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Urban Development Forecasting and Local Finances

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COMMENT ON ADAM SCHMIDT'S "URBAN DEVELOPMENT FORECASTING AND LOCAL FINANCES"

by

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I. INTRODUCTION

Mr. Schmidt deals with the important question of the integration of urban development and local finance forecasts. His discussion of the subject, though cast in very general terms, is interesting and highlights many of the problems associated with this very difficult issue. What I propose to do here is to suggest a couple of additions to Mr. Schmidt's compendium of relevant considerations, and then to comment on a pertinent issue which he has mentioned in passing, i.e., the aspects of the relationship between local finances and urban development which are peculiar to the big cities of developing countries.

II. GENERAL COMMENTS ON THE PAPER

Mr. Schmidt addresses essentially three topics: (a) the methods and problems associated with forecasting urban development; (b) the connections between overall urban development and local finances; and (c) the nature of the public policy roles implied by this connection. I would like to suggest three additions to this discussion, the first two related to (b) and the third to (c).

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1. *Demand and Supply Connections*

First, the relationship between urban development and local finances as presented in this paper implies a demand model, i.e., the local finance (particularly expenditure) implications of urban development are seen as stemming from increased or changed demands for public services. Similarly, the necessary and continuing adjustments to an obtained urban development forecast are viewed as demand-oriented—for example, "...creation of the demands for new municipal services..., quantitative decrease of certain needs in consequence of eliminating bottlenecks...".[1] The relationship between the demand for services is important in this context and appropriately discussed.

However, there are also important considerations arising on the supply side which should be dealt with. Consider the following hypothetical example. Assume two cities to be similar in their growth patterns, and individual preferences, in every respect *except* that City Alpha's growth is primarily attributable to industry sector A, whereas City Beta's growth is primarily attributable to industry sector B. Let us now assume further that the rate of compensation in A is for some reason (e.g., technological advances to increase productivity) greater than that in B, and therefore that the average wage rate in the private sector in Alpha is greater than that in Beta. Now, if the rate of migration into the two cities, the occupational and spatial mobilities of workers within the two cities, and the unemployment rates in the two cities are all equal, then some "rollout" of the private sector wage rate to the public sector might be expected. Ignoring other obstacles for the moment, it would then follow that the price of a unit of public sector labor would be greater in City Alpha than in City Beta. Further, if public sector production functions were the same in the two cities, the longer term cost of government would be higher in City Alpha, i.e., at a particular price, the producer (the city) would not deliver as much service in Alpha as in Beta.

The example presented here is, of course, extreme, in that the *ceteris paribus* assumptions are clearly unrealistic. Nevertheless, this example does suggest that supply considerations—through the development process—may exert a long-term effect on required local expenditures, and that this effect may be viewed as independent of the demand side. In fact, if preferences are allowed to vary in our

[1] See p. 422

simple model, and to the extent that there are varying income elasticities of demand for public goods, there may be later round effects on public service costs. Casual observation would suggest that there is some validity in this thesis, e.g., in the United States, policemen might be expected to make more in an autoworkers city than in a city where textile mills dominate the local economic base.

2. *Taxation and Efficiency Considerations*

The tax side has been treated in Mr. Schmidt's paper, but two extensions of his treatment might be offered. First, it may well be that a (tax-induced) long-run implication of urban development is inefficiency in resource allocation.[2] For example, it is noted that a connection between urban development and local finances forecasting is that the former implies a direct drain on local resources because of development-related projects, and a less direct effect in that future current expenditures may also rise, e.g., because of the need to maintain new development-related projects and because of changes in demand and supply conditions related to development. This implies a need for increased local government revenues which in turn usually implies increased taxes and subsequently a distortion of resource allocation. This is a particularly bothersome problem when the tax is on property and the excess burden is cast in terms of land use.

The second extension to Mr. Schmidt's discussion regarding taxation is related to the first, and has to do with the need for local governments to arrange their tax structures (as opposed to yields) to accommodate, or adjust to, the effects of changes in local economic structure which are implied by urban development. However, in so doing, a further loss in efficiency may be incurred. Nevertheless, an important part of the forecasting problem raised here involves estimating the revenue levels implied by development and estimating the effects (on yield, income distribution, and allocation) of alternative adjustments.

[2] At least in the case of capitalist or mixed economies.

3. *Interrelations Between Taxation and Development*

A third issue has to do with the public policy implications of the longer term relationship between urban development and local finance, and the fact that there is a pattern of one-way causation which must be taken into account. As pointed out in an early section of Mr. Schmidt's paper, a forecast of long-term urban development must somehow be based on assumptions about resource allocation and income distribution in the urban area. Resource allocation and income distribution, however, are partially determined by the level and structure of taxation and spending. It follows that development planning and fiscal planning are simultaneous processes. But here is one great weakness of contemporary planning—the allocation and distribution effects of tax-expenditure-debt packages are usually ignored, or no causation is assumed.

III. THE DEVELOPING COUNTRY CASE

Mr. Schmidt has raised the interesting question of how the urban finance-urban development relationship differs as between developed and less-developed countries. Here, as in his paper, there is not space for a serious treatment of the question; nevertheless, three interesting differences might be suggested.

First, in many developing countries the role of the largest city is of major importance to the nation's economy. Because of this kind of primacy, an "urban strategy" may well be an integral part of national planning, and financial ability (local plus central governments) may play an important role in determining the ability to finance the national plan.

A second difference is the nature of the importance of the allocation and distribution functions of local tax and expenditure policy. Because of housing shortages and marginal subsistence levels in big cities in developing countries, it is possible to use tax and subsidy policy to influence urban structure. For example, a relatively small change in transport user charges or a change in the property tax treatment of rent-controlled properties may have a significant effect on the location of employment and residences in the urban area. With respect to distribution, local tax policies may well have a marked effect on the amount of resources mobilized for development and may therefore be a more important consideration in long-term planning than is the case in developed countries.

Finally, there is potentially, if not actually, an acute problem of urban fiscal balance in developing countries which stems from the high rate of rural-urban migration. The imbalance may be set in governmental terms, though there remain questions of regional imbalance. In many developing countries, local government revenue-raising authority and expenditure responsibilities are rigidly defined. Such divisions between central, state, and local governments have historical roots and may well have been realistic at the time of their design. However, increasing urbanization has, in many countries, reversed this balance and left the local governments to face a long-term prospect of rapid increases in expenditure demands, but relatively little increase in revenue-raising authority or external assistance.