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The Outlook for City Fiscal Performance in Declining Regions

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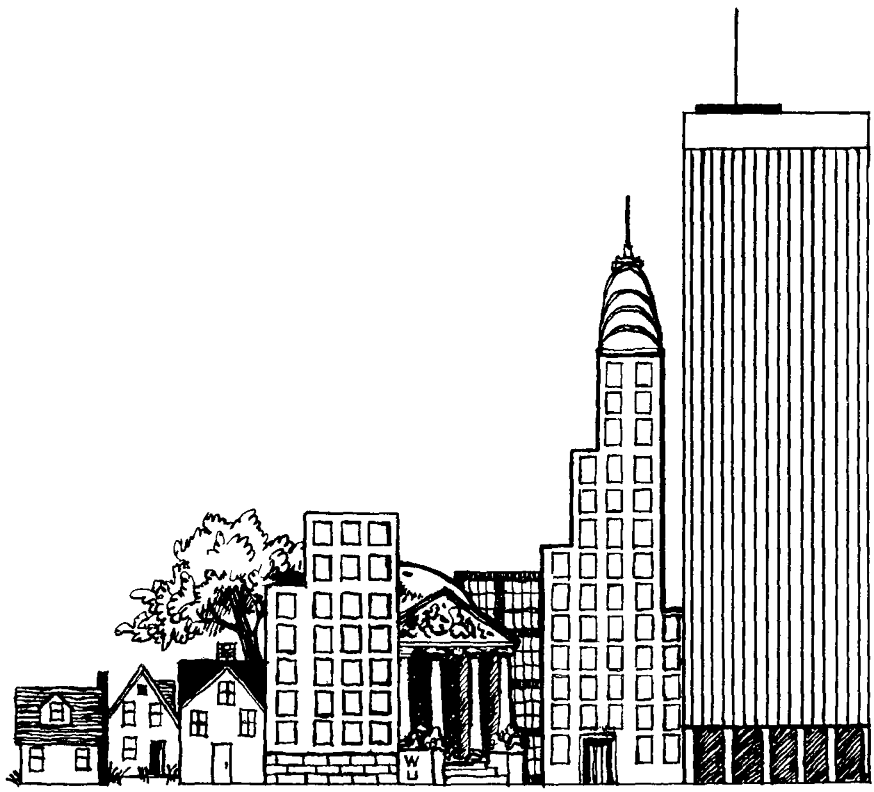

THE FISCAL OUTLOOK FOR CITIES

Implications of a National Urban Policy

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The Outlook for City Fiscal Performance in Declining Regions

ROY BAHL, BERNARD JUMP, Jr., and LARRY SCHROEDER

THE DECADE of the 1970s has witnessed an intensifying debate concerning the underlying economic condition of big cities, particularly those located in the declining Northeast and industrial Midwest. Not only has the country's largest city come within a step of bankruptcy, and avoided it only by the imposition of what some would describe as draconian measures, but several other of the largest have had to slash work forces and otherwise cut back services as recession and inflation exacerbated troubles brought about by economic base shrinkage.

Now that an economic recovery is under way and inflation has backed off from its double-digit rates, the question remains whether most cities will be able to provide adequate levels of services without the need either to raise taxes excessively or to seek larger and sustained doses of state and federal aid.

The viewpoint of city officials appears to be one of frustration if not despair. The more they try to provide the conditions and services necessary to attract and hold employers and higher-income taxpayers, the more pressure they put on precariously balanced budgets. The more they call on any available taxing capacity and/or postpone all but essential services and capital improvements, the less attractive is the community to the very ones they are trying to hold and draw in. And whatever they try, it still seems as if their economic bases continue to shrink.

An entirely different view seems to emerge loudly from most state capitals and from Washington. More than a little Jeffersonian at its base, this view hardly exudes sympathy for the plight of the cities generally—though some cities apparently earn disproportionately low amounts of sympathy. The more extreme adherents of this view see cities as profligate, poorly managed, and a drain on the resources of non-city dwellers. Furthermore, the cities are seen as always looking for one more program of aid and relief while seldom deserving even the program already benefitting them.

This latter view that cities as such are not in trouble is not without what may seem to be persuasive supporting evidence. For example, there do not appear to be other "New Yorks" on the horizon—no list of likely candidates for default on debt service obligations. The municipal bond market seems able and willing to provide new capital improvement funds at reasonable cost. Similarly, some observers have made much of the emerging state and local government budgetary surpluses which are being reported and the proposals which would use these surpluses to support tax reductions.

Our goals here are to examine the current condition of state and local government finances with an emphasis on cities in the declining regions; to assess the likely fiscal performance of state and local governments in the years immediately ahead; and to explore the alternative public policies that might be used to deal with future trouble spots. Notwithstanding the encouraging news about current budgetary conditions in the state and local government sector, our principal contention is that the factors responsible for the improved fiscal conditions cannot be relied on as a permanent offset to damage done by a further shrinking of cities' economic bases. Moreover, we find no persuasive evidence that cities themselves have the capacity to reverse the process of economic base decline.

We emphasize at the outset that the available evidence about city government financial conditions is inadequate to support any but tentative conclusions of a very general kind. There is no single source of comparable data that would permit even the listing of cities according to surplus or deficit size.

Indeed, such a task would require a case-by-case examination of individual city financial reports and a reconciliation across cities of accounts that are based on many variations of generally accepted accounting principles. Given the weaknesses of financial information about cities, any inferences drawn (including ours) come heavily qualified.

THE AGGREGATE SURPLUS

The first task to be taken up here is to examine the significance of the large and growing surplus in the combined state-local sector as reported in the National Income Accounts (NIA). This is the surplus that has been referred to so widely as evidence of the good state of health in the finances of state and local governments. But it is one thing to speak of a healthy state/local sector overall on the basis of an NIA surplus (though we point out below why even this inference may be risky), and quite another to infer that this tells anything about cities (NIA data do not cover the local government sector alone).

Recent NIA data show a substantial increase in the state-local sector surplus—from an annual rate as low as $3.7 billion in the first quarter of 1975 to a high of $32.9 billion in the third quarter of 1977 (see National Income Accounts, Column 1, Table 1). However, this measure of surplus overstates the financial health of governments because it includes net additions to the assets of state and local government pension funds. The excess of pension fund contributions and earnings over beneficiary payments does not represent additions to fund balances available for general government operation, since the funds are essentially owned by individuals. Accordingly, these surpluses (Social Insurance Funds, Column 2) are subtracted from the NIA surplus in Column 1 to yield a remainder (General Account, Column 3) which can be viewed as an "All Other" surplus or deficit. The results of this adjustment still show a growing surplus, though of a much smaller magnitude. But the question remains whether this surplus is a good

TABLE 1

Budget Surplus in the State and Local Government Sector

(billions of current dollars)

Year		National Income Accounts*	Social Insurance Funds	General Account
1974	(1)	9.5	9.8	-0.3
	(2)	8.8	10.3	-1.5
	(3)	7.7	10.7	-3.0
	(4)	4.2	11.1	-6.8
1975	(1)	3.7	11.3	-7.6
	(2)	4.5	11.8	-7.2
	(3)	6.6	12.3	-5.8
	(4)	8.9	13.1	-4.2
1976	(1)	13.3	13.7	-0.4
	(2)	12.9	14.4	-1.5
	(3)	21.1	14.8	6.2
	(4)	26.5	15.2	11.3
1977	(1)	27.3	15.4	11.9
	(2)	25.4	15.5	10.0
	(3)	32.9	15.5	17.4
	(4)	31.1	15.7	15.4

SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business* 58 (2) (February 1978).

*Seasonally adjusted at annual rates.

indicator of the financial condition of the state and local governments sector. For several reasons, we would argue that it does not.

First, there is the question of why the "All Other" surplus has grown since the 1974–75 recession. Edward M. Gramlich has attempted to trace the behavior of the surplus by further adjusting the Column 3 measure to an estimate of the general operating account surplus.[1] His results show that a major reason for the rising surplus shown in Column 3 is the sharp decline in net construction expenditures. This decline, in turn, might be explained by postponement of capital spending attributable to some combination of a conscious effort on the part of governments to rebuild their financial strength on the balance sheet and to the peculiar effects of the Local Public Works Bill which may well have displaced own-source financing for capital projects. (The Local Public Works Bill awarded grants to state and local governments that could begin projects within ninety days. Since these were likely projects already planned for construction, the Local Public Works money was largely substitutive for local resources.)

Second, and quite apart from problems with the measure of fiscal surplus, is the question of what can we learn about individual jurisdictions from such an aggregate number. That the surpluses of those state and local governments with surpluses exceed the deficits of the deficit units does not provide useful information about the financial health of specific state and local governments. And even with a surplus measure for a specific unit, one needs to know how the surplus came about in order to know whether it really indicates a state of robust health.[2]

STATE-LOCAL RELATIONS

The concept of a local government budget deficit raises the broader issue of whether the financial condition of state governments has any meaning independent of consideration of the financial condition of their local government units. That is to say, can a state government be expected to retain a healthy surplus position while certain of its local government units are fiscally distressed? The New York State case would suggest an affirmative answer because the state is said to have a surplus in excess of $700 million while New York City has a deficit that may exceed $300 million. Recent massive amounts of direct federal aid to cities located in surplus states would suggest that federal policy makers also see a distinction between states and their substate units. From a state government view, local governments have sought and obtained substantial autonomy with respect to budget decisions. Because of this, the state may assume no responsibility for the effects of whatever may place a local unit in financial stress, though it may make it unlawful for local units to incur operating deficits.

On the other hand, there are strong arguments to suggest that states cannot long remain aloof and insulated from the problems of their local governments. Sooner or later, local fiscal stress must be felt at the state level. Even in states where local government autonomy is strongest, the government still plays a major role in determining the size and structure of the local government budget. Some state aid programs are matching and/or have tax effort maintenance provisions; state mandates are common; and most federal passthrough aid is categorical. There is, in addition, the prospect of federal assumption of some proportion of welfare costs. Should that welcome event occur, it will highlight the state-local relation. Few cities will gain direct fiscal relief since few cities currently finance a share of welfare costs. If cities reap any benefits from federal assumption it will be largely because states reallocate to the lower units some of the "freed up" resources.

Another argument for the strong linkage between state and local government fiscal health is the magnitude of the local government budgets and their claim on state government resources. Table 2 shows the budgetary importance of "hardship" and "declining" cities relative to the budgets of their respective state governments. Muller found decline in population (between 1970 and 1973) to be an indicator of future financial problems, and a city hardship indicator was developed by Nathan and Adams.[3]

These data show the substantial importance of overlapping governments in distressed areas in each of these states, even without taking account of the other economically troubled cities in these states. With a problem of this magnitude at the local government level, it is difficult to infer fiscal health either from the NIA-based aggregate budget surplus in the state-local sector or from the reported surpluses of virtually every state government.

REASONS FOR BIG CITY FISCAL PROBLEMS

Three important dimensions of the urban fiscal problem must be considered in arriving at a realistic program to strengthen

TABLE 2

Budgetary Importance of Hardship and Declining Cities

State	Budget Share 1976 (Percent)‡	Percentage of Total State Aid 1976 (Percent)§
California (San Francisco*, San Jose†)	36.33	21.09
Connecticut (Hartford†)	25.15	22.40
Florida (Miami†)	37.46	17.35
Georgia (Atlanta†)	50.48	28.96
Illinois (Chicago*†)	79.18	56.74
Indiana (Gary†)	18.31	13.93
Louisiana (New Orleans*†)	28.17	21.16
Maryland (Baltimore*†)	81.94	60.46
Massachusetts (Boston*†)	63.35	54.42
Michigan (Detroit*†)	59.41	48.74
Missouri (St. Louis*†)	65.25	54.53
New Jersey (Newark†)	42.34	31.36
New York (Buffalo*†, New York†, Rochester†)	151.32	77.32
Ohio (Cincinnati†, Cleveland*†, Columbus†, Dayton†, Youngstown†)	75.41	56.48
Pennsylvania (Philadelphia*†, Pittsburgh*)	59.52	55.05
Virginia (Richmond†)	15.55	11.54
Washington (Seattle*)	39.15	40.93
Wisconsin (Milwaukee*†)	57.25	33.59

*Declining city from Muller classification.

†Hardship city from Nathan classification.

‡Total expenditures of all overlapping governments in the Standard Metropolitan Statistical Area (SMSA) as a percentage of total state government expenditures net of intergovernmental aid to local governments.

§Total state aid to overlapping governments as a percentage of total state aid to local governments.

SOURCES: Thomas Muller, *Growing and Declining Urban Areas: A Fiscal Comparison* (Washington, D.C.: Urban Institute, 1976).

Richard P. Nathan and Charles Adams, "Understanding Central City Hardship," *Political Science Quarterly* 91 (1) (Spring 1976).

U.S. Bureau of the Census, *Local Government Finances in Selected Metropolitan Areas and Large Counties: 1975-76*. Series GF-76, No. 6 (Washington, D.C.: USGPO, 1977).

U.S. Bureau of the Census, *State Government Finance in 1976*. Series GF-76, No. 3 (Washington, D.C.: USGPO, 1977).

the financial viability of large central cities. These interrelated elements of the problem are the declining economic base of metropolitan central cities, the effects of inflation on public expenditures and revenues, and the rising cost of public service delivery. Together, they help explain what is happening to cities and why the problems facing large central cities are in general not controllable by their governments.

Declining Economic Base

A review of the New York City problem illustrates vividly the importance of relating the fiscal health of a city to the basic health of its economy.[4] Often overlooked even now in the course of debate about whether New York City deserves to be "bailed out" is the long-term deterioration in the city's economic base. Whether the city was hopelessly extravagant in its spending, as some argue, or whether New York has had special problems which have caused it to provide a broader range of services than is typical of cities generally, as others contend, the question remains: Why is New York less able to afford these things now than it was a decade ago? In our view, the fundamental answer is traceable to a steady decline in the economic base which ultimately supports jobs, income, and city revenues.

From a peak of 3.8 million in 1969, employment in New York City has declined virtually without interruption down to a current level of about 3.2 million, while employment in the nation as a whole has grown by more than 20 percent. This job loss in New York City is the result of both employment reductions by firms remaining in the city and reductions in the number of firms. The magnitude of this employment loss may be translated into some dramatic statistics. If employment in New York City had grown at the national rate between 1969 and 1978, New York City would have upwards of 750,000 more jobs than it now has.[5]

The New York City government revenue loss implied by this job loss is substantial and goes a long way toward explaining the current fiscal gap faced by the city. An earlier study prepared by the Metropolitan Studies Program at Syracuse University estimated New York City tax revenues per job to be about $820 in 1970.[6] Assuming that an additional job in 1978 would still generate only $820 in city tax revenues, New York City's unrealized job potential implies an unrealized revenue potential that would easily eliminate the city's deficit. Although these data only illustrate the approximate magnitude of job and tax losses, they do help to explain the city's growing inability to balance its budget. What this means is that a long-term solution to New York City's current difficulties must include a revitalization of the economic base or a scheme to compensate the city for this economic loss.

While it must be acknowledged that many of New York City's problems are unique and that New York City's situation is always a gross exaggeration of what is occurring in other cities, the problem of a declining economic base is present in large metropolitan core cities across the country. Older central cities, particularly those in the Northeast, have fared worse than the newer southern and western central cities, but all central cities have experienced employment suburbanization as industries have moved to newer, more spread-out facilities closer to their suburban employees. It is difficult to document these central city employment trends with available data, because no public or private agency collects data on employment in cities. Seymour Sacks has adjusted census journey-to-work data to estimate employment in city areas and finds this stereotype pattern: Between 1970 and 1975, northeastern cities lost employment at an average annual rate of 2.0 percent; midwestern cities declined at 1.6 percent annually, but southern cities grew at 3.2 percent and western cities at 1.6 percent.[7]

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 which are coterminous with counties in the United States.[8] As may be seen from Table 3, New York, Philadelphia, and St. Louis all experienced employ-

TABLE 3

Employment Growth in Ten Metropolitan Central Counties 1965-1975

	Employment				
	1965	1972	1973	1974	1975
Baltimore	345,896	359,852	366,113	331,392	310,039
Denver	199,919	274,680	297,158	275,145	262,024
Indianapolis	267,702	310,187	330,114	337,123	320,196
Jacksonville	127,140	174,886	188,952	199,844	187,122
Nashville	139,391	184,346	199,313	208,114	197,502
New Orleans	213,737	236,785	241,604	216,985	208,320
New York City	3,136,117	3,141,619	3,126,924	3,013,559	2,835,437
Philadelphia	724,161	720,054	726,914	703,747	647,298
St. Louis	358,013	351,394	357,240	330,790	292,711
San Francisco	351,635	387,967	396,538	456,991	433,944
United States	47,743,277	58,015,904	62,055,884	63,487,630	60,564,361

ment declines over the 1965-72 period, with the latter two actually being relatively more severe than New York City. 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. With the recession between 1974 and 1975, all ten counties lost employment.

The employment situation is only somewhat better in the metropolitan areas in which these ten counties are located. (The data in Table 4 are collected by the Bureau of Labor Statistics and include public-sector and proprietorship employment. Hence the data in Tables 3 and 4 are not strictly comparable.) During the 1974-75 recession, eight of the ten metropolitan areas lost employment (see Table 4). Since 1975 there has been some recovery of employment in the SMSAs with only New York City continuing to lose. However, only

Percent Growth				Central City/SMSA* Employment Ratio			
65–72	72–73	73–74	74–75	1972	1973	1974	1975
4.0	1.7	– 9.5	– 6.4	59.62	58.35	51.47	53.30
37.4	8.2	– 7.4	– 4.8	63.87	62.65	55.46	54.82
15.9	6.4	2.1	– 5.0	87.13	87.98	86.90	87.31
37.6	8.0	5.8	– 6.4	92.10	91.49	91.13	90.15
32.3	8.1	4.4	– 5.1	78.70	78.90	76.95	77.90
10.8	2.0	– 10.2	– 4.0	72.33	71.37	62.31	61.38
0.2	– 0.5	– 3.6	– 5.9	78.03	83.78	82.16	81.87
– 0.6	1.0	– 3.2	– 8.0	49.56	48.40	44.70	43.26
– 1.9	1.7	– 7.4	– 11.5	46.43	45.60	41.26	38.51
10.3	2.2	15.2	– 5.0	39.93	38.67	45.62	41.00
21.5	7.0	2.3	– 4.6				

SOURCE: U.S. Bureau of the Census, *County Business Patterns for 1965–75* (Washington, D.C.: USGPO, 1966–76).
*1975 SMSA boundaries were used for all years.

three of the ten recovered at a rate equivalent to the national rate between 1975 and the end of 1977.

While the data presented are far from conclusive, they suggest that the economic base of central cities and even the base of metropolitan areas in the declining region are not growing fast in comparison with the nation. This implies that the private economy in cities will not offer a rate of growth sufficient to sustain continued rapid city government budgetary expansion.

The Impact of Inflation

The national economy has experienced a wide variety of inflationary pressures during the past fifteen years. For several years before 1966 consumer prices rose at annual rates below 2 percent, while during 1974 they were at the double-

TABLE 4

Percentage Change in Total Nonagricultural Employment in Ten SMSAs

(Percentage Change in Employment)

	1965–72	1972–73	1973–74	1974–75	1975–76	1975–77
Baltimore	18.36	2.83	1.40	– 1.58	1.51	4.9
Denver	49.28	7.02	1.37	– 1.81	2.41	7.0
Indianapolis	18.01	4.62	2.28	– 2.35	1.91	6.6
Jacksonville	44.47	7.48	4.10	– 2.07	.39	3.9
Nashville (Davidson)	47.87	7.56	2.95	– 2.02	4.78	9.6
New Orleans	15.27	3.54	1.42	2.41	2.37	3.5
New York City	1.42	–.33	– 2.44	– 4.52	– 2.40	– 2.9
Philadelphia	13.16	1.56	.56	– 3.38	.99	2.2
St. Louis	10.94	2.46	.38	– 3.39	.80	4.3
San Francisco (Oakland)	15.39	3.92	1.76	.74	2.29	5.8
United States	21.21	4.32	1.97	– 1.77	3.10	9.3

SOURCE: 1965 data from *Employment and Earnings: States and Areas* (Washington, D.C.: U.S. Bureau of Labor Statistics, 1977), Bulletin 1370–12. 1972–76 data and monthly data from 1977 (June) from *Employment and Earnings*, September 1977. December 1977 data from *Employment and Earnings*, February 1978.

digit level of 11 percent. It is reasonable to suspect that inflationary pressures would have significant effects upon the financial fortunes of the state and local sector. Unfortunately, the exact impact of inflation of the central city fiscal situation is difficult to calculate. None of the generally available price indexes are accurate measures of changes in the cost of providing government services, and they completely ignore the impact of inflation on revenues. Inflation increases the cost of goods and services purchased by local governments as well as the nominal value of many of the tax bases that support these expenditures. That is, inflation affects property values, the value of retail sales, the nominal level of personal and corporate income, and certain other components of the state and local tax base. Of crucial importance are the relative effects of price level changes on *both* the expenditure and revenue sides of the budget.[9]

The Metropolitan Studies Program at Syracuse University's Maxwell School, under the sponsorship of the National Science Foundation, has developed a set of inflation indexes which measure the impact of inflation on both expenditures and revenues of state and local governments.[10] An analysis using these indexes reveals a variety of information about the impact of inflation upon state and local governments during the past ten years.

The period 1967–72 was one of fairly stable prices as well as very rapid growth in the state and local sector. Prices paid by both state and local governments increased by approximately 23 percent during the period. This accounted for about one-quarter of the growth of expenditures during the period. While there was some increase in real compensation, the bulk of the expenditure growth during the period could be attributed to the growth in number of employees and amounts of materials and supplies used—quantities generally associated with levels of service.

The effects of inflation on revenues during the 1967–72 period was less uniform across the state and local sector. For the local sector the revenue inflation index was slightly greater than the expenditure inflation index. More than one-third of the growth in own-source revenues at the local level could be attributed to the effect of inflation on the revenue base.

While 1967–72 saw fairly stable prices, prices behaved quite erratically between 1972 and 1976. From 1972 to 1974 the Consumer Price Index (CPI) for all goods and services rose by 17.88 percent and the Wholesale Price Index (WPI) of all commodities rose by a massive 43.42 percent. A dampening of price increases accompanied the recession of 1974–75 and the initial recovery stages in 1976. If inflation is once again accelerating as recent reports suggest, it would be especially instructive to analyze the effects of inflation since 1972 on the state and local sector.

While sufficient data are not yet available to break the total growth in expenditures and revenues down into inflation and real effects, we can determine the inflation indexes (1972 = 100) for both expenditure and revenues. These are shown in Table 5 for states and all levels of local governments for both 1974 and 1976.

The revenue inflation indexes indicate how the own-source revenue base would have increased solely in response to inflationary pressures. (Actual revenues could have grown at slower or faster rates depending upon changes in tax rates and other alterations in the tax structure.) The expenditure inflation index indicates how total expenditures in the several levels of government would need to have grown simply to keep real expenditures constant. (Once again, actual expenditures may have grown more or less rapidly as governments changed their levels and/or mix of inputs.) For example, if the estimated increase in the nominal values of municipal tax bases which occurred between 1972 and 1974 had been taxed at 1972 ef-

TABLE 5

State and Local Governments
Expenditure and Revenue Inflation Indexes, 1972–76

	Expenditure Inflation Indexes (1972 = 100)		Local-Source Revenue Inflation Indexes (1972 = 100)	
	(1) 1974	(2) 1976	(3) 1974	(4) 1976
States	125.4	140.8	116.6	128.3
Counties	125.4	140.5	116.7	133.3
Municipalities	125.4	140.6	115.4	130.7
Townships	125.6	141.5	114.8	130.7
School Districts	125.0	138.4	119.2	138.8
Special Districts	125.7	142.5	113.3	124.2
All State and Local	125.3	140.2	116.9	129.6

SOURCE: The indexes were computed using the methods and data sources noted in David Greytak, Bernard Jump, Jr., Edward Cupoli, and Richard McHugh, *The Effects of Inflation on State and Local Government Finances, 1967–1974*. Occasional Paper No. 25 (Syracuse, N.Y.: Metropolitan Studies Program, Syracuse University, 1975).

fective rates, the revenues raised by municipalities would have increased by about 15 percent (revenue inflation index 115.4, see Table 5). On the other hand, if municipalities had maintained 1972 levels of services and compensated employees and transfer recipients in accord with increases in the cost of living, expenditures would have increased by about 25 percent (expenditure inflation index 125.4). Similarly, by 1976 the indexes show that the 1972 revenue base for municipalities would have grown 30 percent over its 1972 level while expenditures would have increased 40 percent over their 1972 levels, disregarding any change in level of composition of labor and non-labor inputs.

Several interesting conclusions can be drawn from the data on Table 5. First, as measured by these indexes, the impact of inflation during the 1972–74 period was approximately equal to that which occurred during the entire previous five years, 1967–72. Second, expenditures were much more responsive to inflation than were own-source revenues at both the state and local levels during the 1972–74 period. Finally, while both indexes continued to increase during the 1974–76 period, the relative cooling of inflationary pressure did allow inflation-induced increase in state-local revenue bases to nearly keep pace with the pressures of inflation on expenditures.

Another convenient way to convey these inflationary effects during the 1972–76 period is to consider the implications of these findings in terms of the purchasing power of state and local governments. These are shown in Table 6 as purchasing power indexes for the several levels of government based on 1972 revenue bases. The period 1972–74 was especially severe for inflationary pressures on state and local governments with the purchasing power index falling nearly 7 percent. While that purchasing power index did not increase from 1974 to 1976, the overall index did not fall substantially and there was even a slight rise for municipalities.[11]

While the inflation indexes suggest that state and local sector purchasing power has fallen considerably since 1972, the actual effect of inflation may have been even more severe than those estimates. This is because the revenue and expendi-

TABLE 6

Indexes of Purchasing Power of 1972 Revenue Base*

(1972 = 100)

	(1) 1974	(2) 1976
States	92.98	91.12
Counties	93.06	94.88
Municipalities	92.03	92.96
Townships	91.40	92.37
School Districts	95.36	100.00
Special Districts	90.14	87.16
All State and Local	93.30	92.44

SOURCE: Computed from Greytak, et al., *The Effects of Inflation on State and Local Government Finances, 1967–1974*. Occasional Paper No. 25 (Syracuse, N.Y.: Metropolitan Studies Program, Syracuse University, 1975).

*1972 revenue excludes intergovernmental aid.

ture inflation indexes used here measure the potential impact of inflation on expenditures and revenues. This means that it is not necessary that state and local governments actually realize the effects that inflation has upon the revenue base. Assessment lags in property taxes would mean that the actual tax base would not expand as greatly as estimated under our inflation indexes and therefore the overall detrimental effect of price increases on the fisc would be understated. Furthermore, for declining cities it is possible that property values did not keep pace with the general rates of increase in property values experienced throughout the nation. Nevertheless, the indexes certainly suggest that a future repeat of double-digit inflation in the national economy could have adverse effects upon the fiscal health of the state and local sector.

Public Employment Costs

With a declining economic base fiscally hard-pressed cities are unlikely to be able to look to the revenue side of their budgets for much relief whether the cause of their fiscal difficulties is short-run and cyclical or more chronic. Necessarily then, absent infusions of state and federal aid, the prescription for maintaining balance in general operating budgets almost certainly will include heavy doses of policies designed to place ceilings on or even reductions in work-force size. With employee compensation accounting for well over 70 percent of cities' operating outlays, it is nothing short of delusion to believe that budget control can be accomplished without an attack on the forces that seem to drive up employment and compensation.

Examination of employment trends during the last few years does reveal a slowdown in the number of employees added to state and local government payrolls. The pattern of state and local employment during the most recent years is in sharp contrast with most of the post–World War II period, when non-federal 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 (see Table 7).

Since 1972, however, the reins appear to have been drawn on state and local government job expansion. Average annual employment growth between 1972 and 1976 fell to about one-half the rate for the ten years preceding, and in 1976 state and local government employment grew by only 1 percent. Even more drastic than the curtailment of job growth for all non-federal governments has been the abruptness with which municipalities have clamped down on their work-force growth. After growing at an average annual rate of 3.2 percent between 1962 and 1972 and another 3.9 percent in 1973, employment by municipalities grew by quite modest amounts in 1974 and 1975, actually declined by 1.7 percent in 1976, and at the end of 1976 it stood at a lower absolute level than in 1973 (see Table 8).

Anyone familiar with the enormous job cutbacks carried out by New York City might assume that these employ-

TABLE 7

Employment (Full-Time Equivalent) of Private Industry and Government, 1962–76 (Calendar Years)

(thousands)

	All Industry	Private Industry	All Government	Federal Civilian	State and Local
1962	58,463	47,261	11,202	1,806	5,932
1972	72,348	57,762	14,586	1,934	9,253
1973	75,484	60,685	14,799	1,911	9,613
1974	76,476	61,437	15,039	1,957	9,887
1975	74,290	58,958	15,332	1,984	10,212
1976	76,728	61,343	15,385	1,993	10,315
		Average Annual Growth Rates			
1962–72	2.1%	2.0%	2.7%	0.7%	4.5%
1972–73	4.3	5.1	1.5	− 1.2	3.9
1973–74	1.3	1.2	1.6	2.4	2.9
1974–75	− 2.9	− 4.0	1.9	1.4	3.3
1975–76	3.3	4.0	0.3	0.5	1.0

SOURCES: U.S. Department of Commerce, Office of Business Economics, *The National Income and Product Accounts of the United States, 1929–1965*, Table 6.4. *Survey of Current Business*, July 1976 and July 1977, Table 6.8.

ment reductions were swamping the employment statistics for all municipalities, producing a statistical aberration. Yet inspection of the employment records for large cities shows that actual reductions in large city work forces are not uncommon and have not been for several years. But though the phenomenon of shrinking municipal government work forces has been manifesting itself in several major cities for longer than just the last couple of years, 1976 (the last year for which data are available) was a noteworthy year in that more than half of the twenty largest cities in the United States reduced the number of employees on their payrolls (see Table 9).

Although it would require detailed city-by-city analysis to determine why the number of large cities involved in employment reductions has increased, it seems logical on an a priori basis to infer that this reflects attempts to compensate

TABLE 8

Employment (Full-Time Equivalent) of State and Local Government, 1962–71

	Average Annual Growth Rates			
	State and Local	State	Local	Municipalities
1962–72	4.5%	5.3%	4.2%	3.2%
1972–73	3.7	2.4	4.2	3.9
1973–74	2.9	4.2	2.4	0.9
1974–75	2.5	3.4	2.2	0.7
1975–76	1.1	2.0	0.7	– 1.7

SOURCE: U.S. Bureau of the Census, *Public Employment in 1976*, Series GE76-No. 1 (Washington, D.C.: USGPO, 1977).

TABLE 9

Employment (Full-Time Equivalent) of Large Cities, 1962–76

	1976	1975	1974	1973	1972	1962
Baltimore	39,278	40,522	38,103	37,538	37,481	26,630
Boston	24,909	24,895	23,373	23,673	24,765	20,269
Cleveland	10,049	12,637	13,260	13,084	12,596	13,079
Chicago	N.A.	48,799	44,416	45,811	45,236	39,008
Dallas	13,026	13,320	13,078	13,356	12,894	7,456
Detroit	20,059	20,511	27,017	25,371	26,583	25,847
Honolulu	8,932	8,905	7,520	7,551	7,733	4,905
Houston	15,082	14,258	11,937	11,839	11,520	8,285
Indianapolis	11,287	11,474	9,988	9,589	7,014	3,754
Los Angeles	44,503	46,929	44,560	44,038	42,689	34,702
Memphis	21,883	21,708	22,114	21,227	22,318	15,403
Milwaukee	9,324	9,687	9,699	9,140	9,388	9,505
New Orleans	N.A.	10,544	10,168	10,398	10,958	8,766
New York	300,591	347,686	395,430	395,640	373,292	267,973
Philadelphia	37,274	37,981	37,124	36,509	36,890	29,741
Phoenix	7,792	7,363	6,932	6,940	6,159	3,674
San Antonio	10,784	11,068	10,356	9,948	9,359	6,849
San Diego	7,091	6,923	6,801	6,511	6,856	4,400
San Francisco	21,599	21,555	21,482	21,046	20,943	16,088
Washington, D.C.	45,249	45,801	50,082	49,273	49,324	27,063

SOURCE: Compiled from U.S. Bureau of the Census, *City Employment in 1962, 1972–1976* (Washington, D.C.: USGPO, 1963–77).

for the combined effects of economic base deterioration and the shorter-run fiscal pressures brought about by abnormally severe inflation and a recession. It is virtually axiomatic that many of the country's largest cities have long been struggling to keep their budgets under control as they witness an exodus by employers and higher income residents. It is reasonable to suspect that inflation and recession hit the public sectors of larger cities harder than they did other types of government, thereby adding another reason why municipal employment had to carry a relatively larger burden of adjustment than did state and local public employment generally.

Some commentators on state and local government fiscal problems make much of what are claimed to be the "excessive" compensation levels for public employees. In this context, *excessive* appears to have several meanings, one of which is the notion that when a governmental unit in budgetary difficulty not only does not reduce compensation levels but actually grants an occasional increase in salaries or fringe benefits, the action is excessive on its face. But in the absence of such practices on a customary basis, even in the private sector, and in view of the not insignificant cost of living increases being borne by employees, it seems unrealistic to establish such benchmarks for determining whether compensation levels are reasonable or excessive. Nevertheless, it is appropriate to inquire whether public employee compensation is out of line with private sector employee compensation and whether governments are succeeding in curbing compensation growth.

Although average wage levels in state and local government for some time have exceeded private industry wage levels, the gap has been narrowing and is now quite small (see Table 10). Yet, 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. But the explanation for governments' apparent inability to achieve budget-

TABLE 10

Average Annual Wages and Salaries per Full-Time Equivalent Employee by Industry, 1972–76 (Calendar Year)

Year	All Industry	Private Industry	Federal Civilian	State and Local Government
1962	$ 5,064	$ 5,082	$ 6,239	$ 5,017
1972	8,760	8,590	12,679	8,916
1973	9,290	9,106	13,497	9,505
1974	9,991	9,832	14,112	10,063
1975	10,845	10,690	15,195	10,862
1976	11,623	11,486	16,201	11,572
		Average Annual Growth Rates		
1962–72	5.6%	5.4%	7.4%	5.9%
1972–73	6.1	6.0	6.5	6.6
1973–74	7.5	8.0	4.6	5.9
1974–75	8.5	8.7	7.7	7.9
1975–76	7.2	7.4	6.6	6.5
		Average Growth per 1 Percent Increase in CPI		
1962–72	1.70%	1.60%	2.20%	1.80%
1972–73	.98	.97	1.05	1.06
1973–74	.68	.73	.42	.54
1974–75	.93	.96	.85	.87
1975–76	1.24	1.28	1.14	1.12

SOURCES: U.S. Department of Commerce, Office of Business Economics, *The National Income and Product Accounts of the United States, 1929–1965*, Tables 6.2 and 6.4; U.S. Bureau of Economic Analysis, *Survey of Current Business*, July 1976 and July 1977, Table 6.9.

ary economies by checking wage growth is probably not hard to find.

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 work-force 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 work-force size and to grant no wage increases to remaining employees and still end up with a higher average wage for the work force. Second, the years 1972 to 1976 were marked by the severest 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 Consumer Price Index 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. But the available data do not support such an assumption. With a few exceptions, most large cities' total payroll expenditures and average wages have grown at a considerable rate. In fact, for thirteen of the twenty cities in Table 11, the rate of increase in annual earnings between 1975 and 1976 exceeded the rate of increase in wages and salaries for the state and local sector. Furthermore, several of these have been considered distressed cities.

To what extent these increases are the result of the same averaging effects discussed above is a matter for speculation—though the large size of some cities' increments to *total* payrolls would suggest that considerably more than the arithmetic of averaging has been at work (see Table 12). 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 the rapid growth in city wage expenditures would be beyond the scope of this chapter, the matter deserves careful study.[12]

Employee compensation expenditures do not stop when the wage bill is paid. Supplements or fringe benefits such as pensions, social security coverage, and health and hospital in-

TABLE 11

Average Annual Earnings per Full-Time Equivalent Employee in Large Cities, 1972–76*

	1976†	1975	1972	Percent Annual Increase 1975–76	Percent Average Annual Increase 1972–75
Baltimore	$10,656	$10,068	$ 9,948	5.8	.4
Boston	13,068	11,808	9,708	10.7	7.2
Cleveland	14,184	12,648	10,560	12.1	6.6
Chicago	13,800	13,800	11,640	0.0	6.2
Dallas	12,468	11,448	8,328	8.9	12.5
Detroit	17,724	15,504	12,288	14.3	8.7
Honolulu	13,164	11,832	9,936	11.3	6.4
Houston	12,324	11,088	8,664	11.1	9.3
Indianapolis	9,252	8,460	7,920	9.4	2.3
Los Angeles	17,760	16,260	13,764	9.2	6.0
Memphis	10,476	10,236	6,948	2.3	15.8
Milwaukee	14,940	13,548	12,048	10.3	4.2
New Orleans	8,100	8,100	6,852	0.0	6.1
New York	15,384	13,944	11,532	10.3	7.0
Philadelphia	14,148	14,100	11,376	.3	8.0
Phoenix	14,400	12,468	9,372	15.5	11.0
San Antonio	11,844	10,500	8,616	12.8	7.3
San Diego	15,732	14,928	11,436	5.4	10.2
San Francisco	15,192	15,120	12,816	.5	6.0
Washington, D.C.	15,792	14,664	9,384	7.7	18.8

SOURCES: U.S. Bureau of the Census, *City Employment in 1975, 1976*, Table 4; U.S. Bureau of the Census, *Local Government Employment in Selected Metropolitan Areas and Large Counties: 1972*, Table 4.

*Includes all employees other than teachers.

†Equals October earnings multiplied by 12.

surance add considerably to an employer's costs. The costs associated with providing such supplements to employees have been growing faster than wages in private industry and in federal, state, and local government. And despite the fact that supplement costs per employee for private industry and for state and local governments are dwarfed by supplement cost

TABLE 12

Personal Service Expenditures of Large Cities, 1962-76

(thousands of dollars)

	1976	1975	1974	1973	1972	1962
Baltimore	$436,807	$436,790	$389,195	$361,797	$365,812	$128,500
Boston	402,483	354,871	297,959	293,947	243,380	108,500
Cleveland	138,765	156,952	146,912	129,493	126,830	75,350
Chicago	699,401	677,907	666,086	622,473	567,484	258,500
Dallas	161,019	139,044	125,965	111,241	98,926	35,950
Detroit	394,492	376,835	338,390	321,528	276,449	150,500
Honolulu	98,704	90,846	86,478	73,984	71,978	27,530
Houston	164,119	134,259	115,874	104,349	95,141	39,450
Indianapolis	110,800	87,892	84,377	67,656	67,999	16,750
Los Angeles	788,547	720,442	617,166	585,824	572,071	248,500
Memphis	215,736	205,068	188,053	166,836	169,067	66,350
Milwaukee	132,532	118,840	112,333	116,672	97,814	55,750
New Orleans	106,624	98,457	86,573	78,723	71,240	36,950
New York	5,717,787	5,870,806	6,059,080	5,159,398	4,193,104	1,652,000
Philadelphia	529,264	467,672	434,925	422,057	386,915	148,500
Phoenix	110,480	98,034	85,962	74,798	63,220	15,950
San Antonio	113,742	93,977	83,216	74,116	66,310	29,250
San Diego	104,074	92,586	84,252	65,349	59,870	27,550
San Francisco	330,804	283,902	290,506	269,365	252,873	103,500
Washington, D.C.	769,161	716,965	602,768	572,511	507,223	12,650

SOURCE: U.S. Bureau of the Census, *City Government Finances* (1963, 1973-77), Table 5.

for federal employees, the approximately $1850 average 1976 outlay by states and local jurisdictions (an amount that was equivalent to about 16 percent of average earnings) makes supplements a significant item in government budgets (see Table 13).

The importance of trying to control the cost of fringe benefits is even more obvious when it is recognized that the $1850 per employee for supplements to basic wages understates the true cost of fringes. That is to say, an employee receives additional fringe benefits in his paycheck in the form of paid vacations, holiday pay, sick leave, and so forth. When the cost of this pay for time not worked is subtracted from

TABLE 13

Average Annual Supplements to Wages and Salaries per Full-Time Equivalent Employee by Industry, 1962–76 (Calendar Years)

	All Industry	Private Industry	Federal Civilian	State and Local Government
1962	$ 471	$ 482	N.A.	$ 431
1972	1,124	1,150	$1,497	1,110
1973	1,298	1,331	1,689	1,248
1974	1,460	1,485	2,006	1,437
1975	1,677	1,706	2,442	1,619
1976	1,882	1,904	2,809	1,848
	Percent Average Annual Growth Rates			
1962–72	9.1	9.1	N.A.	9.9
1972–73	15.5	15.7	12.8	12.4
1973–74	12.5	11.6	18.8	15.1
1974–75	14.9	14.9	21.7	12.7
1975–76	12.2	11.6	15.0	14.1
	Percent Average Growth Per 1 Percent Increase in CPI			
1962–72	2.8	2.8	N.A.	3.0
1972–73	2.5	2.5	2.1	2.0
1973–74	1.1	1.1	1.7	1.4
1974–75	1.6	1.6	2.3	1.4
1975–76	2.1	2.0	2.6	2.4

SOURCES: U.S. Department of Commerce, Office of Business Economics, *The National Income and Product Accounts of the United States, 1929–1965, Tables 6.4 and 6.7. Survey of Current Business,* Tables 6.5, 6.6, and 6.8.

wages and added to the cost of supplements to gross wages, the actual cost of fringe benefits for the typical municipal employee is likely to be equivalent to between 40 and 50 percent of pay for time worked, a share that is considerably higher than the share typical of private industry (see Table 14). Whether municipalities' fringe benefits are excessive or private industries' inadequate is not a matter to be explored here; the important point for present purposes is simply that

TABLE 14

Annual Pay for Hours Worked and Employer Cost for Fringe Benefits, Employees of Selected Municipalities and All Private Industry, 1973 and 1975

	Annual Pay for Hours Worked			Employer Cost of Fringe Benefits			Fringe Benefit Cost as a Percentage of Pay for Hours Worked	
	Amount		Percentage Change	Amount		Percentage Change		
	1973	1975	1973–75	1973	1975	1973–75	1973	1975
Police	$ 9,170	$10,699	16.7	$3,878	$5,002	29.0	42.3	46.8
Fire	8,973	10,194	13.6	3,696	4,812	30.2	41.2	47.2
Sanitation	6,868	8,232	19.9	2,737	3,567	30.3	39.9	43.3
Other General Municipal Employees	7,409	8,182	10.4	2,730	3,215	17.8	36.8	39.3
All Private Industry	8,167	9,318	14.1	3,007	3,713	23.5	36.8	39.8
All Manufacturing Industry	8,092	9,126	12.8	2,907	3,651	25.6	35.9	40.0
All Non-manufacturing Industry	8,238	9,571	16.2	3,151	3,799	20.6	38.2	39.7

SOURCE: Edward H. Friend and Albert Pike, III, *1975 National Survey of Employee Benefits for Full-Time Personnel of U.S. Municipalities* (Washington, D.C.: Labor Management Relations Service of the National League of Cities, 1977), pp. 48–49.

fringe benefits have a budgetary significance far greater than is implied by the limited attention they typically receive.

This is not to say that fringe benefits are totally beyond the purview of officials charged with expenditure control. Appropriately, the two most expensive benefits—employer pensions and social security coverage—have begun to receive widespread publicity. Currently, some 70 percent of all state and local government employees work for jurisdictions that participate in the social security programs. On occasion some state or city proposes to withdraw from participation as a way to check expenditures, the most highly publicized example being New York City's 1975 announcement of intent to withdraw (which subsequently was cancelled). There could be an upsurge of interest in withdrawing from social security participation as a result of legislation in December 1977 that raised both the social security tax rate (in several steps over a number of years) and the level of earnings subject to the tax (also in several steps and in a fashion that automatically boosts the level as average earnings increase).

Although the costs of social security coverage are high relative to most other fringe benefits and likely to rise at an increasing rate in the future, it is the rare municipality that does not spend even more on the provision of pensions for employees. Not only do pension costs dominate in the total cost of fringes furnished by state and local governments, they also have been growing 75 percent faster than average state/local salaries since 1972 (see Table 15). As it is well known that many jurisdictions long have failed to contribute sufficiently to cover the value of pension benefits accruing to current members of the work force, it is practically certain that employer contributions for pensions will continue to grow relative to salaries. Thus it is unlikely that many municipalities will find budget relief in the domain of their pension benefit programs.

THE CURRENT FISCAL SITUATION

There have been no more New Yorks in the sense of defaults, federal emergency loan guarantees, or the other trappings

TABLE 15

Personal Service Expenditures and Employer Contributions for Employee Retirement Programs, State and Local Governments 1962–76

	Personal Service Expenditure per Employee	Employer Retirement Contributions per Employee	Retirement Contributions as a Percentage of Personal Service Expenditures
1962	$ 4,822	$ 316	6.6
1972	8,518	622	7.3
1973	8,983	694	7.7
1974	9,547	794	8.3
1975	10,514	903	8.6
1976	11,412	1,029	9.0
	Percent Average Annual Growth Rate		
1962–72	5.9	7.0	
1972–73	5.5	11.6	
1973–74	6.3	14.4	
1974–75	10.1	13.7	
1975–76	8.5	14.0	

SOURCES: U.S. Bureau of the Census, 1972 Census of Governments, *Vol. 6, Topical Studies, No. 4: Historical Statistics on Government Finances and Employment,* Tables 1 and 17; ibid., No. 1: *Employee Retirement Systems of State and Local Governments,* Table 3; *Governmental Finances* (selected years), Table 5; *Public Employment* (selected years), Table 2; *Finance of Employee-Retirement Systems of State and Local Governments* (selected years), Table 1.

that accompany the collapse of a city's financial operation. Somehow, in the face of declining economic base, inflation, and rising public employment costs, cities have managed to stave off the most obvious manifestations of true financial crisis. It would seem valuable to identify those compensating factors which have allowed even the most distressed cities to remain solvent. In our judgment the most important of these factors are national economic recovery, increased direct federal assistance, and service level reductions and deferred expenditures.

Economic Recovery

There can be no question that the recovery of the national economy, with lower rates of both inflation and unemployment, has played an important role in maintaining the fiscal viability of large cities. It is important to point out, however, that even with recovery central cities may not regain former levels of economic activity as rapidly as suburban areas, and cities in the Northeast and industrial Midwest may gain relatively less and recover more slowly than cities in other parts of the country.

There are a number of a priori reasons why core areas do not share equally in national growth during periods of recovery. During a recession, industries with declining employment reduce activities relatively more where operating costs are higher and where physical plant is oldest (i.e., in declining regions generally and in central cities specifically). The process does not reverse itself during the recovery. Expansions have been occurring where comparative costs are lowest—in the growing regions, suburbs, and nonmetropolitan areas. The same pattern appears true with respect to the birth and death of firms. Firms die rapidly in the central city during recession, but new firms open more rapidly in suburbs during recovery.[13] As a result, one would expect central city areas to suffer greater employment losses during a recession and make less employment gain during a recovery than suburban areas. The problem of central city failure to recover is multiplied by a location in the Northeast or industrial Midwest. The manufacturing-dominated urban economies which face high production costs, particularly for energy, are likely to share least in a recovery.

Unfortunately, any discussion about central city economic performance during the recovery must be heavily speculative. There simply are not adequate data covering the last thirty months that would enable one to track the changes in central city employment and income through the most recent recession and the subsequent recovery. However, the relatively poorer performance of central cities during the 1969–71 recession and recovery is borne out by a study prepared for HUD by the Oak Ridge Laboratories.[14] Although the 1969–71 recession was less severe, and the 1971–72 recovery not as sustained as the latest recession/expansion, the results of the Oak Ridge study support the basic premise that private sector employment in core areas declines more during recession and recovers less during expansion. The data in Table 16 show that only core counties (metropolitan counties containing the central business district of a central city and located in SMSAs with population in excess of 100,000) had absolute losses in employment during the 1969–71 period, and that during the recovery they gained employment at about half the rate of other counties (i.e., other central counties, suburban counties, and nonmetropolitan counties). Even these results likely overstate the relative performance of central city economies since the central county often contains suburban areas which are growing more rapidly than the central city. In sum, the lesson from the last cycle is that core areas do gain in the absolute from national growth, but relative to the rest of the country they continue to fall behind..

While core areas generally will benefit least from the recovery, some central cities will benefit a great deal less than

TABLE 16

Annual Rate of Growth of Total Private Employment by Type of County for March 1969 to March 1971 and for March 1971 to March 1972

Type of County	Annual Growth Rate 1969–71	1971–72
Core	–0.9	2.3
Other Central	0.6	4.7
Suburban	0.1	4.3
Nonmetropolitan	0.4	5.6

SOURCE: Computed from *County Business Patterns* as reported in Kathryn Nelson and Clifford Patrick, *Decentralization of Employment During the 1969–1972 Business Cycle: The National and Regional Record* (Oak Ridge, Tenn.: Oak Ridge National Laboratory, June 1975), p. 15.

others during the recovery. Particularly those central cities in growing regions and those with areawide boundaries (county or metropolitan areas) should benefit proportionately more. The Oak Ridge study also showed that core counties in the Northeast and Midwest Census regions fared worse in the last recession *and* recovery. These regions contain the bulk of the most "distressed" of American cities, by anyone's index.

Ideally, we would trace the pattern of core areas through the present cycle to determine if the thesis that core areas in the Northeast and Midwest regions recover least and slowest is a valid one. Data are not available for such an analysis, but the comparison presented above (see Table 3) shows that employment growth in ten central counties and their SMSAs fits this pattern for the recession period; during the recovery the SMSA employment trends also fit this pattern (see Table 4). Although this is only superficial evidence, it is alarming because it suggests that the most distressed cities and areas share least in the recovery.

Direct Federal Assistance

A major reason why large central cities have performed above expectations is the massive inflow of direct federal aid to cities. In many cases direct federal grants now account for more of the financing of total current expenditures than do own-source revenues (see Table 17).

Much of this increase in direct aid is the Carter Administration's Economic Stimulus Package, the key elements of which are Anti-recession Fiscal Assistance (ARFA), Local Public Works (LPW), and Public Service Employment (Comprehensive Employment and Training Act—CETA). A recent U.S. Treasury report describes the aid flow under these three programs to forty-eight large city governments, classified by degree of fiscal strain (see Table 18).

These data leave little doubt about the critical importance of these programs to the basic financial health of large city governments. To say that they are being relied on to finance current operations is a gross understatement. Their re-

TABLE 17

Direct Federal Aid as a Percentage of Own-Source General Revenue, Selected Cities and Fiscal Years, 1957–78

City	Fiscal Years, Percentage				Per Capita Federal Aid‡	
	1957	1967	1976	1978 Est.	1976	1978 Est.
St. Louis	0.6	1.0	23.6	56.1	$ 86	$228
Newark	0.2	1.7	11.4	64.2	47	291
Buffalo	1.3	2.1	55.6	75.9	163	239
Cleveland	2.0	8.3	22.8	60.3	65	190
Boston	*	10.0	31.5	30.2	204	219
Unweighted Averages	0.8	4.6	29.0	57.3	113	233
Baltimore	1.7	3.8	38.9	46.4	167	225
Philadelphia	0.4	8.8	37.7	53.8	129	204
Detroit	1.3	13.1	50.2	76.8	161	274
Chicago	1.4	10.9	19.2†	42.1	47	117
Atlanta	4.3	2.0	15.1	40.0	52	167
Unweighted Averages	1.8	7.7	32.2	51.8	111	197
Denver	0.6	1.2	21.2	25.9	90	150
Los Angeles	0.7	0.7	19.3	39.8	54	134
Dallas	0.0	*	20.0	17.8	51	54
Houston	0.2	3.1	19.4	23.8	44	71
Phoenix	1.1	10.6	35.0	58.7	57	117
Unweighted Averages	0.5	3.1	23.0	33.2	61	105
Unweighted Average of 15 Cities	1.1	5.2	28.1	47.5	95	179

SOURCES: ACIR staff computations based on U.S. Bureau of the Census, *City Government Finances in 1957, 1967, and 1976.* Estimated city own-source general revenue for 1978 based on annual average increase between 1971 and 1976. Direct federal grants to each city for fiscal 1978 based on ACIR staff estimates of the federal stimulus programs for 1978 and Richard Nathan's estimates for all other federal aid in fiscal 1978 as set forth in his testimony before the Joint Economic Committee on July 28, 1977. (As reported in *Intergovernmental Perspective,* Winter 1976).

*Less than 0.5%.

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

‡Based on 1975 population.

duction, in money or real terms, would seriously compromise the financial position of these governments.

TABLE 18

Allocations of ARFA, LPW, and CETA to 48 City Governments Classified by Level of Fiscal Strain, 1978 Estimates

Per Capita Total ESP Allocations	High	Moderate	Low	All 48	National
ARFA	$ 28.65	$12.01	$ 6.65	$18.04	$14.68
LPW	34.76	23.08	13.16	26.60	27.53
CETA	42.74	37.96	30.74	38.69	30.28
TOTAL	$106.15	$73.77	$50.55	$83.33	$72.49

ESP Allocations as Percentage of Adjusted Own-Source Revenues	High	Moderate	Low	All 48	National
ARFA	2.5	1.8	1.3	2.1	1.6
LPW	3.7	5.0	4.0	4.1	3.7
CETA	4.7	7.2	8.0	5.8	4.1
TOTAL	10.9	14.0	13.3	12.0	9.3

SOURCE: U.S. Department of the Treasury, Office of State and Local Finance, *Report on the Fiscal Impact of the Economic Stimulus Package on 48 Large Urban Governments*, January 23, 1978.

Service Level Cutbacks and Deferred Expenditures

A third reason for the relatively strong performance of central cities since 1974 has been their willingness to attempt to hold the line on costs and even to try to cut back on public service levels. This has taken a number of forms, including reductions in public employment, elimination of certain programs, and the deferral of capital facility maintenance and replacement. While such measures temporarily enhance the fiscal health of these cities, they also mean that the most dependent segments of the population receive lower quantities and/or qualities of public services. They also mean that the cities will have to contend later with even greater levels of obsolete and deteriorated capital stock. It is questionable whether such postponements work to the long-term benefit of anyone.

THE OUTLOOK

Projecting the future fiscal health of the state and local sector, especially for those governments within the declining regions, is a hazardous exercise. However we see three general areas of special importance for the likely course of events—the state of the economy in the region, the likelihood of continued substantial infusions of federal aid, and the ability of governments to continue to cut services through employment reduction and capital expenditure deferrals.

State of the Regional Economy

The two major determinants of the general health of a regional economy are the expansion of economic activity in the area and the rate of increase in prices. It is not clear that the future course of either factor will work to the advantage of distressed regions. While federal policies such as massive tax cuts may stimulate the national economy enough to sustain economic growth through 1980, whether the Northeast, and especially the large cities in the region, can share fully in this growth seems doubtful in the absence of other more region-specific stimulative policies. It is difficult to presume that general economic growth will reverse or even slow the flow of employers and population from the "snow belt" to the "sun belt." Furthermore, as noted above, general economic expansion is unlikely to increase the relative attractiveness of large cities as sites for private employment vis-à-vis suburban or outlying areas.

If continued economic expansion heats up the economy enough to set off a new surge of inflation at rates close to those experienced in the early part of the decade, there seems to be little doubt that the Northeast will be able to avoid "sharing" in such inflation. Unfortunately, as our analysis for the previous inflationary period has shown, public sector expenditures were more responsive to these pressures than were own-source revenues. Thus we would argue that while the expansionary macro effects are unlikely to be uniform across regions or across central city and non-central city areas, price increases in the U.S. economy are much more likely to be uniformly distributed across these regions and subregional areas.

This implies that continued national recovery, while it may improve the fiscal position of local governments in the Northeast and Midwest by stimulating employment and income, will probably have an even more favorable effect on the local government fisc in the growing regions. Hence continued growth in the economy over the next three to five years will likely result in pressuring governments in the declining region to reduce their public sectors to a size more commensurate with the taxpaying ability of their private sector resources. If the rate of inflation does not increase, this may mean tax reduction, but if prices rise, any employment reduction savings may be offset by an acceleration of compensation rate increases.

Federal Aid

Probably the major factor influencing the fiscal performance of governments in the Northeast region is continuation of the massive inflow of direct federal aid to cities. In 1978, CETA, local public works, and countercyclical grants were distributed in above-average per capita amounts to governments in the Northeast and Midwest. To give some idea of the current importance of these programs, Treasury estimates for the forty-eight largest cities show that withdrawal of all three programs would call for a tax increase equivalent to 16 percent of own-source revenue or an equivalent reduction in expenditures.[15]

The entire stimulus program is due to expire at the end of September 1978—though we choose not even to contemplate the effects if the program is permitted to expire.

The Potential for Service-Level Reductions

If the pattern of the past three years continues, local governments will continue to reduce employment, postpone capital spending, and cut back services. If inflation rates do not accelerate substantially, tax cuts may also occur. State and local policy makers are becoming increasingly sensitive to the charge (substantiated or not) that a major cause of the relative decline of the region is due to the relatively high taxes already borne by residents and firms, an example being the recent move by the New York State legislature to decrease income tax rates, especially in the upper income brackets, in hopes of encouraging executive decision-makers to remain within the state. While tax bases may expand as the general economic condition of the region improves, it is unrealistic to expect that these policy-makers will further increase tax rates. The real issue is whether expenditure growth can be controlled enough to permit tax reduction.

On the expenditure side there are also major dilemmas in the face of fiscal pressures. While cutbacks in public employment levels constitute one option that apparently is being used, unless major increases in the productivity of the remaining employees can be attained, the quantity and/or quality of public service outputs are likely to suffer. Furthermore, this policy option ignores the resistance from public employee organizations to further cutbacks in the levels of such employment and relatively low increases in compensation. As well, there is the major public policy question of the equity effects of such cutbacks since the primary beneficiaries of such services, especially in the central cities, tend to be economically disadvantaged.

Some observers hope that decreased expenditures can be achieved via decreased or smaller increments in compensation levels. But this too seems unlikely in the near future, especially if inflationary pressures and/or increases in real wages are experienced in the private sector. Even if some public employee organizations have moderated their demands during the recent past in response to fiscal pressures, it is unlikely that such restraints can continue for long into the future.

Finally, some non-labor expenditures, especially capital spending, might be further delayed; however, the effectiveness of such restraints is quite questionable. Deterioration of capital facilities such as public transportation, bridges and high-ways, sanitation facilities, and water production facilities not only have deleterious effects on service levels but also may tend to speed up the exodus of the economic base from the cities. Likewise, price increases in non-labor inputs which most likely have low elasticities of demand tend to make even current non-labor expenditures difficult to cut back.

Summary

There is little to be optimistic about in assessing the outlook for cities in the declining regions. National recovery will not resolve the fiscal problems facing the cities, since they do not share fully in this growth. Inflation could further aggravate the problems faced by these governments by consuming savings that may come from decreases in employment and services furnished. Finally, there are limits to service level reductions in the short run. The fiscal solvency of these governments would therefore seem heavily reliant on the continued existence of substantial federal assistance.

POLICY OPTIONS: STATE AND LOCAL GOVERNMENT ACTIONS

The magnitude of the fiscal problem facing state and local governments in the declining regions suggests that remedial policy must involve all three levels of government. What we see as needed for the near future are austerity budgets at the local level, increased state government involvement in financing local government services and authorizing regional finance and governance methods, and hopefully, yet another new federalism as part of a national urban policy.

No-Growth City Budgets

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

The primary form which this adjustment will take is likely to involve changes in the level and mix of public expenditures. Planning for future growth will be replaced by planning for the conversion to a stable or very slow growing economy. This retrenchment is already taking place in the area of capital spending, where cities have postponed those kinds of capital expenditures which are effectively luxuries (e.g., municipal recreation or auditorium facilities and other municipal public buildings) as well as more essential capital projects (e.g., improvements to water and sewer systems or delaying the construction of new school buildings).

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

Finally, there are cutbacks in the level of public employment. Until the most recent recession there has been little historical evidence of large cities, especially declining cities, reducing the size of the public sector. George Peterson found that declining cities spent 60 percent more on a per capita basis for a common set of functions than did growing cities. Muller reached similar conclusions when comparing public employment levels.[16] Peterson also notes that over the 1964–73 period, city employees (per capita) increased by 41 percent while population was declining by 10 percent. Per capita employment in growing cities increased by 10 percent over the same period.

Many cities, however, did reduce employment during the recent recession and seem able to live with the smaller work force. If there was any virtue to the recession, it was that it enabled local governments to make significant reductions in the size of their operations. However, this economic and fiscal retrenchment has potential dangers because too severe a curtailment of public-sector activities may well exacerbate the growth problem. At the same time there are some potential advantages to slower growth if the government is able to mobilize its resources to take advantage of the opportunities. The problems of traffic congestion, environmental decay, and housing shortages are three examples of areas in which a period of slow growth, once the state and local economy has adjusted to it, can provide a necessary breathing space.

State Government Subsidy

A second response to the longer-term needs of central cities would be to increase state financial assistance to city governments. If one takes the lesson of the New York experience and looks ahead to potential solutions to city financial problems in general, the most logical reform will be increased participation by the state government in the delivery of urban government services. In the case of New York City, perhaps the best solution to its problems is to turn the city into a Cleveland—a city that has minimal responsibility for the delivery of social services. However, if a state assumes primary responsibility for delivering welfare, education, and health-hospital services, a new set of financing and equity issues come to the forefront. First, state governments will have to search for new resources since state assumption inevitably involves cost increments. Unless the proper choice of tax instruments is made, such state assumption may be accompanied by unfavorable consequences with regard to income distribution: if sales taxes are chosen over income taxes as the financing mechanism, tax burdens on the urban poor may rise as a result of state assumption.[17]

A second problem is the possibility that state governments may not adequately recognize the particular social service needs of the urban poor, who tend to be clustered in the central city. Population shifts, as are presently occurring, imply an increasing suburban dominance of state legislatures and less likelihood that a greater share of scarce state resources will be allocated to core cities.

Over and above these issues is the financial difficulty in which state governments are increasingly finding themselves. Rising public employee costs and increased service demands are factors that have affected state as well as city governments. In the highly urbanized states of the Northeast, where the economic base has grown slowly relative to the rest of the nation and where tax effort is already high in many cases, it is not clear that such expansions in government resources are feasible or possible. In fact, a major problem facing many state governments is how to shrink the size of what has become an overdeveloped public sector. With such financial pressure on state government budgets, the acceptance of social service financial responsibilities from cities will not be made with great enthusiasm; the maintenance of social services at adequate levels in central cities is doubtful.

PRINCIPLES OF A NATIONAL URBAN POLICY

A clear statement of the overall objectives of a national urban policy has yet to be made, especially in light of President Carter's urban policy announcement of March 27, 1978. From recent policy proposals, however, one might infer three general goals of reform.[18] The first is an equity objective to improve the relative and absolute real income position of low income residents of the central city. Proposals to improve the relative position of low-income city residents include those designed to provide jobs and improved public services to city residents, as well as programs which would eliminate or compensate for city-suburb disparities in fiscal burdens, public-service levels, and wealth.

A second general objective is to save the city as a fiscal and economic entity. This objective seems to have two components. One is a romantic notion that because of the historical importance of city life to American culture, the city ought to be preserved for future generations to enjoy. The other is the argument that an infrastructure is already in place in the city and it would be inefficient to replicate that infrastructure elsewhere while idle capacity exists in the city. Policies aimed at "revitalization" of the city through subsidies for plant location or expansion and physical renewal programs are reflections of this policy objective.

A third objective of federal policy toward cities is to improve the management capabilities of local governments. Technical assistance, longer-term planning requirements as a condition of federal aid, programs to increase citizen participation, mandated improvements in financial management, reporting, and disclosure, and better coordination of the federal grant programs as they affect cities are all part of reforms that might achieve the "better management" objective.

The equity objective is paramount and ought to dominate thinking about a federal policy toward the cities. If the increasingly used phrase "revitalizing the city" has any meaning at all, it is the need to find a way to improve the quality of life of the urban poor. In that sense, it is a means of reaching the equity objective through redistributing an increased urban income. The infrastructure argument is not based on any strong evidence. Indeed, the cost of renovating much of the obsolescent urban infrastructure may be prohibitive.

Management, efficiency, and productivity objectives are always found in statements about the goals of policy reform because of their noncontroversial nature. Moreover, management and administrative reforms have the additional desirable features of costing relatively little and being all but impossible to evaluate. While management and administrative improvements are clearly needed in American cities, they should not be as dominant an element in a new national urban policy as they were, for example, in the intergovernmental fiscal reforms of the previous administration. Indeed, the grant system reforms of Richard Nixon's new federalism succeeded well in diverting attention from the issue of income redistribution.

Problems in Formulating an Urban Policy

The problems of formulating and implementing a federal policy toward cities will surely hamper the effectiveness of any such policy. The most important of these problems stems from an ignorance of the net effect of the many federal programs and policies that now exist. The system of federal interventions is enormously complicated, administered in a piecemeal fashion, and would appear to affect urban problems on a reinforcing basis only by accident. This means that a monitoring of the net effectiveness of a set of federal policies and programs designated as a "National Urban Policy" is not possible. But the formulation of a policy toward cities cannot wait for an analysis of the net impact of all federal programs. The answer may be to monitor the objective function. If the objective is indeed the redistribution of real income to the urban poor, then it would seem possible to identify such aspects of success as improvements in public service levels in target areas and employment status changes of central city residents. Since city employment and the city fiscal situation are affected by other factors as well, such monitoring will give only an estimate of the expansion in federal activity needed to achieve the redistribution objectives.

The formulation of a workable urban policy is also hampered by the need for political compromise. In order to achieve majority coalitions, policies to benefit inner city residents and/or suburban governments and policies to rejuvenate the sagging Northeast and Midwest are more acceptable if they include additional assistance for the sunbelt states. There is probably no better example of the neutering of federal policy by compromise than General Revenue Sharing. Conceived as a device to aid the hardest-pressed local governments on a formula basis, it became a general-purpose aid package of relatively small size distributed among all general purpose state and local governments in a fashion that bears little relation to need. It is important to reconcile this tendency for compromise with the reality of limited federal resources which, to be effective, must be diverted to a limited number of areas where needs are greatest.

Finally there is the considerable difficulty of converting a fe~~deral urb~~an policy to a national urban policy. The latter would require a coördination of federal and state governments. But the federal government does not have enough leverage (or has not used it) to induce state governments to address underlying urban problems such as the fragmented structure of local government, the overassignment of social service functions to local governments, and the suburban biases of some state aid programs. As a result, state and federal programs designed to help the cities may offset each other, and federal policy has attempted to work around underlying problems (e.g., government fragmentation) rather than force major structural reforms.

Propositions for a National Urban Policy

If the time has finally come for the formation of a federal policy toward cities, two major constraints of the past must be removed. The first is the dominance of a conservative political strategy: whether a program can command majority support has too often dominated considerations about how well the program would accomplish intended goals. An effective federal strategy to aid central city residents will clearly not be politically popular. The primary direct beneficiaries of the program (some residents of some central cities in some states) constitute a minority of the U.S. population. Moreover, since resources are limited, an effective federal program will reallocate real income from a larger to a smaller sector of the population. Since most voters and legislators will not be easily convinced that the indirect benefits to them of revitalized cities are somehow greater than their perceived costs, a realistic federal policy toward the cities is not likely to be politically acceptable.

The second constraint to be removed is the limited funding traditionally afforded urban aid programs. Assuming that workable programs can be identified, large and long-term funding commitments will have to be made. Income redistribution is expensive, the fiscal problems of cities are severe, and the private sector will indeed ask a high price to relocate in the city or train disadvantaged minorities. The tendency of the past to fund "major" reforms at low levels will have to be reversed. A realistic policy must also avoid the standard but ludicrous position that somehow a set of management and coordination reforms will free up so much money that new programs can indeed be funded at low levels.

With the removal of these constraints, a federal urban policy toward cities might be constructed in the context of four sets of considerations.

The first is diversity. The very fact that the term "city" appears in so much of the discussion of a national urban policy underlines the need to consider diversity in formulating such a policy. "City" means different things in different states; and cities have problems, "distress," "hardship," and "strain" that vary widely depending on what units of measure are used to determine the relative position of the city.[19] But despite such diversity and noncomparability, limited federal resources demand that priorities for the distribution of urban aid be established—that target populations and hardship cities be identified and that the list of eligibles not be long. Whether or not the administration's definition of "hardship cities" will be defined with narrowness sufficient to be of real fiscal help remains to be seen. If political considerations result in a program that includes essentially all metropolitan area cities, then the income redistribution and fiscal relief programs will not likely have a major impact.

A second proposition is that the fiscal and economic health of central cities are not separable in that cities cannot be revitalized economically unless they are revitalized fiscally. The income redistribution objective that requires providing jobs for the urban poor and increasing the level of public services available to them is consistent with a strategy of simultaneously improving the economic and fiscal base of the city. However, federal policy must be flexible enough to differentiate between fiscal relief measures and strengthening employment opportunities for the urban poor when jurisdiction boundaries are not areawide. Labor markets are areawide, and effective job programs may not simultaneously strengthen the fiscal base of the central city government.

There are two sides to the fiscal-economic base relationship. A declining economic base impairs the capacity of the local government to provide adequate services, and the resultant eroding service levels and rising tax rates accentuate economic decline. A more effective federal view of the city fiscal crisis would be to compensate declining cities for the revenue losses due to employment declines. This compensation is more likely to be successful in the form of increased direct aids, state or federal government financial assumption, or induced regional tax base sharing than in the form of subsidies to create private sector jobs. Countercyclical aid and CETA are steps in the direction of compensating city governments for fiscal losses, though the realities of continuing city decline suggest that they may become permanent city fiscal assistance programs.

The third proposition concerns revitalizing the city economy. Effort at revitalizing the central city economy should be a part of a new federal policy toward the city. A number of important considerations might underlie that effort. The need is to create jobs for low-income city residents, not jobs in the city area. Indeed, the best employment opportunities for many inner-city blacks may well be the blue collar manufacturing sector which is increasingly located in suburban areas. If job creation programs are focused on central city location rather than central city residents, neither fiscal nor employment revitalization is likely. There were strong economic reasons for private sector movement from the central city, and subsidies of greater magnitude than heretofore discussed would be required to reverse that trend.[20]

A second important consideration regarding job creation programs in the central cities has to do with whether or not such programs will actually reach the urban poor and the employment created will be permanent rather than temporary. Subsidizing the private sector to increase investment in central city locations does not assure increased employment opportunities for the urban poor, most of whom are unskilled and unemployable. The private sector has never shown a willingness to finance training of the disadvantaged on a massive scale; hence any federal job-creation policy will have to be accompanied by substantial investments in training activities. Many would argue that it is the training activity, rather than the private sector subsidies, which will have the most beneficial long-run effects for the urban poor. Another aspect of revitalizing the city economy is identifying and subsidizing the employment advantages of the core city area. Many have suggested that the future of the core city is in the service sector, but there is too little hard evidence or research identifying specific segments of the service sector.

A fourth proposition is that National Urban Policy ought to define the role of the state government. A major mistake of the past has been a failure to coordinate federal and state programs for aiding central cities. Federal programs were structured to take two important considerations as given: (1) the fragmented governmental and financial structures of metropolitan areas; (2) the assignment of expenditure and financing responsibility between the state and its local governments. Yet fragmented local government structure is at the very heart of the urban problem, particularly in the Northeast and industrial Midwest where one would presume the most significant amount of urban aids will be targeted. To provide aid to these regions without insisting on a better balance between taxpaying capacity and expenditure requirements of local governments in metropolitan areas would be incorrect in that it would implicitly reward suburban jurisdictions who have refused to share taxpaying wealth with central cities. Put another way it would in effect constitute a penalty to governments elsewhere in the country who have taken positive steps toward urban problems by tax base sharing, regional financing, or areawide governance.

Part of federal policy toward cities should be the requirement of a state government urban policy. Two elements of such a state program are important. The first is provision for regional financing of certain important local services. The objective of income redistribution through provision of higher quality services in central cities is not compatible with high-income suburbs and low-income cities each financing their own services. Changed annexation laws, tax base sharing, regional financing, or state government direct assumption with financing based on progressive income taxation are all ways to achieve this redistribution. It is important to note that the above reforms would require legislation initiated at the state government level.

Second, with the redistribution objective in mind there needs to be a better coordination among direct federal aid to cities, federal aid which passes through state governments by mandate to local governments, and state aid programs so as to distribute the entire assistance package in a reinforcing way.

One basic principle is inescapable. A realistic federal policy toward the cities ought to accommodate the notions that economic and population decline is inevitable for many cities, that decline is not necessarily undesirable, that real income redistribution should be the ultimate objective of a national urban policy, and that such a policy can only be implemented successfully if it is an intergovernmental partnership.