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Fiscal Problems of Cities in the Northeast

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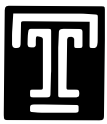

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8 *Fiscal Problems of Cities in the Northeast*

Looking out from 1975, nearly any observer of municipal finances would have offered a gloomy prognosis. New York was by no means the only city facing deep-seated economic problems and a taxable capacity growth too slow to accommodate the growth in expenditure requirements. Various analysts saw a real possibility for default in Buffalo, Detroit, Boston, Yonkers, Cleveland, and even New York State.

In fact, however, there have been relatively few cases of financial collapse since 1975. Cleveland, Wayne County, and the Chicago schools are notable exceptions, but there have not been many more New Yorks. Some have seen this absence of crisis as a sign of renewed fiscal and economic health in cities, while others are convinced that it reflects a postponement of crises yet to come. Which view is correct? Have overzealous analysts overstated the case? After all, the obsolete and crumbling central city infrastructure has not yet crumbled; ten more years of woefully deficient central city services have not produced more urban ghetto riots; "underpaid" public employees have not brought city operations to a standstill with a series of major strikes; public employee layoffs have been accomplished without noticeably severe declines in public servicing; and city governments have indeed been able to pay their bills. In light of this, is there still a fiscal crisis? If one is to argue a crisis outlook for northeastern cities, then one must explain the absence of severe financial distress since 1975—which is the purpose of this chapter.

Explaining the Financial Health of Cities[1]

New York City's financial collapse in 1975 changed nearly everyone's view of urban fiscal problems. The focus of interest shifted from concern with social problems and inadequate public services in inner cities to preoccupation with financial strength and susceptibility to default. Public employee unions, local politicians and bureaucrats, federal and state government policymakers, the financial community, and even citizens' groups seem to accept the new priority. More than any other single factor, this change in public attitude may be responsible for maintaining the financial solvency of northeastern cities. In effect, it made possible the kinds of sacrifices from public employees and public service beneficiaries that were necessary.

Beyond this change in attitude, one might offer three hypotheses to explain why there were no more New Yorks.

1. *The Improving Economy Thesis*: The post–1975 economic recovery benefited cities, as has the 1983–1984 recovery; the most recent recession (1981–1982) did not harm them as badly as in 1975. A revitalization of central cities is occurring, and the demographic makeup of cities is changing in a way that lessens the pressure for increased public expenditures.
2. *The Increasing Resources Hypothesis*: Federal and State grant inflows were substantial enough to prop up the slow growth in state taxes in the immediate aftermath of the 1975 recession. Thereafter, inflation also bid up local tax revenues. The result was that resources were adequate to cover expenditure requirements. The more moderate effects of the latest (1981) recession on northeastern cities and the 1983 recovery have kept city revenues buoyant.
3. *The Deferral Hypothesis*: Because of the New York City scare, city governments were able to reduce employment rolls, dramatically slow the rate of increase in public employee wage rates, cut public service levels, and defer maintenance and additions to the capital stock.

Available evidence bears out some parts of each of these hypotheses as explanations of city financial health since 1975. Interestingly, each of these issues also highlights a relative disadvantage of northeast cities.

The fundamental issue here is whether the conditions and policies that have staved off default will continue into the 1980s; the specific concern is how cities in the declining region will fare.

[1]Some of this material is covered in more detail in Bahl (forthcoming), ch. 3.

The Improving Economy Thesis

A major factor that brought many central cities to the brink of financial disaster in 1975 was the decline in their economic base. The job and income loss shrunk available revenues, and the increased unemployment rate pressured social service expenditures. Some have hypothesized that the situation improved after 1975: (1) that city economies have recovered, thereby holding up revenue growth, and (2) that population size and composition have changed in ways that relieve public expenditure requirements.

EMPLOYMENT CHANGES

The competitive position of northeastern (and industrial midwestern) cities weakened in the decade of the 1970s. In a sense they were doubly damned, losing jobs to both the faster growing Sunbelt region and to their own suburbs. The litany of underlying causes is well known. The cost of doing business (labor, taxes, energy) is relatively high in the Northeast, and markets—population and income—are moving to the South and the West. Between 1950 and 1980, the Northeast regional share of national employment fell from 27.1 to 21.6 percent, that of personal income from 29.9 to 23.1 percent, and that of population from 26.1 to 21.7 percent.

Evidence suggests that central cities in the Northeast have received a declining share of this declining share and that employment suburbanization has occurred as industries have moved to newer, more modern, and campus-type facilities closer to their suburban employees. Unfortunately, this pattern cannot be documented as clearly as one would want. When one moves from a discussion of regional trends to analysis of individual cities, and to making city/suburban comparisons, a severe data constraint is encountered. There simply are not regular estimates of employment in city areas; analysts must be content with some form of extrapolation between population census years and retailing/manufacturing census years, or with analyzing a relatively small sample of coterminous city-counties. Both approaches are utilized in this chapter.

Seymour Sacks (1978) has adjusted census journey-to-work data to make intercensal estimates of employment in city areas. He finds a stereotype pattern: between 1970 and 1975, northeastern cities lost employment at an average annual rate of 1.6 percent; midwestern cities saw almost no change on average, but southern cities grew at 3.5 percent and western cities at 2.7 percent. Relative to their suburbs, cities in the Northeast fared badly. In only one of fifteen cases studied did central city employment increase as fast as suburban employment. Sacks's more recent work shows a continuation of this trend. Of sixteen large northeastern central cities for which there were data, only four showed any employment growth between 1975 and 1977.

By comparison, thirteen of twenty midwestern central cities, seventeen of twenty-four southern cities, and fourteen of seventeen western cities registered employment increases (U.S. Department of Housing and Urban Development, 1980, table 23). The average rates of change were −0.3 percent in the Northeast, 3.3 percent in the Midwest, 3.8 percent in the South, and 5.7 percent in the West. In only three of the northeastern standard metropolitan statistical areas (SMSAs) did city employment increase as fast as that in the suburbs.

The lack of regularly published data on central city employment severely limits the documentation of employment decline. One source of data, the Census Bureau's *County Business Patterns*, limits any comparisons of experiences across central cities to those ten cities that are coterminous with counties.[2] Though a very small sample, Baltimore, New York, Philadelphia, and St. Louis could represent the declining city type, and the remainder, the growing city type.

As seen in Table 8.1, Philadelphia and St. Louis experienced employment declines over the 1965–72 period, and there was virtually no growth in New York. Between 1973 and 1974, six of the ten central counties were losing employment with the four gaining counties—Indianapolis, Jacksonville, San Francisco, and Nashville—conspicuously outside the declining region. During the recession between 1974 and 1975, all ten counties lost employment.

During the post-1975 recovery period, the "declining" counties did not fare as well. None of the four experienced any employment increase until 1978, a full two years after the national recovery had begun. By 1979, when the national employment growth rate was 7.3 percent, the average growth rate for these four declining counties was 2.8 percent and for the six growing counties, 4.8 percent. In 1980 and 1981, the declining counties lost employment at a greater rate than the nation while the growing counties exceeded national economic performance.

These data also reveal a continuing trend toward suburbanization. The share of SMSA employment in the central city/county declined in all ten SMSAs studied (Table 8.2). It is interesting to note, however, that in 1979 in the four "declining" SMSAs the central city (county) employment share averaged 49.3 percent, while in the growing SMSAs it averaged 65.5 percent. In 1981, only in Jacksonville and San Francisco did the share increase.

DEMOGRAPHIC CHANGES

Another possibility is that some of the pressure is off central city budgets because of a changing population. The argument would go that local govern-

[2]These data also have the disadvantage that they exclude government and proprietorship employment. Furthermore, there is a substantial publication time lag in the data.

TABLE 8.1
Percent Increase in Employment in Ten Metropolitan Central Counties

County	*1965–1972*	*1972–1973*	*1973–1974*	*1974–1975*	*1975–1976*	*1976–1977*	*1977–1978*	*1978–1979*	*1979–1980*	*1980–1981*
Baltimore	4.0	1.7	−9.5	−6.7	−3.8	−1.2	2.2	1.8	0.8	−2.4
Denver	37.4	8.2	−7.4	−4.8	2.3	2.8	12.2	6.4	2.6	1.0
Indianapolis	15.9	6.4	2.1	−4.8	3.7	2.9	5.6	5.7	−2.2	−4.3
Jacksonville	37.6	8.0	5.8	−6.4	−0.9	−1.5	9.5	4.0	1.4	2.0
Nashville	32.3	8.1	4.4	−4.4	4.2	3.8	8.6	6.0	−2.1	1.3
New Orleans	10.8	2.0	−10.2	−4.0	1.2	1.0	9.1	4.2	−2.0	0.9
New York City	0.2	−3.0	−1.4	−6.2	−1.0	−2.7	3.1	4.3	−0.6	1.0
Philadelphia	−0.5	0.9	−3.2	−8.0	−1.3	−4.4	3.8	2.5	−2.8	−1.7
St. Louis	−1.8	1.7	−7.4	−11.5	−0.2	−3.9	4.8	2.5	−4.8	−4.8
San Francisco	10.3	2.2	15.2	−2.8	0.4	−5.3	10.9	2.3	1.2	4.9
United States	21.5	7.0	2.3	−4.7	3.4	3.9	8.1	7.3	−0.8	0.0

Source: U.S. Bureau of the Census, *County Business Patterns for 1965–81* (Washington, D.C.: Government Printing Office, 1966–1983).

TABLE 8.2
Percent of SMSA Employment in Central City/County*

County	*1972*	*1975*	*1977*	*1979*	*1981*
Baltimore	59.62	50.55	46.74	44.57	43.03
Denver	63.87	54.64	51.53	49.81	48.50
Indianapolis	87.13	86.18	85.43	84.31	83.75
Jacksonville	92.10	90.33	88.15	87.62	87.65
Nashville	78.70	78.03	76.40	75.48	75.15
New Orleans	72.33	63.28	58.45	59.44	55.10
New York City	84.10	81.78	80.50	79.97	79.75
Philadelphia	49.56	43.26	40.43	39.26	38.08
St. Louis	46.43	35.70	34.78	33.15	30.90
San Francisco	39.93	41.67	37.29	37.10	37.92

*1975 SMSA boundaries were used for all years.
Source: U.S. Bureau of the Census, *County Business Patterns for 1965–81* (Washington, D.C.: Government Printing Office, 1966–1983).

ment expenditure needs have been lessened because there is a smaller population to be served, fewer school-aged children, and fewer public assistance recipients. On the other side of the coin is the possibility that the composition of population has also changed in unfavorable ways (i.e., there is an increasing share of the elderly and the very poor, and a large backlog of unmet social needs to be dealt with).

In fact, the data bear out some of this argument. Between 1950 and 1980, population in the Northeast grew at a rate that was less than half that of the nation. Again, central cities have grown even slower than the rest of the region. Of the eighteen largest northeastern cities, only one had any population increase between 1970 and 1980. While compositional effects are less easily described, a few trends are evident; for example, population densities have declined and school enrollments have gone down.

The Increasing Resources Hypothesis

Another possible reason for the unexpected fiscal health of Northeastern cities is that their revenue systems have remained buoyant. The two elements of this strong revenue performance are the growth in federal grants and the favorable effects of inflation and economic growth on local tax revenues.

FEDERAL ASSISTANCE

A major reason why large central cities performed above expectations in the period immediately after the recession was the massive inflow of direct federal aid to cities. Much of the increase in federal assistance in the aftermath of the recession was the Carter administration's economic stimulus

package.[3] Various analyses showed that the stimulus package was heavily targeted on large cities that were thought to be characterized by a high degree of fiscal strain (U.S. Department of the Treasury, 1978).

Growth in this aid, however, has tapered off since 1978 with the overall decline in federal assistance to state and local governments. Referring to Table 8.3, note that the ratio of federal aid to own-source revenue has declined in ten of the fifteen reported cases. But while distressed cities benefited more from federal aid increments, they may be most hurt by federal aid reductions. The admittedly limited comparison in Table 8.3 suggests that declining cities are more dependent on federal assistance.

What one may say from these data is that central cities did benefit substantially from direct federal assistance during the 1975–81 period. Indeed, this was a major force in supporting the budgets of northeastern cities during the fiscal crisis of the late 1970s. The pattern of increase in federal grants has been reversed since 1978, but the importance of such assistance in city budgets is much larger than it was ten years ago.

INFLATION, ECONOMIC GROWTH, AND LOCAL TAXES

The post-1975 recovery and inflation had a stimulating effect on state and local government revenue, and the aftermath of the New York City scare helped local governments keep expenditure growth at a low level. As may be seen in Table 8.4, real per capita taxes increased in 1977 whereas real per capita expenditures actually fell. This, plus infusions of federal aid, gave state and local governments some much-needed breathing room. While local governments have been able to continue this pattern of real expenditure reduction, they have not been able to sustain real revenue increases. A combination of tax limitations, discretionary rate and base reductions, slow economic growth, and another recession led to real per capita tax revenue declines between 1977 and 1981. The revenue decline for state governments was less severe because income and sales tax revenues were more responsive to inflation and generated a growth that permitted discretionary reductions in 1979 and 1980.

Did northeastern cities fare any worse than the rest of the country? The data in Table 8.5 suggest that they did. When tax revenue grew at a high rate in these cities, the reason seemed to be a discretionary change (as suggested by a large difference in the growth rates between the two periods). Between

[3]Key elements of the stimulus package were antirecession fiscal assistance (ARFA), local public works (LPW), and public service employment under the Comprehensive Employment and Training Act (CETA).

TABLE 8.3
Direct Federal Aid to City Governments: Selected Cities and Fiscal Years

	Federal Aid as Percent of Own Source General Revenue					*Per Capita Federal Aid*	
City	*1957*	*1967*	*1976*	*1978*	*1981*	*1976*	*1981*
St. Louis	0.6	1.0	23.6	34.0	40.6	$ 86	$239
Newark	0.2	1.7	11.4	30.4	17.9	47	67
Buffalo	1.3	2.1	55.6	77.5	54.6	163	218
Cleveland	2.0	8.3	22.8	57.9	25.3	65	121
Boston	*	10.0	31.5	20.9	14.5	204	160
Unweighted averages	0.8	4.6	29.0	44.1	30.6	113	161
Baltimore	1.7	3.8	38.9	53.7	45.1	167	279
Philadelphia	0.4	8.8	37.7	29.7	16.1	129	103
Detroit	1.3	13.1	50.2	44.2	85.6	161	379
Chicago	1.4	10.9	19.2†	46.7	44.8	47	157
Atlanta	4.3	2.0	15.1	19.7	20.7	52	133
Unweighted averages	1.8	7.7	32.2	38.8	42.4	111	210
Denver	0.6	1.2	21.2	26.2	16.8	90	130
Los Angeles	0.7	0.7	19.3	31.2	21.1	54	90
Dallas	0.0	*	20.0	13.2	15.5	51	59
Houston	0.2	3.1	19.4	15.3	16.9	44	67
Phoenix	1.1	10.6	35.0	51.9	33.6	57	101
Unweighted averages	0.5	3.1	23.0	27.6	20.8	61	90
Unweighted averages of fifteen cities	1.1	5.2	28.1	36.8	31.3	95	154

*Less than 0.5 percent.

†Percentage based on federal aid excluding general revenue sharing: funds withheld pending judicial determination.

Source: U.S. Bureau of the Census, *City Government Finances in 1957,1967, 1976, 1978 and 1981* (Washington, D.C.: Government Printing Office, various years).

1975 and 1977, six of the ten cities in the declining regions had a real tax revenue increase, whereas between 1977 and 1981, only two of the ten had a real increase.

The Deferral Hypotheses

A third possible reason for the relatively strong performance of central cities since the 1974–75 recession has been their willingness and ability to hold the line on costs—even if it has meant reducing service levels. This retrenchment has taken a number of forms, including reductions in public employment, elimination of certain programs, and the deferral of capital facility maintenance and replacement. The data would seem to bear out these arguments and to suggest that northeast cities have led this retrenchment movement.

TABLE 8.4
Comparisons of State and Local Government Fiscal Activity, 1969–1981

Average Annual Percent Increase	*1969–1974*	*1974–1975*	*1975–1976*	*1976–1977*	*1977–1978*	*1978–1979*	*1979–1980*	*1980–1981*
*Real Per Capita Total Expenditures**								
State governments	4.6	7.1	9.2	−2.3	−2.0	−2.1	0.2	2.6
Local governments	3.6	4.8	5.0	−0.4	−0.3	−1.8	−2.4	0.6
Municipalities	3.9	4.7	4.9	−3.4	0.7	−3.9	−2.1	−0.5
Real Per Capita Current Expenditures								
State governments	5.7	8.5	5.1	3.4	4.5	−2.6	−0.1	2.7
Local governments	4.3	4.5	6.5	1.4	1.0	−2.2	−3.0	−0.3
Municipalities	4.7	3.8	5.6	0.1	1.2	−3.3	−3.4	−1.3
Real Long-Term Debt Outstanding								
State governments	4.4	0.3	9.7	4.5	6.2	−1.5	−3.5	0.3
Local governments	2.0	−4.3	0.9	3.2	0.3	−3.1	−2.3	−3.4
Municipalities	1.8	−4.3	5.3	1.2	4.1	−10.3	−3.2	−4.1
Employment								
State governments	4.0	3.4	2.0	3.7	2.2	3.6	1.1	−0.6
Local governments	3.8	2.2	0.7	3.8	0.9	1.5	0.9	−1.4
Municipalities	2.7	0.7	−1.6	2.9	−0.2	1.2	−1.2	−2.6
Real Per Employee Compensation								
State governments	0.6	−2.5	1.1	0.0	−0.8	−3.8	−3.5	−0.6
Local governments	0.6	−1.8	0.3	−0.3	−3.1	−3.2	−3.7	−0.6
Municipalities	1.5	−2.4	0.9	−1.5	−2.1	−4.6	−3.5	2.0
Real Per Capita Tax Revenues								
State governments	4.4	−2.1	4.4	5.3	3.0	−2.1	−4.2	−0.9
Local governments	2.7	−1.6	3.3	3.0	−1.2	−10.9	−6.4	−0.5
Municipalities	2.0	−1.4	3.5	3.9	−1.8	−8.2	−5.1	−1.0

*Amounts deflated by the consumer price index (CPI).

Sources: U.S. Bureau of the Census, *Governmental Finances in 1968–69, 1973–74, 1975–76, 1977–78, 1978–79, 1979–80, 1980–81* (Washington, D.C.: Government Printing Office, various years); U.S. Bureau of the Census, *Public Employment in 1981* (Washington, D.C.: Government Printing Office, various years); U.S. Bureau of the Census, *City Government Finances in 1968–69, 1973–74, 1974–75, 1975–76, 1976–77, 1977–78, 1978–79, 1979–80, 1980–81* (Washington, D.C.: Government Printing Office, various years).

TABLE 8.5
Indicators of Financial Performance: Twenty Largest Cities (average annual percent change), 1975–1980

City	*Current Expenditures**		*General Obligation Debt Outstanding*		*Employment*		*Payroll Per Employee*		*Taxes*	
	1975–77	*1977–81*	*1975–77*	*1977–81*	*1975–77*	*1977–81*	*1975–77*	*1977–81*	*1975–77*	*1977–81*
Baltimore	7.1	0.1	0.2	9.2	−4.9	−2.2	−1.0	9.7	4.2	4.7
Boston	11.9	3.8	10.6	3.8	0.1	0.1	12.6	0.1	15.3	3.2
Cleveland	4.3	8.0	18.5	3.7	−7.6	−4.0	−1.9	5.3	3.0	12.9
Chicago	10.7	9.0	3.3	−2.0	−3.5	−1.7	5.8	6.7	4.9	4.9
Dallas	12.0	13.5	−1.4	7.7	2.5	−0.1	7.0	10.8	8.9	8.3
Detroit	5.2	12.3	−3.7	6.8	8.0	−3.9	12.8	14.1	7.0	2.3
Honolulu	19.1	1.6	7.8	4.5	7.3	−4.9	17.9	7.4	8.1	10.3
Houston	22.5	15.7	9.9	15.5	5.1	3.7	12.4	11.3	15.9	13.5
Indianapolis	13.4	8.9	2.8	2.4	−0.1	1.1	6.3	8.8	7.2	5.8
Los Angeles	8.8	9.5	8.0	1.6	−1.6	−2.8	2.3	10.9	10.9	6.4
Memphis	11.9	8.7	20.3	8.5	−13.8	−3.8	−6.1	9.5	8.9	8.7
Milwaukee	9.0	8.3	3.2	9.0	−1.9	−1.1	5.1	5.9	2.0	−1.1
New Orleans	12.2	13.4	−0.4	18.0	9.0	−6.6	26.0	8.1	7.3	13.1
New York	4.5	3.1	16.8	−8.9	−5.5	1.2	−0.7	7.5	11.5	5.4
Philadelphia	8.3	8.3	12.3	6.4	−0.3	−2.9	4.9	6.9	20.3	6.6
Phoenix	11.8	13.0	11.8	8.1	8.4	−0.1	15.2	10.3	12.6	9.6
San Antonio	19.6	10.9	25.6	20.3	1.7	−3.2	8.6	6.3	9.5	8.5
San Diego	8.5	10.3	−4.2	−2.0	1.4	−1.9	6.7	8.5	14.4	8.2
San Francisco	5.1	6.2	18.8	10.9	0.3	−1.1	3.2	10.9	15.6	1.2
Washington, D.C.	8.9	6.4	17.0	4.9	0.8	−3.8	7.1	8.1	16.6	11.2

*The average percent change in the CPI was 6.1 percent during 1975–1977 and 10.7 percent during 1977–1981.

Sources: U.S. Bureau of the Census, *City Government Finances in 1974–75, 1976–77, 1980–81* (Washington, D.C.: Government Printing Office); U.S. Bureau of the Census, *City Employment in 1975, 1977, 1981* (Washington, D.C.: Government Printing Office).

EMPLOYMENT REDUCTIONS

Examination of employment trends since 1975 reveals a slowdown in the number of employees added to state and local government payrolls. The pattern of state and local employment during recent years is in sharp contrast with most of the post–World War II period, when nonfederal public employment expanded at rates greatly above those for private industry and the federal government. For example, annual employment growth between 1962 and 1972 averaged 4.5 percent for the state/local sector as compared with a private industry growth rate of less than one-half that rate.

However, the reins appear to have been drawn on state and local government job expansion after 1974 (see Table 8.4). Average annual employment growth between 1974 and 1981 fell to about one-half the rate for the preceding ten years, and did not regain the level of the 1969–74 period.

Even more drastic than the curtailment of job growth for all nonfederal governments has been the abruptness with which municipalities have clamped down on their workforce growth. After growing at an average annual rate of 2.7 percent between 1969 and 1974, employment by municipalities grew very little from 1974 to 1975 and has actually declined since 1976.

Inspection of employment records for large cities shows that actual reductions in large city workforces are not uncommon and have not been for several years (Table 8.5). Nine of the twenty largest cities reduced employment between 1975 and 1977, and sixteen of the twenty largest cities reduced the number of employees on their payrolls between 1977 and 1981.

Have all municipalities continued to reduce employment since 1975? The answer from Table 8.5 is that it depends in part on the region and the growth/decline position of the local economy. Six of nine declining cities (and eight of eleven growing cities) had declines after 1975, or smaller rates of increase between 1977 and 1981 than between 1975 and 1977.

Finally, employment declines were made possible because of population decline. In fact, when the change in city employment per ten-thousand population is calculated for this sample of the twenty largest cities, only five of the nine declining cities have reduced employment in proportion to population decline.

COMPENSATION INCREASES

State and local governments may also have dealt with their fiscal problems by curbing the rate of increase in public employee compensation (i.e., by deferring compensation increases). One might ask whether the growth in public employee compensastion is out of line with the growth in private sector compensation, and whether governments are succeeding in slowing the growth in compensation.

The compensation restraint argument would seem borne out for the state and local government sector in general. Although average wage levels in state and local government have for some time exceeded private industry wage levels, the gap narrowed after 1977 and the state and local government sector has now fallen behind. The narrowing of the gap has come about because average wage growth in private industry accelerated after 1973, not because public employers succeeded in braking the rate at which their employees' wages grew. In fact, yearly growth in state and local government employee wages and salaries was greater in every year between 1972 and 1976 than it was throughout the period 1962 to 1972. After 1976, however, the growth in state and local government wages fell back to the rates of increase in the 1960s. Indeed state and local government employee salary rates have increased at a rate below the consumer price index (CPI) since 1977 (see Table 8.4).

The explanation for this slow growth in average compensation might be explained by factors other than deferral. First, some of the wage growth implied in the averages is an illusion. To the extent that governments add fewer new employees or even effect reductions in workforce size, this is likely to have a disproportionate impact on younger, lower-paid employees. By the nature of arithmetic averages, it is quite possible to reduce workforce size and to grant no wage increases to remaining employees and still end up with a higher average wage for the workforce. Second, the years 1972 to 1976 were marked by the most severe inflation encountered in twenty-five years, and it would not be surprising if government employers were unable to withstand employees' efforts to obtain some relief in the form of wage increments. Still, the growth of wages paid to the average state/local employee relative to advances in the CPI suggests that employees lost ground in terms of the purchasing power of their income.

If large cities generally were harder-pressed fiscally than were states or other local jurisdictions—as a reading of public employment trends seems to bear out—it might be expected that city employee wages could have grown at more modest rates than wages for other state/local employees. If the deferral hypothesis holds, one might expect compensation increases to fall short of CPI increases.

Of the cities compared in Table 8.5, five are in the Northeast region and another four are in the declining Midwest region. The remaining eleven are in the growing region. From 1975 to 1977, only three of the nine declining cities gave increments below the CPI (as compared to four of eleven growing cities). Between 1977 and 1981, however, one of the nine declining cities increased compensation above the rate of increase in the CPI, as compared to four of eleven growing cities.[4]

[4]To what extent these increases are the result of the preceding averaging effects is a matter

CAPITAL INVESTMENT

Capital investment is an easily deferred item of state and local government expenditure. New buildings can be postponed, cars and trucks can be used for another year, and major renovations can wait. Moreover, such deferrals are often politically expedient. Where are the political points for replacing obsolete underground water mains or increasing the efficiency of a sewage treatment plant?

In fact, capital expenditures of state and local governments have declined in real terms and as a share of the total budget. Peterson (1978) reports that gross capital investment fell from 27 percent of total state and local spending in 1965 to a low of 14 percent in 1977. As might be expected, there were real declines in state and local government debt outstanding through the late 1970s (Table 8.4).

While some of this decline might be attributed to the completion of the interstate highway system and to higher interest costs, much of it would appear to be due to the postponement of capital project investments and the deferral of maintenance and renovation. Such deferrals have made the financial position of state and local governments appear stronger than it is. What is the meaning of an annual budget surplus in a case where necessary capital expenditures have been put off? This question cannot be answered other than by relying on impressionistic evidence about the inadequacies of the existing capital stock.

One can, however, surmise that the postponement and deferral of capital renovation and maintenance does not have the same undesirable effects in every state and local area. Indeed, capital replacements can be put off and renovation cycles extended, apparently without causing cities to crumble. However, the older the capital stock the more likely are these effects to cut into public service levels and economic development efforts. One would suspect that the slowdown in capital spending would create particularly severe capital obsolescence problems for older cities. The implication of capital deterioration in these cities, which tend to be the more financially pressed in any case, is that the reported budgetary position overstates their financial health. In essence, a part of their budgetary balance is carried in the form of a gap between the "necessary" and actual condition of the local capital stock. Knowledge of fiscal distress could be supplemented if governments could be identified and ranked according to how much they have deferred capital expenditures and according to the condition of their capital stock.

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for speculation—although the large size of some cities' increments to total payrolls would suggest that considerably more than the arithmetic of averaging has been at work. One explanation for some portion of the increases is that employees in large cities are more likely to be effectively organized to persuade employers to grant wage adjustments that offset a substantial part of cost-of-living increases. Although further pursuit of explanations for rapid growth in city wage expenditures would be beyond the scope of this chapter, the matter deserves careful study.

The Outlook

Can cities in a declining region continue their relatively strong fiscal performance? The answer depends on whether one expects continued help from a growing national economy, increasing federal grants, and a continued ability to defer wage rate increments and capital investment.

On the question of United States economic growth, it is interesting to speculate on how much of the national growth will actually benefit the declining region in any case. Federal grant reductions are a much more likely scenario than the increments of the 1970s. All of this suggests an outlook of very slow revenue growth for cities in the 1980s. The question then becomes whether continued deferrals are possible. Is the capital stock really obsolete, and will unions and central city residents continue to accept government retrenchment because of a fear of financial collapse?

Whatever the scenario of the 1980s, short of a dramatic turnaround in federal policy, northeastern cities are likely to feel more of a fiscal squeeze than is the rest of the country. The resource constraints will be most severe for the declining and distressed cities: all of the trends bend against them. They suffer most in recession and benefit least during recovery, their heavy reliance on the property tax makes them a sure fiscal loser during times of inflation, and their heavy dependence on federal aid makes them the biggest losers in the federal government expenditure retrenchment process.

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