates and bases of the tax systems within the several states.

28. A review of the issues surrounding productivity measurement and improvement is presented in Jesse Burkhead and John P. Ross, *Productivity in the Local Government Sector* (Lexington, Mass.: D.C. Heath, 1974).