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The New Urban Fiscal Economics

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THE NEW URBAN FISCAL ECONOMICS

Roy Bahl

I. INTRODUCTION

Few domestic policies in the last two decades have had as uncertain a direction as that of U.S. urban policy. From the mid-1960s through the early 1970s, "urban policy" was Washington-based and premised on the view that the dominant concern was how to respond to the rural to urban population flow. Indeed, in one of its first "urban policy reports" to the nation, the newly created U.S. Department of Housing and Urban Development declared that a primary policy concern was to address this migration and then design policies to "manage the kind of development that this (urban) growth requires."[1]

By the mid-1970s, however, the growth management theme gave way to one of concentrating on urban decline and fiscal stress. The

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rural to urban migration came to at least a temporary end, and population loss joined job loss as an indicator of "urban decline." In fiscal terms, many of the nation's cities seemed ready to take the fall, a concern that was dramatized by the well publicized New York City financial crisis (1974–76). Accordingly, urban fiscal analysts turned their attention to indicators of financial emergencies in central cities and first ring suburbs, falling municipal bond ratings, underfunded retirement systems, and a deteriorating physical infrastructure. Although "urban policy" was still seen, at least in Washington, as a national policy concern, the reality of having to deal with the urban predicament became a state-local one. Thus it was New York State, not the federal establishment, that took on the job of addressing New York City problems.

By the 1980s the fiscal crisis of urban areas seemed to have faded away as a national issue. Congress not only turned away from the 1970s topics of national development banks, welfare reform, and targeted employment credits, but it also began the process of dismantling the big urban aid programs. Indeed, today's national mood has a decidedly anti-urban distress flavor. In fiscal terms this new attitude is evident in the "non-place" orientation of the Federal Tax Reform Act of 1986.

These changing circumstances set the stage for the twofold purpose of this paper. The first is to examine why the dire straits predicted in 1970 for the cities never materialized. The second is to take a closer look at one key national policy of the decade—the Federal Tax Reform Act—in terms of its potential impact on urban governments.

II. WHAT HAPPENED TO THE FISCAL CRISES?

In this paper, three possible explanations are offered. The first is that the basic problems were recession and inflation, and with the strong recoveries of the late 1970s and mid-1980s and the lower rates of inflation in most of the past decade, cities simply outgrew their problems. The second hypothesis is that the urban fiscal problem was essentially poor planning and management and during the last decade cities have found a way to live within their means and still provide adequate services. The third explanation is that cities avoided their fiscal problems by passing them on: in the forms of deferred human and physical capital investment, higher tax rates and lower urban service levels. The first two explanations suggest that cities will face the

rest of this decade and enter the era of less federal assistance and the new U.S. income tax code in reasonable shape to compete. The third does not.

The remainder of this discussion is presented in four sections. Next, we update the measures which are typically used to gauge the fiscal condition of cities and of state and local governments. We turn then to the implications of the changing U.S. economy and changing federal policy for the economic strength of large urban areas, i.e., how have urban economies benefited from the national policies of the 1980s? Third, the fiscal response of large urban governments to these economic and federal policy changes is studied, with an eye to determining whether real retrenchment has been the order of the day. Finally, this evidence is brought together in a conclusions section to consider the three hypotheses suggested above and to explore the implications for the future.

A. Trends in Fiscal Condition

There is no generally accepted measure of the fiscal health and distress of state and local governments. No matter how scientific the manipulation of the data, the final conclusion about who is distressed and who is not is partly dependent on the judgment of the analyst doing the work. Nevertheless, three general indicators of financial health seem to have held the floor during most of the past decade. These are the general surplus of the state and local government sector as recorded in the National Income Accounts (NIA), Philip Dearborn's studies of city budget conditions, and the comparative, statistical studies of fiscal and economic distress. The question we raise here is how these indicators of fiscal health and distress—which were read in the 1970s to indicate severe financial problems—have tracked during the 1980s.

1. The NIA Surplus

The most used (and misused) measure of fiscal conditions is the general surplus of state and local governments as reported in the NIA. An increase in the surplus—a measure of the excess of current revenues over total expenditures—may result because of economic growth or increased government efficiency, but one may also get to a larger surplus by raising taxes to exorbitant levels, reducing essential expenditures or deferring infrastructure maintenance.[2] Still, the surplus

measure provides some indirect evidence about fiscal health. It measures the extent to which current revenues can cover total expenditures and contribute to further improvements in public service levels, lower tax rates and debt repayment. Movements in this surplus are a rough indication of the direction of state and local government sector bugetary movements.

In fact, the size of the surplus in recent years is seen by some as an indication of the strong fiscal position of state and local governments. There has been a positive general account surplus since the second quarter of 1983, averaging $19.6 billion in 1984 (4.15 percent of total state and local government expenditures), $9.0 billion in 1985 (1.74 percent of expenditures), and $10.3 billion in the first two quarters of 1986 (1.89 percent of expenditures). This surplus position and recent tax reductions by state governments suggest that state and local governments have discretionary funds with which to support public service levels and to generally deal with fiscal problems. The question arises as to whether such a surplus is a signal that the fiscal situation of state and local governments really has improved over what it was in the 1970s.

Actually, there is nothing all that unusual or different about the size of the general surplus in the past three years—it is following the business cycle in much the same way that it has during other recent contractions and expansions. The level of the surplus during the present expansion is also in line, i.e., relative to total state and local government expenditures, the surplus has stayed in the same range as in past business cycles.

Has the state and local government surplus reacted more or less to the business cycles of the 1980s? We have calculated a kind of cyclical swing in the general surplus, i.e., the difference in the average quarterly general surplus in a contraction and that in the following expansion. The greater the swing, the more sensitive the surplus to a particular business cycle. For example, the average quarterly surplus "swung" from a negative $3.6 billion to a positive $2.0 billion during the 1969–73 business cycle (Table 1). That is, state and local governments made up the average quarterly deficit of $3.6 billion and added another $2.0 billion for a swing of $5.6 billion during this cycle. If these data are deflated and computed across business cycles, we can reach the conclusion that the surplus has been less cyclical in the 1980s than in the 1970s. This indicates a more conservative fiscal behavior on the part of state and local governments, perhaps because of painful lessons learned in the 1970s.

Another question is whether the business cycle has "hurt" state and local governments as much in the 1980s as in the 1970s. We can get to the answer with the data presented in Table 1, except we must take into account the average duration of the business cycle and calculate "net accumulation," i.e., by how much did the state and local government sector recover its deficit *and* accumulate reserves during the expansion? A larger net accumulation implies that the state and local government sector financial position was helped more by the recovery than it was hurt by the recession. This was the case during the 1973–80 cycle

Table 1. General Account Surplus of State and Local Governments: Trends and Cyclical Swing

Year: Quarter	*Amount (in billions of 1982 dollars)*	*Percent of Total Expenditures*
1980:IV	7.09	1.72
1981:IV	3.86	0.95
1982:IV	-3.82	-0.92
1983:IV	10.40	2.47
1984:IV	17.21	4.00
1985:IV	7.46	1.66
1986:I	13.22	2.92
1986:II[a]	4.11	0.89

Cycle	*Cyclical Swing (in billions)*		*Net Accumulation (in billions)*	
	In Current Dollars	*1982 Dollars*	*In Current Dollars*	*1982 Dollars*
1969:III–1973:IV	5.62	13.24	1.38	0.57
1973:IV–1980:I	8.93	13.99	19.77	24.55
1980:I –1981:III	6.92	7.52	9.11	9.93
1981:III–1986:II[a]	10.85	9.61	38.18	34.07

[a]The latest data available at the time of this writing were for the second quarter of 1986.

Sources: Department of Commerce, Bureau of Economic Analysis, *National Income and Product Accounts of the United States, 1929–76*, and *Survey of Current Business* (July 1982, 1983, 1984, 1986 and February, March and, August 1986).

when state and local governments added about $20 billion more to their surplus during the 19 quarters of expansion than they drew down during the six quarters of recession, and it is true of all four cyclical periods studied here. During the present business cycle that began in the third quarter of 1981, state and local governments have accumulated a surplus of $30 billion. This is the largest real accumulation in the last four business cycles, and moreover, it has occurred in a time when the growth in federal aid has been sharply curtailed. This would seem to be evidence of a new fiscal strength of the state and local government sector in the 1980s.

2. *Where is the Surplus?*

What we do not learn from these trends in NIA data is how these positive surpluses and accumulations are distributed across the 50 states and 30,000 local governments. In particular, we do not learn what we most want to know in this paper—how the large urban area governments have fared during the most recent expansion. The NIA are not disaggregated below the national level and no complete disaggregation of the surplus is done. There are, however, three analyses that go some way toward answering our questions. The BEA does a periodic division of the surplus among state versus local governments;[3] the National Conference of State Legislatures tracks the surplus of state governments;[4] and Philip Dearborn follows the budgetary position of a sample of large city governments.[5]

From these more disaggregated data we can learn three important things about the changing fiscal health of state and local governments during the past decade. The first is that local governments as a class have fared better than state governments, throughout the period. Local governments showed a smaller deficit during the recessions of the mid-1970s and early 1980s, and a larger surplus during the recovery of the late 1970s. During the expansion of 1976–79 the state government sector general surplus (or deficit) averaged only .01 percent of expenditures while the local government sector averaged 1.1 percent of expenditures. The story is a bit more mixed for the period of expansion since 1983. State governments' general surpluses have averaged a negative .33 percent of expenditures in 1983 and 3.97 percent in 1984, while local governments have averaged 2.41 percent in 1983 and 1.50 percent in 1984. It would appear that local governments are less affected by the business cycle due, in part, to the stability of the property tax as a revenue source.

The second finding is a very dramatic shift in the distribution among states in the size of balances held. At various times in the 1970s, Texas, Oklahoma, Alaska, and California accounted for a substantial proportion of cash balances held by the states. By the mid-1980s, the situation had changed dramatically and the large balances were held by northern states, while the farm belt and energy belt states were feeling serious budgetary pressures.

The third lesson is that large cities have built a reasonably comfortable financial position in recent years. Direct evidence about how large cities have fared may be obtained from the work of Dearborn, who for many years has been tracking their financial condition. His most recent results are particularly interesting because they suggest that large central cities have found a way to share in the growing surplus. First, it should be noted that his 30-city sample is a good representation of growth and decline conditions: 20 lost population between 1971 and 1984, the population of the entire sample shrank by 4 percent, five cities lost more than 20 percent of their populations, and five had a gain of more than 20 percent.

His analysis focuses on liquidity position, fund balances, and the gap between general fund revenues and expenditures. One clear result of his tracking is that large city budget deficits are cyclical, usually occurring in the (fiscal) year following a national recession. Thirteen of his 30 cities ran a deficit in 1976, 19 in 1980, 10 in 1981, and 16 in 1983. But in 1984, only six cities showed an operating deficit. Moreover, he finds the improvement in fiscal position to be generally widespread, as may be seen in Table 2. General fund balances as a percent of revenues more than doubled between 1976 and 1984. These results lead Dearborn to conclude that large cities were "in perhaps the best financial condition they have been in since 1971, as judged by their success in balancing budgets and maintaining balance sheet surpluses and liquidity."[6]

The National League of Cities does not reach so upbeat a conclusion as does Dearborn, but their survey of the actual and prospective fiscal condition of 660 cities in 1984–86 does not indicate a surprising fiscal strength. Their results are that well over one-half of all cities began 1986 with a general fund surplus in excess of 6 percent of total expenditures and with a revenue growth rate in excess of 6 percent during 1985.[7] Nearly 60 percent of the cities surveyed expected to use part of their existing balances to finance 1986 operations.

Table 2. Selected Major Cities' General Fiscal Condition, Balance (or Deficit)[a] as a Percent of Total Revenues

	1971	*1976*	*1981*	*1984*
New York	- 9.2	-31.1	- 0.5	0.1
Chicago	-47.5	-24.8	-10.5	- 8.5
Los Angeles	—	—	3.1	—
Philadelphia	- 6.1	-10.2	4.4	1.8
Detroit	- 3.7	- 5.6	-16.2	- 3.1
Houston	10.8	7.4	15.5	3.7
Baltimore	2.4	8.1	2.7	0.7
Dallas	4.3	6.7	6.9	5.9
Cleveland	-16.6	0.2	- 7.4	- 0.9
Indianapolis	4.5	2.7	3.8	6.1
Milwaukee	12.3	21.8	18.6	6.8
San Francisco	15.8	9.5	23.5	21.8
San Diego	7.3	8.3	8.6	9.5
San Antonio	5.7	- 3.9	10.0	6.8
Boston	13.4	-10.7	- 7.5	- 6.0
Memphis	6.7	2.7	5.0	9.3
St. Louis	- 2.9	1.2	- 0.7	0.8
New Orleans	- 1.2	4.5	8.4	2.3
Phoenix	4.4	3.0	0.1	4.4
Columbus	3.3	3.4	- 0.2	4.3
Seattle	22.9	1.3	6.3	12.3
Jacksonville	26.3	11.9	11.4	6.6
Pittsburgh	7.9	5.6	1.1	0.7
Denver	8.2	6.4	5.1	3.1
Kansas City	1.2	4.5	9.6	6.5
Atlanta	17.3	25.0	17.5	18.2
Buffalo	2.1	-15.0	- 0.3	- 0.03
Cincinnati	0.9	2.7	10.6	5.9
Nashville	6.3	16.9	6.3	4.2
Minneapolis	12.9	6.6	15.7	14.4
Unweighted Ave.	3.8	2.0	5.0	4.7

[a]Because of deficiencies in financial reporting, especially in 1971 and 1976, many balances or deficits are not in accordance with generally accepted accounting principles. *Pro forma* adjustments were made to reported balances and deficits in some cases to make them more compatible with accepted accounting principles. For 1981 and 1982 balances, the undesignated fund balance was generally used, but in some cities it was referred to as unrestricted.

Source: Philip Dearborn, "Fiscal Conditions in Large American Cities," paper prepared for National Academy of Sciences, July 1986.

3. *Fiscal Distress*

In the 1970s there was a flurry of research activity designed more to rank than to measure the fiscal and economic strain on cities. This work was stimulated by the use of federal assistance to support urban finances in the early 1970s and the need to find objective indicators of urban distress to include in the grant formulae. But perhaps more important, these studies were an attempt to show that the changing U.S. federalism and the changing structure of the U.S. economy had left some cities with an inability to provide their citizens with either jobs or an adequate level of public services. Many thought this was more a permanent than a temporary situation and that long-term federal intervention would be required.

The comparative approach is focused on urban areas, usually large cities, and attempts to measure relative economic, social, and fiscal health. The comparison usually considers more than budgetary position in trying to get a fix on the balance between resources available to the local governments and service level "needs." The specific measurements used are sometimes flawed and always debatable, but the intent of most of these studies is to identify cities whose populations have heavy concentrations of high-cost, low-income families. Despite the very great differences in approach, there has been substantial consistency in the findings. Nearly all lists of cities in trouble in the 1970s included the large cities of the North and Midwest and few southern or western cities.[8]

Katherine Bradbury, building on her earlier work with colleagues, has attempted to determine whether the distressed cities of the 1970s have realized an improved or worsened position in the 1980s.[9] She finds, essentially, that the relative position of the distressed cities of the 1970s has not changed. Her quantitative rankings show that the "distress position" generally worsened between 1975 and 1980 for cities that had declining populations, and smaller shares of their metropolitan populations, and for cities located in the North. Ladd et al. also see a worsening of fiscal distress over time.[10] They find that the expenditure needs-revenue gap of central cities has been increasing over the past two decades, and that the fiscal condition of the largest cities is far worse than that of middle- and smaller-sized cities. Even Dearborn's generally optimistic conclusions include a flag about the continuing fiscal disadvantage of northern cities. He finds continuing fund deficits, low liquidity, and/or severe revenue-expenditure balances in New York, Chicago, Philadelphia, Detroit, Boston, Cleveland, St. Louis, and

Buffalo (see also, Table 2). This leads him to conclude that cities with problem balance sheets had a hard time improving their condition, while those in a healthy condition continued to improve.

B. Cities and the Changing U.S. Economy

Much has been made of the relationship between national economic performance and the economic condition of cities. Some see the issue in terms of the very straightforward proposition that a rising tide lifts all boats. Others think that some sectors of the economy do not share adequately in national growth and would put central cities in this class. The first question to ask, then, is how have central city economies performed in the first half of the 1980s?

The national growth in income, employment, and prices is only one dimension of the changing economy which can have an important impact on city finances. It is also important to consider the effects of discretionary policy, particularly reductions in federal and state aid. Another set of potentially significant impacts relates to changes that are outside the direct control of governments: the tax limitation sentiment, the Sunbelt shift, and the increasing concentration of the poor and elderly population.

1. *The Economic Base of Urban Areas*

The 1970s were a rough period for urban economies. For the first time several metropolitan areas were losing population, urban unemployment rates were up, and the most rapid growth was outside of metropolitan areas. The problem came to a head with the recession of the mid-1970s, which had a devastating effect on the economies of many large central cities, particularly those in the older industrial region of the country. These "declining" urban areas—and there were a great many of them—did not keep up with the rest of the nation in the economic recovery of the last half of the 1970s. As a result, many large cities entered the 1980s in a quite different way than they had entered the 1970s: their per capita income advantage over the rest of the nation had fallen or disappeared, their national employment and population shares were greatly diminished, and they were looking at the prospects of more decline as the recession of 1980 began to set in.

Since fiscal collapse never came, the question we want to address here is whether the expected economic decline materialized in the 1980s. We cannot survey all cities, and, moreover, it is well known

that employment and personal income data are not available below the county level. We can, however, report the results of an analysis of the economic performance of U.S. counties and regions in the 1980s, and then turn to our own analysis of large city-counties.

Daniel Garnick's analysis of BEA's employment data series gives a good account of the transition from the 1970s to the 1980s.[11] His results, described in Table 3, show that employment in metropolitan core counties grew at a rate well below the national average between 1969

Table 3. Employment Growth by Region and County Type: for Selected Years (average annual percent increase)

	1969–79	*1979–84*
U.S.		
Total	2.16	1.38
MSA Core Counties	1.26	1.08
Mideast		
Total	0.68	1.08
MSA Core Counties	–0.96	0.25
Great Lakes		
Total	1.36	–0.38
MSA Core Counties	0.37	–0.87
New England		
Total	1.62	2.06
MSA Core Counties	1.88	2.71
Plains		
Total	2.10	0.61
MSA Core Counties	1.04	–0.13
Southeast		
Total	2.70	1.86
MSA Core Counties	2.93	2.87
Rocky Mountains		
Total	4.41	2.16
MSA Core Counties	2.36	1.44
Far West		
Total	3.36	1.97
MSA Core Counties	2.95	2.04

Source: BEA data reported in Daniel Garnick, "Local Area Economic Growth Patterns: A Comparison of the 1980s and Previous Decades," paper prepared for the National Academy of Sciences, July 1986.

and 1979.[12] The same pattern was true in the more slowly growing Mideast, Plains and Great Lakes regions, except that core county employment actually declined in the Mideast. The first part of the 1980s—plagued by two recessions—has shown a slower overall national growth and an even slower growth in core counties. This slower growth in core counties is also observed in the Mideast and in the Great Lakes and Plains regions where employment has declined. The story is quite different, however, in New England, the Far West and in the Sunbelt, where core counties have exceeded total regional growth in total employment. Core areas in the Mideast region have done better in the 1980s than they did in the 1970s, but they have not done well. In the Great Lakes region they have done worse. Journalists and politicians who have been pleased to announce the turnaround in the relative growth of regions have simply called it wrong.

These county data do not describe central *city* economies and cannot be matched with fiscal data. This shortcoming leads us to study the employment growth pattern of 10 large city-counties, a sample that gave some good insights in an earlier (1978) paper.[13] The sample has some diversity in population size and in regional location with five northern, three southern and two western cities.

One might begin such analysis by studying the pattern of employment growth in the labor market areas—approximately the metropolitan areas—as described in Table 4. All except New York experienced growth during the 1970s but the northern areas grew more slowly. All except Denver and Jacksonville had employment declines in the recession of the early 1980s. As the recovery set in, after 1983, all except the Denver area experienced growth, but the northern areas grew more slowly than the southern and western areas and generally more slowly than the rest of the nation. The story here is that the growth in metropolitan employment in the North has long lagged that in the rest of the country and this lag has continued into the 1980s.

If we consider the employment growth in the central city-counties of these metropolitan areas, the slower growth of the urban core in the older industrial region becomes more apparent. As may be seen in Table 5, four of the five northern core areas suffered an employment loss during the 1970s; only Nashville had a growth rate above the U.S. average, and every county's share of employment in its metropolitan area declined. The performance of these urban economies in the first three years of the 1980s has been similar: those in the northern region have been losing jobs and their share of metropolitan employment has

Table 4. Percentage Change in Total Nonagricultural Employment in Ten Metropolitan Areas: 1970–1985

Metropolitan Area	*1970–81*	*1981–82*	*1982–83*	*1983–84*	*1984–85*
Baltimore	1.64	–1.70	–0.47	3.87	4.09
Denver (Boulder)	4.98	1.45	3.47	3.57	–3.23
Indianapolis	2.22	–3.42	–0.88	5.39	4.12
Jacksonville	3.22	1.61	3.01	7.09	7.43
Nashville (Davidson)	3.35	–1.39	4.88	8.12	5.32
New Orleans	3.07	–1.58	–1.94	4.41	1.46
New York	–0.63	–0.12	.30	2.76	1.72
Philadelphia	0.71	–1.92	1.78	3.53	2.91
St. Louis	0.86	–1.67	1.26	4.78	3.08
San Francisco (Oakland)	2.24	–1.25	–0.49	3.85	4.31
U.S.	2.37	–1.94	1.65	4.60	3.55

Sources: Department of Labor, Bureau of Labor Statistics, *Employment, Hours, and Earnings, State and Areas, 1939–82* and *Employment and Earnings*, September 1981–1985 and March 1982–1986.

declined. New Orleans, and more recently Denver, have shown a similar pattern. The declining dominance of these counties in their own metropolitan areas is perhaps the most dramatic change described in this table. By 1983, Philadelphia, St. Louis, and Baltimore all accounted for less than one-half of metropolitan area employment.

Data problems aside, this information tells a story of little, if any, employment growth in these central city-counties in the 1980s, with especially pronounced declines in those located in the North. In the case of these particular central cities, one could not say that the economies performed better in the early 1980s than in the 1970s.

Table 5. Employment Growth in Ten Metropolitan Central Counties: 1972–1983

	Percent Growth in Employment				Central County/Metropolitan Area Employment Ration		
	1972–80	*1980–81*	*1981–82*	*1982–83*	*1972*	*1980*	*1983*
Baltimore	−1.91	−2.42	−5.15	−1.61	59.33	43.91	40.28
Denver	2.61	0.99	1.55	−4.91	69.70	55.39	51.46
Indianapolis	2.37	−4.26	−3.28	−1.71	87.13	84.01	82.78
Jacksonville	2.37	1.98	2.09	2.43	92.39	88.03	86.89
Nashville	3.49	1.27	−3.76	0.30	78.70	74.93	74.08
New Orleans	0.01	0.92	−5.43	−3.96	70.43	53.77	50.80
New York City	−0.98	0.96	−1.17	−0.33	91.21	88.41	88.14
Philadelphia	−1.62	−1.73	−4.27	−0.29	49.56	38.57	36.42
St. Louis	−2.50	−4.80	−2.61	−5.59	54.99	37.63	33.99
San Francisco	2.83	4.92	−6.83	0.66	67.34	62.64	62.41
U.S.	3.23	0.01	−0.75	−1.77			

Note: 1983 Metropolitan boundaries were used for all years.

Source: U.S. Department of Commerce, Bureau of the Census, *County Business Patterns for 1972*, 1980–1983.

2. *Federal and State Aid Policy*

Another event of major importance in the late 1970s and early 1980s was a substantial slowing of the growth in federal grants to state and local governments. The U.S. Advisory Commission On Intergovernmental Relations (ACIR) places the beginning of the slowdown at about 1978. Since then, real federal grants have fallen from $49.4 billion to an estimated $37.7 billion in 1987, and from 3.7 percent of GNP to 2.2 percent. The result of this decline is that state and local governments have become much less dependent on federal aid: from 31.7 percent of own source revenues in 1978, federal assistance is projected to drop 19.5 percent in 1987.

Even more important, the big urban aid programs—CETA, ARFA, and Local Public Works—had disappeared by the early 1980s. As may be seen in Table 6, big city governments had become greatly depend-

Table 6. Direct Federal Aid as a Percentage of Own-source General Revenue, Selected Cities and Fiscal Years: 1967–1984

	Fiscal Years, Percentage			*Per Capita[a] Real[b] Federal Aid*		
	1967	*1977*	*1984*	*1977*	*1982*	*1984*
St. Louis	1.0	27.5	22.9	$192	$155	$159
Newark	1.7	31.9	35.2	214	44	99
Buffalo	2.1	87.6	34.4	486	326	162
Cleveland	8.3	56.9	28.4	245	187	123
Boston	10.0	21.4	19.8	300	151	158
Unweighted Average	4.6	45.1	28.1	287	172	140
Baltimore	3.8	45.5	17.6	331	160	129
Philadelphia	8.8	30.1	13.3	220	156	104
Detroit	13.1	46.7	23.5	267	337	119
Chicago	10.9	30.2	32.3	122	153	130
Atlanta	2.0	13.9	15.9	78	94	126
Unweighted Average	7.7	33.3	20.5	204	180	121
Denver	1.2	21.1	8.8	155	117	87
Los Angeles	0.7	24.3	13.8	105	78	72
Dallas	0.0	15.8	9.4	61	56	50
Houston	3.1	14.4	8.4	48	71	46
Phoenix	10.6	37.9	22.3	92	95	93
Unweighted Average	3.1	22.7	12.5	92	83	70
Unweighted Average of 15 Cities	5.2	33.7	20.4	$194	$145	$110

[a]Based on 1980 population figures.
[b]In 1982 dollars.

Source: U.S. Department of Commerce, Bureau of the Census, *City Government Finances in 1966–7*. 1980–1, 1981–2, 1983–3, 1983–4.

ent on federal assistance in the 1970s. For example, St. Louis, Buffalo, Chicago, Baltimore, and Detroit among this group all received $40 in direct federal aid for every dollar raised from own sources. On average, the reliance on federal aid in these 15 large cities dropped from one-third to about one-fifth of total local revenues in seven years. The drop was especially severe in the early 1980s—a reduction of $35 per capita in real terms between 1982 and 1984. For certain cities, and particularly some of those in the declining region, the losses were very great. The question to be asked is whether, and how, these revenue losses were replaced, and with what consequences for local public services.

Urban governments are also affected by the discretionary policies of state governments. In particular, state assistance to local governments has been reduced. The U.S. Treasury reports that per capita real state aid to local governments peaked in 1979 and in 1983 was lower than at any other time since 1974.[14] In 1975, cities received $42 in state aid for every $100 of own source revenues. By 1984, this ratio had dropped to $29.

3. *Other Changes in the Economy*

There were other important changes in the U.S. economy that might help explain the performance of cities in the 1980s. One important possibility, it is alleged, is that the economic shifts to the Sunbelt that so dominated the 1970s are over. The data presented in Table 3 do not support this argument. The Mideast and Plains regions are growing at rates below the national average; the Great Lakes region is in decline; and the Southeast, Southwest and Far West continue to grow faster than the rest of the nation. Some of the steam may have been taken out of Sunbelt growth by the recessions of the early 1980s, and by falling oil prices, but a reversal in the pattern of regional shifts has not occurred.

Another major factor affecting state and local government budgets in recent years is the aftermath of the tax limitation movement. There have not been a succession of Proposition 13 and 2 1/2 programs in the 1980s, but the message of the limitation movement does not seem to have been lost. This recognition of voter sentiment against higher taxes has probably been a major reason for the more conservative expenditure policies of the 1980s and it may explain some of the strength in budgetary position that cities have shown.

Some have raised a question about the implications of the changing structure of the U.S. population for city finances. While the prospects for an increasing concentration of the elderly are well documented, the

potential impacts on city budgets in the 1980s are not easily sorted out. On the one hand, the elderly pump a good deal of money into the economy—witness the increasing share of transfer payments in personal income—but they are not easily reached by local property taxes and are exempt from some portion of local sales taxes. It does seem true that it costs more to supply services to the aged, but much of this is supported by federal assistance. The net effect on local budgets, and how this has affected the performance of the city fisc in the 1980s, is simply unclear.

Still another major factor is the question of poverty. The evidence points to a heavy and increasing concentration of the poor in central cities. John Kasarda notes that minority population in central cities in the Northeast grew from 33 percent in 1975 to 41 percent in 1985 (28 to 36 percent in the Midwest) and that the average, national central city poverty rate had grown from 12 percent in 1960 to nearly 20 percent by 1983.[15] There has been a pronouced growth in the number of households headed by black females—prime candidates for continued poverty—and 64 percent of such households now live in central cities. The growth in this concentration of the poor seems incongruous with the budgetary health reported above.

C. Fiscal Responses in the 1980s

How have urban governments adjusted their budgets in response to the changing economy and the retrenchment in external aids in the early 1980s? There are a number of possibilities: reductions or expansions in the size of the public employment workforce and in the rate of public employee compensation, increased or decreased tax rates, reduced borrowings and shifts from one type of expenditure to another are a few. The one response in which we are most interested, changes in the quality of public services, is not directly measurable, but we may get some idea of this from other indicators. In the sections below we consider first the response of state and local governments in aggregate and then turn to the response of governments in large urban areas.

1. State and Local Governments

As noted above, the state and local government sector has reacted to the economics of the 1980s by accumulating a general account surplus. It apparently has done this by some combination of increasing tax rates and slowing the rate of growth in expenditures. To better understand how this has happened, we have compared the fiscal outcomes of the

1970s and the 1980s, as shown in the top panel of Table 7. A first finding is that while the rate of increase in real personal income fell off in the 1980s compared with the 1970s, real taxes grew at an increasing rate. Compared to the entire decade of the 1970s, state and local governments in aggregate did not cut taxes in the 1980s.[16] This finding squares with Gold's report that there were significant tax increases in 1982 and 1983, mostly by state governments, in the aftermath of the recessions of the early 1980s. The very rapid growth in the general account surplus during 1983 is explained by these fiscal actions. In 1984 and 1985, however, many of these temporary tax increases were rolled back and the surplus began to moderate.[17]

Table 7. Average Annual Percent Change in Selected Fiscal Indicators: 1970–1984

	In Current Dollars		*In 1982 Dollars*	
	1970–80	*1980–84*	*1970–80*	*1980–84*
All State and Local Governments				
Personal Income	10.56	8.33	2.28	1.90
Federal Aid	14.28	3.98	5.73	- 2.19
Taxes	9.92	9.41	1.69	2.92
Direct Expenditure:				
Capital	7.81	2.99	- 0.26	- 3.13
Other	12.05	9.34	3.67	2.86
Current	12.14	8.93	3.74	2.47
Assistance and Subsidies	6.53	6.65	- 1.45	0.32
Interest on General Debt	13.14	18.27	4.67	11.25
Insurance Benefits and Repayments	14.75	8.91	6.17	2.44
All Municipalities				
Personal Income	10.56	8.33	2.28	1.90
Federal Aid	23.32	- 1.01	14.09	- 6.88
Taxes	8.64	8.75	0.51	2.30
Direct Expenditure:				
Capital	8.65	3.67	0.52	- 2.48
Other	10.95	9.11	2.64	2.64
Current	11.28	8.44	2.96	2.00
Assistance and Subsidies	2.19	6.04	- 5.46	- 0.25
Interest on General Debt	10.46	17.96	2.19	10.96
Insurance Benefits and Repayments	11.56	11.41	3.21	4.80

Sources: Department of Commerce, Bureau of the Census, *City Governmental Finances in 1984*; *Governmental Finances in 1983–4*; and Bureau of Economic Analysis, Regional Economic Measurement Division, *Personal Income by State and Regions*, August 1986.

On the expenditure side, state and local governments have held the line in the 1980s. Whereas the real increase in current general expenditures of state and local governments was about 3.7 percent per year in the 1970s, it was 2.5 percent per year between 1980 and 1984. Retrenchment on the capital expenditure side was even more severe through 1984, though there was some resurgence in 1985. The story seems to be that taxes were first increased to compensate for the loss in external aid and to protect current expenditures, and then were reduced as the surplus accumulated during the expansion. Expenditure austerity has remained the rule of the 1980s on the capital outlay side and, as will be shown below, state and local governments have followed a course of reducing their public employment rolls and increasing the average rate of compensation of their employees.

The fiscal response of municipal governments in the United States is much the same, as may be seen from Table 7. Real tax rates increased between 1980 and 1984 to compensate for major federal aid reductions.[18] Over the same period there was a very substantial slowing in the rate of growth in current expenditures and a real decline in capital expenditures. As a result, the aggregate local government surplus rose during the 1980s, as described above.

Employment. Because expenditure control seems such an important part of the story, one may raise a question about which expenditures rose and which were cut back. An analysis of public employment trends indicates that after the 1972–80 period of sustained growth in the state and local government sector at a rate just above that for private industry, a retrenchment took place (Table 8). In both the 1980–81 and 1981–82 periods, state and local government sector employment actually decreased. Since 1982 the employment rolls have again begun to expand, but at a rate well below that in the private sector.

Even more extreme than this retrenchment in state and local sector employment is the curtailment in job growth for municipalities (see Table 9). Municipal employment declined for four consecutive years from 1979 to 1983. Moreover, the rate of decline was at least twice that of the state and local sector as a whole, and steeper than that for other local governments. The increase in 1984 was an important reversal of this trend.

These patterns prompt one to wonder if one very large city such as New York could drive the changes in the sector. The data in Table 10

Table 8. Employment (Full-Time Equivalent) of Private Industry and Government: Calendar Years 1972–1985 (in thousands)

	All Industry[a]	Private Industry	All Government	Federal Civilian	State and Local
1972	72,348	57,773	14,586	1,934	9,253
1980	85,925	69,621	16,328	2,056	11,227
1981	86,686	70,411	16,297	2,024	11,169
1982	86,041	69,846	16,221	2,014	11,078
1983	86,715	70,465	16,274	2,031	11,100
1984	91,172	74,681	16,511	2,065	11,259
1985	93,629	76,888	16,765	2,090	11,465
		Average Annual Growth Rates			
1972–80	2.17	2.36	1.42	0.77	2.45
1980–81	0.89	1.13	-0.19	-1.56	-0.52
1981–82	-0.74	-0.80	-0.47	-0.49	-0.81
1982–83	0.78	0.89	0.33	0.84	0.20
1983–84	5.14	5.98	1.46	1.67	1.43
1984–85	2.69	2.96	1.54	1.21	1.83

[a]*All Industry* is the sum of: Agriculture, Forestry and Fishery; Mining; Construction; Manufacturing; Transportation and Public Utilities; Trade; Finance, Insurance and Real Estate; Government and Government Enterprise; less "Rest of World." *Private* is the above but including Rest of World and not including Government and Government enterprise.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, July 1976, July 1984, and July 1986.

Table 9. Employment (Full-Time Equivalent) of State and Local Government: 1970–1984

	Average Annual Growth Rates			
	State and Local	State	Local	Municipalities
1970–79	2.81	3.26	2.64	1.46
1979–80	0.94	1.11	0.89	-1.10
1980–81	-1.18	-0.61	-1.40	-2.54
1981–82	-0.81	-0.13	-1.07	-1.52
1982–83	0.52	1.07	0.30	-0.91
1983–84	2.37	1.96	2.54	1.46

Source: U.S. Department of Commerce, Bureau of the Census, *Public Employment in 1984*, 1983, 1982, 1981, 1980, 1979, 1970.

Table 10. Employment (Full-Time Equivalent) of Large Cities: 1972–1984

	FTE Employment in 1984		*Average Annual Percent Change in FTE Employment*				
	Total	*Per 10,000 Population*[a]	*1972–80*	*1980–81*	*1981–82*	*1982–83*	*1983–84*
Baltimore	30,057	388	0.95	-17.19	- 2.77	0.27	- 7.94
Boston	19,130	341	0.12	0.00	-25.28	3.65	- 1.18
Cleveland	8,430	151	-3.90	0.00	0.04	- 4.23	- 3.95
Chicago	—	—	-0.06	- 5.61	3.18	—	—
Dallas	14,500	154	0.91	- 3.72	4.56	1.12	2.72
Detroit	17,766	156	-2.63	- 5.06	- 1.64	- 9.75	- 1.88
Honolulu	8,223	105	1.75	- 5.57	- 0.32	- 0.33	- 1.36
Houston	19,585	113	5.45	3.45	6.96	- 9.65	11.19
Indianapolis	10,841	153	7.18	- 1.95	- 8.22	0.34	- 1.67
Los Angeles	41,798	138	-0.56	- 0.52	- 1.63	1.01	3.61
Memphis	22,579	350	-0.14	- 4.20	1.91	4.24	0.52
Milwaukee	8,726	138	-0.18	- 3.78	- 0.95	- 0.44	- 0.59
New Orleans	11,231	199	1.69	-23.77	5.94	8.87	1.98
New York	334,618	472	-1.95	2.34	2.72	0.42	- 0.61
Philadelphia	32,236	194	-1.83	5.29	- 3.82	0.60	- 0.57
Phoenix	8,918	108	4.91	- 4.77	- 3.04	2.49	4.29
San Antonio	11,750	143	0.89	0.00	7.07	5.24	3.84
San Diego	7,359	80	0.34	- 6.31	4.89	5.07	1.14
San Francisco	23,933	346	0.08	- 1.38	0.00	12.85	2.03
Washington, D.C.	39,720	627	-2.14	- 7.10	1.87	- 2.59	3.84
Unweighted Average	35,337	229	-0.94	- 1.48	- 0.56	- 0.74	0.13
Weighted Average	29,805	176	-0.26	- 4.89	- 1.89	- 3.34	0.25

[a]Based on 1980 population figures

Source: U.S. Department of Commerce, Bureau of the Census, *City Employment in 1984*, 1983, 1982, 1981, 1980, and 1972.

indicate that New York City does not drive the statistics in the way that many observers have imagined. New York, which encompasses only 3 percent of the state and local sector employment, moved in an opposite direction from the sector for four of the five periods analyzed. Even for the entire 1972–80 period, when the state and local sector employment increased by 2.45 percent (see Table 8), city employment in New York decreased by 1.95 percent. On the other hand, the 20 cities taken together account for 34.2 percent of municipal employment. From 1980 on (with the exception of 1981–82) the employment in these cities did move in the same direction as total municipal employment. From a comparison of the data in Tables 9 and 10, however, we may say that the turnaround in 1984 is primarily due to employment expansions in medium-sized municipalities. Specifically, cities with population between 300,000 and 999,000 showed the largest net gains in employment.

Compensation. This story of employment retrenchment leads us to question whether austerity also was the order of the day on the compensation side of the wage budget. The answer is that it was not. State and local governments may have cut back on employment and on capital spending in the 1980s, but they did not slow the rate of increase in compensation.

A first step in exploring this issue is to ask whether the growth in public employee compensation levels is out of line with private sector employee compensation and whether governments are succeeding in curbing compensation growth. The data in Table 11 show that for each year between 1980 and 1984 average annual salaries per full-time equivalent employee in the state and local sector were below those in the private sector. The "catch-up" occurred in 1985. Also to be noted is that with recent inflation at an unusually low level, the annual growth rates in salaries for the state and local government sector were well in excess of the changes in the CPI, sometimes growing by as much as 60 percent faster.

Though we accept this conclusion that wages paid to the state and local government sector workers have grown faster in the 1980s than those paid elsewhere in the economy, it should be emphasized that there are many issues at work here. One possibility is that, because of shrinking population bases in cities, it was necessary to raise wages in order to be competitive in the marketplace. Another is that unions and state and local governments may not have adjusted their agreements or

Table 11. Average Annual Wages and Salaries per Full-Time Equivalent Employee by Industry: Calendar Years 1972–1985

	All Industry	*Private Industry*	*Federal Civilian*	*State and Local*
1972	8,760	8,588	12,679	8,916
1980	15,789	15,749	21,259	15,142
1981	17,225	17,165	23,074	16,453
1982	18,435	18,331	24,452	17,826
1983	19,330	19,190	25,455	18,870
1984	20,149	19,990	26,478	19,933
1985	20,996	20,806	27,611	21,149
	Real[a] Average Annual Growth			
1972–80	-1.10	-0.89	-1.99	-1.84
1980–81	-1.16	-1.25	-1.66	-1.55
1981–82	0.84	0.62	-0.15	2.09
1982–83	1.59	1.42	0.86	2.56
1983–84	-0.02	-0.08	-0.23	1.32
1984–85	0.61	0.50	0.69	2.45
	Percent Real Average Growth per 1 Percent Increase in CPI			
1972–80	-0.12	-0.10	-0.23	-0.21
1980–81	-0.11	-0.12	-0.16	-0.15
1981–82	0.14	0.10	-0.02	0.34
1982–83	0.49	0.44	0.27	0.80
1983–84	-0.00	-0.02	-0.05	0.31
1984–85	0.17	0.14	0.19	0.69

[a]Deflated amounts are in 1967 dollars; the Consumer Price Index was used to deflate the series.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, July 1976, July 1984, and July 1986.

their expectations to the realities of a lower rate of inflation. Yet another is that some of the wage growth implied in the averages is an illusion. To the extent that governments add fewer new employees or reduce the workforce size, there is likely to be a disproportionate impact on younger, lower-paid employees. By nature of arithmetic averages, it is quite possible to reduce workforce size and to grant no wage increases to remaining employees and still end up with a higher average wage for the workforce. Most likely, the growth in average compensation is attributable to all three of these effects.

If large cities were harder pressed fiscally than were states or other local jurisdictions, it might be expected that city employee wages would have grown at more modest rates than wages for other state and local government employees. In fact, however, during the early 1980s 13 of the largest cities in the country had growth rates of average earnings per full-time equivalent well above the rate for the state and local government sector as a whole (see Table 12). Others grew more

Table 12. Average Annual Earnings[a] per Full-Time Employee[b] in Large Cities: 1972–1984

				Average Annual Percent Change (in 1972 dollars)	
	1972	*1980*	*1984*	*1972–80*	*1980–84*
Baltimore	7,860	13,464	20,184	-0.57	2.26
Boston	9,708	14,556	20,220	-2.21	0.33
Cleveland	10,560	17,520	23,100	-0.97	-0.97
Chicago	11,640	18,828	24,468	-1.28	-1.33
Dallas	8,328	17,580	23,340	2.06	-0.80
Detroit	12,288	22,224	26,484	0.11	-3.44
Honolulu	9,936	16,812	22,236	-0.72	-0.89
Houston	8,664	17,988	22,236	1.85	-2.55
Indianapolis	7,920	13,176	18,504	-0.93	0.61
Los Angeles	13,764	21,672	32,916	-1.61	2.60
Memphis	6,948	14,592	16,512	2.00	-4.68
Milwaukee	12,048	19,572	25,860	-1.23	-0.92
New Orleans	6,852	11,028	17,052	-1.34	3.06
New York	11,532	17,880	25,296	-1.80	0.79
Philadelphia	11,376	19,332	25,164	-0.67	-1.29
Phoenix	9,372	18,204	25,764	1.01	0.80
San Antonio	8,616	15,384	22,092	-0.05	1.17
San Diego	11,436	21,276	26,436	0.46	-2.43
San Francisco	12,816	21,132	30,540	-1.04	1.33
Washington, D.C.	9,384	20,472	25,800	2.48	-2.08
Total State and Local Government Sector	8,916	15,142	19,933	-0.68	-1.01

[a]October earnings multiplied by 12.
[b]Includes all employees other than instructional.

Sources: U.S. Department of Commerce, Bureau of the Census, *City Employment in 1980*, 1984; *Local Government Employment in Selected Metropolitan Areas and Large Counties: 1972*; and Bureau of Economic Analysis, *Survey of Current Business*, July 1976, July 1984, and July 1986.

slowly and some even showed absolute declines in average compensation. In other words, the overall picture is unclear. In general, though, it appears that the cities in the older region had a slower rate of growth in average wage level.

Employee compensation includes much more than wages. Fringe benefits such as pensions, Social Security coverage, and health and hospital insurance add considerably to state and local government expenditures. 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 (compare Tables 13 and 11).

Table 13. Average Annual Supplements to Wages and Salaries per Full-Time Equivalent Employee by Industry: Calendar Years 1972–1985

Years	*All Industry*	*Private Industry*	*Federal Civilian*	*State and Local Government*
1972	$1,125	$1,151	$1,497	$1,110
1980	2,828	2,828	3,950	2,991
1981	3,141	3,123	4,558	3,402
1982	3,729	3,483	5,011	4,145
1983	3,793	3,681	5,717	4,507
1984	4,142	3,843	6,092	4,767
1985	4,298	3,949	6,688	5,112
		Real[a] Average Annual Growth		
1972–80	- 2.56	- 2.83	- 1.97	- 1.71
1980–81	0.62	0.04	4.56	3.05
1981–82	11.89	5.09	3.59	14.81
1982–83	3.21	2.41	10.53	5.34
1983–84	0.01	0.12	2.21	1.45
1984–85	0.17	- 0.77	5.99	3.56
		Percent Real Average Growth per 1 Percent Increase in CPI		
1972–80	- 0.29	- 0.32	- 0.22	- 0.19
1980–81	0.06	0.00	0.44	0.29
1981–82	1.94	0.83	0.59	2.42
1982–83	1.00	0.75	3.27	1.66
1983–84	0.00	0.03	0.52	0.34
1984–85	0.05	- 0.22	1.68	1.00

[a]Deflated amounts are in 1976 dollars; the Consumer Price Index was used to deflate the series.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, July 1976, July 1984, and July 1986.

The cost per employee in the state and local government sector is approximately $5,112, equivalent to about 24 percent of average earnings, up from around 12 percent in 1972. Fringe benefits, therefore, are a significant item in state and local government budgets (see Table 13).[19] Note from the table that fringe benefit compensation has grown faster than both the CPI and the private sector level for well over a decade.

The largest component of state and local government fringe benefit expenditures is pensions. As may be seen from Table 14, employer contributions in the state and local government sector are up to about 11 percent of wages and salaries. These contributions grew faster than wages through the 1970s and early 1980s, and led to a generally higher level of retirement benefits in the public than in the private sector.[20] However, the growth in employer contributions has fallen off dramatically since 1982.

Table 14. Wage and Salary Expenditures and Employer Contributions for Employee Retirement Programs, State and Local Governments: 1972–1984

	Wage and Salary Expenditure per Employee	*Employer Retirement Contributions per Employee*	*Retirement Contributions as a Percentage of Personal Service Expenditures*
1972	8,518	622	7.3
1980	14,836	1,587	10.7
1981	16,387	1,834	11.2
1982	17,506	2,008	11.5
1983	18,776	2,107	11.2
1984	19,677	2,208	11.2
	Real[a] Average Annual Percent Change		
1972–80	-0.4	4.5	
1980–81	1.7	6.4	
1981–82	-1.4	1.0	
1982–83	-0.9	-3.0	
1983–84	-2.6	-2.6	

[a]Deflated to 1972 dollars.

Sources: U.S. Department of Commerce, Bureau of the Census, *Public Employment in 1984; Governmental Finances in 1983-4*, 1981-2, 1971-2; *Finances of Employee-Retirement Systems of State and Local Governments*, 1983-4; 1972 Census of Governments, Topical Study, Number 1, *Employee Retirement Systems of State and Local Governments.*

2. *Large City Government Responses*

What has been the response of the largest cities in the United States to the new economics of the 1980s? Has it differed from that of all municipalities and, if so, what have they done differently from the 1970s that explains Dearborn's findings of a relatively sound budgetary position, and Ladd et al.'s finding of a growing gap between expenditure needs and revenues available? We have studied the fiscal response of overlapping local governments in the 17 largest Metropolitan Statistical Areas (MSAs) and can give some description of their fiscal response. The picture is one of a rather dramatic retrenchment.

The procedures we have used in computing this response are important because they aid the understanding of these results and because the approach taken here is different from what is usually done. First we include the fiscal actions of all overlapping local government in these metropolitan areas. Second, we have made the time series consistent by relying on the narrowest definition of the MSA, e.g., if only three counties are common to an MSA throughout the period, we have used only those three counties in computing the fiscal responses.[21] Third, we report results for three time periods in Table 15: 1970–75, a period of fiscal expansion; 1975–79, the aftermath of the recession and the height of the tax limitation movement; and 1979–83, a period of two short recessions and the beginning of the present economic expansion.[22]

On the revenue side between 1970 and 1975, these data show real per capita increases in taxes, aid and borrowing of over $84. These resources funded a substantial increase in real expenditures and in public employment. During the last half of the decade, the real increase in aids fell to around $40 per capita, and both taxes and borrowing declined in real per capita terms. Real per capita expenditures increased relatively little and public employment growth slowed dramatically. It would appear that the real increase in per capita expenditures that took place in the last half of the decade, as well as the tax reductions and net debt retirement, were financed by federal and state aid. It seems pretty clear that urban governments were making a definite choice to reduce the size of their activities.

When the real increments in federal and state aid turned negative in 1979–83, local governments responded first by cutting real per capita taxes and net borrowing during 1979–81. Between 1981 and 1983, they increased both real per capita taxes and borrowing. The increases in compensation for local public employees during 1980–83, then, seem to have been financed by reductions in the number of employees,

Table 15. Absolute Changes in Selected Fiscal Variables: Unweighted Averages for 27 Cities[a]

	1970–75	*1975–79*	*1979–81*	*1981–83*	*1979–83*	*1970–83*
Real Per Capita:[b]						
Taxes	10.17	- 7.21	-15.94	10.59	- 5.35	- 2.39
Expenditures	81.32	5.15	-15.57	- 6.17	-21.75	64.72
Expenditures Excluding Public Welfare	78.87	11.97	-13.00	- 4.77	-17.77	73.07
Employment Per 1000 Population	4.54	1.16	- 2.33	- 1.15	- 3.49	2.21
Debt Per $1000 Personal Income	- 1.38	-22.27	- 2.26	5.71	3.45	-20.19
Real Per Capita Debt Outstanding	10.75	-40.71	-26.92	18.46	- 8.46	-38.42
Real Per Capita:						
State Aid	43.06	6.89	- 3.91	- 9.84	-13.75	36.20
Federal Aid	31.58	23.77	- 8.71	-12.15	-20.86	34.49

[a]The 27 cities are listed in Table 16.
[b]Deflated amounts are in 1972 dollars.

Sources: Department of Commerce, Bureau of Census, *Local Government Finances in Selected Metropolitan Areas and Large Counties: 1969–70,* 1974–75, 1978–79, 1980–81, 1982–83; *Local Government Employment in Selected Metropolitan Areas and Large Counties: 1970,* 1975, 1979, 1981, 1983; *Current Population Reports,* Series P-25, No. 739, November 1976, No. 873, February 1980, No. 957, October 1984, Series P-26, No. 82-1-SC. September 1984, No. 65-52-C, October 1984, No. 78-4, August 1979, Bureau of Economic Analysis, *Survey of Current Business,* April 1985, 1983, June 1978; *Local Area Personal Income: 1970–75,* August 1977.

reductions in other current expenditures and increased taxes in 1983. Unfortunately, as noted above, this data series ends with 1983 and we can go no further with the story in Table 15.

We can now return to the fiscal health of local governments and cities, implied in the National Income Accounts and observed by Dearborn, and point to an austerity explanation. Large cities dropped their real per capita expenditures by over $20 and their employment by three per 1000 residents between 1979 and 1983. Some part of the fiscal strength of local governments in the 1980s was almost certainly achieved through reductions in public service levels.

There is, of course, variation across urban areas in this fiscal response, as is described in Table 16. However, the general conclusion seems to hold. Some 21 of these 27 cities reduced real per capita expenditures in the 1980s, 16 cut real per capita taxes and 23 faced real per capita reduction in federal aid. It is notable that only one of the six urban

Table 16. Absolute Per Capita Changes in Selected Fiscal Variables

City	1970–75			1975–79			1979–83		
	Taxes	Federal Aid	Expenditures	Taxes	Federal Aid	Expenditures	Taxes	Federal Aid	Expenditures
Baltimore	-11.21	36.51	102.58	-4.61	28.57	-100.22	-1.02	-40.65	-11.23
Cleveland	-20.06	28.04	81.63	-1.81	37.24	55.36	9.98	-18.32	-9.60
Chicago	14.37	15.60	91.15	-15.04	31.80	-13.30	24.89	-1.42	-18.34
Detroit	-58.66	37.30	99.26	74.47	25.97	31.78	27.41	-13.07	-21.43
Milwaukee	-13.07	28.48	51.97	-27.05	10.08	28.07	16.79	-10.82	4.90
Minneapolis-St. Paul	24.29	42.41	92.99	2.62	23.59	-44.34	-14.49	-31.77	6.08
Philadelphia	8.81	27.37	69.92	24.40	4.51	21.37	-19.45	10.27	-23.62
Dallas	31.03	15.25	88.15	4.58	13.33	27.84	-6.35	-14.98	-3.92
Denver	10.23	23.80	141.48	43.45	12.15	8.65	-22.45	-27.99	-46.52
Atlanta	54.50	53.26	93.23	-8.86	61.69	20.02	-6.45	-72.06	-52.41
Boston	48.27	24.11	105.46	-7.36	52.44	49.84	-94.89	-12.25	-118.43
Washington	22.33	90.77	147.93	49.22	22.88	-7.05	14.48	-66.33	-55.06
Pittsburgh	-13.39	18.53	38.64	14.47	7.40	100.30	23.76	19.00	-15.30
Seattle	32.58	20.60	10.76	-19.37	40.67	6.89	-34.82	-39.26	-47.59
Miami	0.29	14.82	99.87	32.73	32.41	75.16	-10.23	16.73	-39.95
Houston	17.08	21.37	54.23	45.54	5.04	126.63	3.27	-5.20	32.30
Indianapolis	-3.16	26.26	80.15	-44.33	19.91	-12.53	-11.74	-22.52	-2.43
Los Angeles	7.21	25.97	54.21	-146.69	25.61	-50.53	-8.39	-21.33	-25.82
Memphis	19.42	38.06	95.43	-10.59	9.82	-27.51	-2.78	8.96	6.83
San Francisco	7.87	42.60	34.06	-165.20	1.47	-51.67	-4.19	-25.21	-22.05
Tampa	-20.16	27.00	56.84	18.83	41.51	63.02	-7.91	-47.58	-68.25
Honolulu	-15.91	36.95	14.33	-2.01	39.04	-27.55	-0.02	-48.46	-16.21
New Orleans	6.31	33.37	36.83	19.30	27.03	19.43	31.99	-21.95	40.26
New York	74.61	44.05	234.77	-8.15	15.42	-256.66	17.31	-9.77	-14.39
Phoenix	12.91	26.12	103.85	27.93	15.29	62.51	-76.34	-19.90	-62.92
San Antonio	12.71	29.50	86.73	-1.32	21.46	35.70	2.60	-23.50	15.42
San Diego	25.51	24.68	29.15	-89.94	15.38	-2.17	4.46	-23.73	-17.48
Unweighted Average	10.17	31.58	81.32	-7.21	23.77	5.15	-5.35	-20.86	-21.75

Source: Department of Commerce, Bureau of the Census, *Local Government Finances in Selected Metropolitan Areas and Large Counties: 1969–70*, 1974–75, 1978–79, 1980–81, 1982–83.

areas that did not cut real per capita spending (Milwaukee) is in the industrial region.[23]

D. A Review of the Hypotheses

These data give us a reasonable basis for explaining why severe urban fiscal crises have not materialized in the 1980s. The first hypothesis is that cities have shared in national economic growth which has buoyed up revenue growth, and in low rates of inflation which has helped to control expenditures. This hypothesis would hold that as a result, national economic policy has made it possible for urban areas to grow out of their fiscal problems. The data do not support this explanation. In aggregate, core counties did not do as well in the first half of the 1980s as they had in the 1970s; their growth was slower than that in the rest of the economy, and central *cities* probably did even worse than the core counties. Likewise, the distressed regions of the 1970s have not caught up in the 1980s: the Plains and Great Lakes regions had employment declines and the Mideast had a very modest growth, well below the national average. There is no evidence that the performance of city economies has markedly improved in the 1980s.

The second proposition is that urban governments have become more able to cope with the realities of limited resources, i.e., they live within their fiscal means and have managed to do this while providing an adequate level of public services. The first part of this proposition is certainly true—city budgets are more austere in the 1980s than in the 1970s. In the shadow of the tax limitation movement and faced with large federal aid cuts, local governments have slowed the rate of growth in their expenditure budgets and have cut real tax and borrowing rates. To illustrate the magnitude of this austerity, local governments in the 27 largest MSAs spent over $20 less per capita (in real terms) in 1983 than in 1979.

This austerity has led to some measure of fiscal health. Not only have there been no major crises, but the local government aggregate surplus has grown steadily in the 1980s and most large cities find themselves with reasonably sized cash balances. Perhaps the best proof of this new austerity is that state and local governments' budgets were less affected by the business cycles of the 1980s than by those of the 1970s.

A third explanation is that budget austerity has been accomplished at the expense of reductions in the quality of public services. Because we

cannot measure the quality of public services directly, this hypothesis cannot be easily tested. Yet there is some indirect evidence that public service levels have been compromised. On the one hand, it is shown above that in the 1980s central cities have had slower growing economies than in the 1970s and real federal aid reductions have been substantial. On the other hand, we can observe that cities did not react to this by raising taxes to restore the real position of the city budget. Rather, they reduced real taxes, maintained larger balances, cut employment, increased employee compensation, and reduced real capital outlays. The more likely conclusion, then, is that the new austerity of the 1980s has involved a reduction in the quality of urban public services.

III. URBAN FINANCE AND FEDERAL INCOME TAX REFORM

A. Potential Effects of Federal Tax Reform

Given this setting and the current condition of cities, we now turn to the potential impact of the federal tax reform on the fiscal condition of cities. The word ''potential'' is important because the actual impact will depend on how producers, consumers, and investors react to the new income tax rules. Theory can tell us something about the direction of the response, but we are much more at sea when it comes to estimating the magnitude of the response.

It also needs to be emphasized that not all metropolitan cities will be affected in the same way. Much of the discussion below is concerned with the problems that will face core cities located in jurisdictionally fragmented metropolitan areas. Though there are important exceptions, this tends to be more of a problem in the older urban areas in the Northeast and the industrial Midwest. The newer cities in the South and West, again with some notable exceptions, have managed to avoid the city-suburb disparities that have grown up in the North.

1. City-Suburban Competition

An early consequence of the tax reform may be increased city-suburb competition for a smaller pool of state grant money. This will come about because of a slower growth in state tax revenues and an increase in the relative price of suburban property taxes. The reduction

in the federal marginal tax rate will raise the price of state and local government taxes for those who itemize deductions. Voters will react to this by demanding lower state taxes than they otherwise would have demanded, but we do not know how much less they will want or which taxes they will most object to.

Research in this subject does not give us a clear answer to the question of what might be the response to a change in the tax price. Gramlich's analysis suggests that it may be small,[24] Kenyon[25] and Inman[26] find a response to state income but not sales taxes, and Feldstein and Metcalf[27] estimate a positive response from combined personal taxes on income, consumption, and property values. Let us suppose, as seems reasonable, that the longer run growth in state sales and income taxes will be less than it would have been if the marginal tax rate had not been lowered.

With a slower growth in taxes, it is likely that the revenue pool available from which to draw state aid to local governments will be smaller in the future than it would otherwise have been. Note that state aids to local governments in 1982 and 1983 did not increase even though there were substantial increases in state taxes in those years. A continuation of this pattern would suggest a smaller real pool of state aid for distribution to local governments.

The other half of this story is that the competition for this aid will be more keen. Suburban residents, who have higher incomes and are more likely to itemize will lose some of the subsidy to their property tax bill and could well look to the state capital for relief in the form of increased school aid. This pressure will be reinforced by the stiffened resistance of the industrial tax base to increases in the property tax. Such proposals are not likely to fall on deaf ears in suburban-dominated state legislatures, particularly in states where effective property tax rates have reached high levels. Central cities, whose residents do not suffer as much directly from the loss of deductibility, may not fare well in such competition.

There is another important dimension to the city-suburb competition that will result from the new tax reform. Many city residents, itemizers who use private schools, may now be tilted in the direction of suburbs where tax rates are no higher but where they see public education services as adequate. If state aids are adjusted to increase the subsidy to suburban property tax financing of local schools, this type of metropolitan decentralization will be encouraged. There has been little hard research on this issue, a notable exception being Gramlich's work

which implies that even full elimination of deductibility would give only a modest incentive for higher income residents to leave the central city.[28]

2. *Interstate Competition*

The combination of lower marginal tax rates, elimination of sales tax deductibility, the cap on tax-exempt borrowing for private purposes, and the continued decline in federal aid will force state and local governments to an even greater reliance on their own resources. Much of the subsidy that has softened interstate tax differences will be gone, and more than ever before, state and local governments will compete for jobs using fiscal incentives.

To the extent that economic development objectives will drive state fiscal policies even more than they presently do, central cities may suffer since such policies will not be pro-poor. Tax incentives to attract industry will likely be focused on company tax holidays or reduced tax rates, industrial and commercial property tax forgiveness, or a reduction in the higher marginal personal income tax rates. There will be a substantial amount of pressure on state and local governments to reduce business taxes, to partially make up for the federal tax increases on certain types of businesses. The resulting revenue reductions must be made either by reduced public services or by increases in other taxes. It is even possible that competition will pressure a shifting in state and local government financing responsibility from the business sector to individuals.

On the expenditure side the story is much the same. Industrial subsidies to attract plant location and general improvements in infrastructure will be leading candidates for inclusion in a state or local government's industrial policy. Education services may also play a role, likely in the direction of improving technical training or improving the general education system in the state or the area.

Big city governments, especially those in the North, may not gain from competitive industrial policies, even if they work. Lower taxes mean less direct state spending in local areas and also may mean less state aid for urban programs. Moreover, the tax structure changes implied for such an economic development program will tend to reduce the progressivity of the tax system, and perhaps shift financing responsibility toward the now higher-priced sales tax.[29] On the expenditure side, economic development programs can stimulate job growth and may improve core area economies. On the other hand, central city

areas are still losing jobs and appear to be less competitive and therefore unlikely to share fully in any job growth that results from a successful industrial policy. Moreover, it has been learned in recent years that even low-paying service sector jobs are not a good match for the lowest income unemployed in central cities.

3. *City Government Revenues*

In some cities there will have to be an immediate revenue windfall adjustment if taxpayers are not to face increased local tax liabilities. This is because local governments in several of the 14 states that permit local income taxes are somehow tied to the federal tax base. Given the recent propensity of large urban governments to reduce real tax rates even in the face of federal and state aid cuts, the likely short-run response will be revenue reduction. In 26 states, local government sales tax burdens on taxpayers will also rise because of the elimination of deductibility. Short-run relief from the windfall is less likely because of the relatively small magnitude of some sales taxes and because the sales tax tends to be invisible to local taxpayers.

In the long run, the tax reform will probably lead to a dampening of the growth in city government revenues. There are two considerations that lead us to this conclusion. The first is simply the higher price of sales, income and property taxes. The second is that the tax reform will remove the subsidy to higher income housing costs, reduce the demand for home ownership, and depress the growth in the value of real estate. This will dampen the growth in the property tax base.[30]

4. *Politicians, Windfalls, and the Long Run*

The first adjustments to the federal tax reform will come when states deal with the revenue windfall from the expanded federal income tax base. The initial reaction from virtually every statehouse has been to guarantee returning the windfall to the taxpayers. A decade ago the reaction would have been to view these as discretionary funds with which to address the most pressing urban fiscal problems. The spirit of the tax revolt movement is still present, however, and governors must deal with taxpayer watchdogs who are demanding state tax relief. The demands will be accentuated because of the increase in Social Security taxes.

Three important issues face the states in dealing with this windfall issue, and all have important potential implications for cities. The first

is simply the estimation of the size of the revenue gain to be returned. This estimate requires some assumptions about how taxpayers will react to the new law; for examples, will there be substantial taking of capital gains at the end of 1986, will rental housing and nonresidential construction begin to dry up and by how much, how will consumption patterns react to the removal of deductibility for sales taxes and credit card interest, etc.? There will be much debate about the magnitude and timing of these impacts: politicians will likely push for making the assumptions that give maximum tax relief and state officials will probably underestimate the impacts to counter this. Too great a return to taxpayers could reduce the real value of the pool of funds available for state assistance to local governments—the recent past has shown state aid to be sensitive to the rate of growth in tax revenues.

The second issue is the way in which the windfall will be returned. The most common suggestions are relief at the bottom and the top of the income scale. City residents will benefit some from this relief—since bottom-end taxpayers do not itemize but would benefit from the rate reduction—but the large poverty population in the cities is outside the tax base and would be untouched. Cities actually might be hurt by such a program in another way: if middle income suburban residents, typically itemizers, are burdened most by the tax reform (if they have taxable income expansions that are not offset by rate reductions) they might bring even greater pressures on state legislatures to relieve property tax burdens with increased state aid.

Other ways to return the windfall are being considered. Reduction in sales taxes is one possibility and could well be more redistributive than income tax relief. This may now be a less favored alternative with sales tax deductibility gone. States could decide to spend some of the windfall, to support expanded urban aid programs and/or new state initiatives to deal with the problems of the urban poor (e.g., workforce), or even to reduce future drains on state tax revenues by retiring outstanding short-term debt. None of these spending options seem likely since they would go against the fiscal grain of the mid-1980s—reductions in federal subsidy have been accompanied by reductions in expenditures and public employment.

The third issue involves the possible differences between the long-run and short-run consequences of the tax reform. It is pretty clear that next year will see a revenue windfall in income tax states, but the reforms undertaken could well reduce the long-run elasticity of the state income tax. Indeed, reductions of the rate progressivity of state

systems has been the pattern in recent years. This would imply less automatic responsiveness in state tax revenues to future growth in income and more than ever would tie the growth in state spending to the growth in state personal income.

5. *Effects on Poor People*

As noted above, the urban poor are not directly affected by the federal tax reform since they are not in the income taxpaying population. They receive no increased take-home pay as a result of the lower federal rates and they would pay no more if their state governments kept the windfall. In fact, the urban poor would fare better if the windfall were spent on human capital development in inner cities. The events of the past decade seem to make it clear that those living in poverty are not likely to share in the employment benefits of a stronger national economic growth.

The other side of the coin is that the tax reform will have important indirect effects on the urban poor. We can but speculate about these. The long-run income elasticity of the reformed federal income tax will be lower, perhaps suggesting even greater federal aid cuts in the future. On the other hand, a more rapid national economic growth could have just the opposite effect, even with a lower income tax elasticity. State aid to central city governments and state direct expenditures on pro-poor services could be lower than they otherwise would have been because of interstate and interlocal fiscal competition. Depending on how investors react, there will be less rental housing construction and a drift toward higher rents.

The setting is important. These impacts of tax reform come at a time when federal aid is being cut and when jobs are not growing in the inner city areas.

6. *Effects on City Economies*

There is, potentially, a brighter side to the story as regards the impact of the tax reform on central city economies. At least there is a brighter side for certain types of cities. The new code removes an investment subsidy that has benefited manufacturers who make heavy investment in plant and equipment. Replacing this with a generally lower corporate tax rate is bad news for cities that still rely heavily on a manufacturing base. One could argue that the new code will further shake the already weak competitive position of many goods producing

firms. The removal of the tax subsidy from manufacturing has a brighter side. The relative price of physical construction (including housing) will rise under the reform and the mobility of firms and people might be slowed. Whether these impacts would be great enough to make a difference is another question.

The other way to look at the impact of the tax reform is that the relative profitability of investments in the service sector will increase. Most cities have realized a substantial portion of their employment growth in this sector in recent years. Even so, it is not clear that increased jobs in the service sector will improve the lot of the lowest income residents in the central city. Indeed, some have argued that service jobs do not "fit" the urban poorest, and may even exacerbate the unemployment problem.[31]

A second favorable effect on local governments is that in raising the price of taxes, the reform should encourage government efficiency. Public officials will have to be more accountable for their use of higher-priced local taxes. As a result, one can expect to see more innovative approaches to service delivery as cities search for less costly ways to do business. More privatization and contracting out, and a much heavier use of benefit charges are certain to play a more prominent role in city finances.

B. Concluding Comments on Tax Reform

The federal income tax reform is a strong step in the right direction for U.S. economic policy. It focuses on economic efficiency at a time when there is need for the U.S. economy to be more productive, it cleans up a host of complexities in a tax code that badly needed cleaning up, and it takes a great amount of unfairness out of the system. But it has side effects. These might be acceptable as a necessary cost of reforming the system, but they ought to be explicity recognized.

One such side effect is changes in the nature of American federalism. The new tax code gives another push to reducing the state and local government role in taxing and spending. Real reductions in federal aid, competition among the states and the lingering sentiments of the tax limitation movement should ensure this outcome. Likewise, interlocal competition, greater pressures to hold the line on property taxes, and reduced state aid will probably govern the growth in local expenditure budgets and the trend of fiscal centralization to the state government level will continue.

The other side effect has to do wtih cities—especially the larger, older cities of the North whose economies are declining and whose concentration of poverty population is substantial. The market solution—that economies can somehow grow or decline or adjust their way out of economic problems—has not worked for these cities. The economic expansion of the past two decades have passed these places by. If economic policy is to serve also as urban policy in this country, then it must find a way to address this market failure.

NOTES

1. U.S. Department of Housing and Urban Development, *1968 Annual Report*, p. 34.
2. The problems with the surplus measure are reviewed in Roy Bahl, *Financing State and Local Government in the 1980s* (New York: Oxford University Press, 1984), pp. 35–50.
3. The BEA work is reported periodically in the *Survey of Current Business*. The most recent analysis is David J. Levin and Donald L. Peters, "Receipts and Expenditures of State Governments and of Local Governments: Revised and Updated Estimates, 1959–84," May 1986, pp. 26–33.
4. Steven Gold regularly tracks the financial condition of state governments for the National Conference of State Legislatures. His most recent (at the time of this writing) reporting is in "State Fiscal Conditions," paper prepared for the National Academy of Sciences, Committee on National Urban Policy, 1986.
5. Phillip Dearborn has for many years followed the budgetary position of large cities. His earlier work for the Advisory Commission on Intergovernmental Relations, *City Financial Emergencies: The Intergovernmental Dimension* July 1972, and *Bankruptcies, Default and Other Local Government Financial Emergencies*, March 1985, give a good comparative view of the changing financial condition of cities. His most recent reporting is in "Fiscal Conditions in Large American Cities, 1971–1984," paper prepared for the National Academy of Sciences, Committee on National Urban Policy, July 1986.
6. Dearborn, "Fiscal Conditions in Large American Cities, 1971–1984," p. 36.
7. National League of Cities, *City Fiscal Conditions in 1986*, a Research Report of the National League of Cities, July 1986.
8. For a review of this literature, see Bahl, *Financing State and Local Governments in the 1980s*.
9. Katherine L. Bradbury, "Urban Decline and Distress: An Update," *New England Economic Review* (July-August 1984), pp. 39–55.
10. Helen Ladd, John Yinger, Katherine Bradbury, Ronald Ferguson, and Avis Vidal, *The Changing Economic and Fiscal Conditions of Cities* (Cambridge, MA: John F. Kennedy School of Government, Harvard University, 1986).
11. Daniel Garnick, "Local Area Economic Growth Patterns: A Comparison of the 1980s and Previous Decades," paper prepared for the National Academy of Sciences, July 1986.

12. Metropolitan core counties have a population greater than one million.

13. Roy Bahl, Bernard Jump, Jr., and Larry Schroeder, "The Outlook for City Fiscal Performance in Declining Regions," in Roy Bahl (ed.), *The Fiscal Outlook for Cities: Implications of a National Urban Policy* (Syracuse, NY: Syracuse University Press, 1978).

14. U.S. Department of the Treasury, *Federal-State-Local Fiscal Relations: Report to the President and the Congress* (Washington, DC: U.S. Government Printing Office, September 1985), pp. 124–32.

15. John D. Kasarda, "The Regional and Urban Redistribution of People and Jobs in the United States," paper prepared for The National Academy of Sciences, Committee on National Urban Policy, July 1986.

16. Compared to the high-water mark in 1978, however, taxes were lower in 1983.

17. For a discussion of the surplus in 1984 and 1985, see David Levin "State and Local Government Fiscal Position in 1985," *Survey of Current Business* (February 1986), pp. 35–38.

18. We define the real tax rate as the ratio of taxes to personal income. It is likely that the real rate implied in Table 7 is an overstatement because the personal income growth in cities is almost certainly less than the national personal income growth reported in the table.

19. The importance of trying to control the cost of fringe benefits is even more obvious when it is recognized that the $5,112 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 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.

20. Alicia Munnell and Ann Connolly, "Comparability of Public and Private Compensation: The Issue of Fringe Benefits," *New England Economic Review* (July/August 1979) pp. 27–45.

21. Detail on the reconstitution of the MSAs is available from the authors.

22. The data end with 1983 because beginning with 1984, these data are reported only by large county area and metropolitan areas can no longer be recreated.

23. The others were San Antonio, New Orleans, Memphis, Houston, and Minneapolis-St. Paul.

24. Edward Gramlich, "The Deductibility of State and Local Taxes," *National Tax Journal*, Volume 38, No. 4, December 1985, pp. 447–65.

25. See Daphne Kenyon's paper in this volume.

26. Robert Inman, "Does Deductibility Influence Local Taxation," NBER Working Paper 1714, October 1985.

27. Martin Feldstein and Gilbert Metcalf, "The Effect of Federal Tax Deductibility on State and Local Taxes and Spending," NBER Working Paper 1791, January 1986.

28. Gramlich, pp. 458–61.

29. One estimate is that the relative tax price of the sales tax will increase by 8 percent because of the reform. This is discussed in Dennis Zimmerman, "Federal Tax Reform and State Use of the Sales Tax," paper prepared for the Seventy-Ninth Annual Meeting of the NTA-TIA, Hartford, Connecticut, November 11, 1986.

30. These effects are discussed in James R. Follain and Patric H. Hendershott, *Tax Reform and Real Estate: The Impact of the Senate Finance Committee Plan*, The Urban Institute, 1986.

31. William Julius Wilson, "The Urban Underclass in Advanced Industrial Society," in *The New Urban Reality*, edited by Paul E. Peterson (Washington, DC: Brookings Institution, 1985).