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The Fiscal Outlook for Southern Cities

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THE FISCAL OUTLOOK FOR
SOUTHERN CITIES

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THE FISCAL OUTLOOK FOR SOUTHERN CITIES

Roy Bahl*

I. INTRODUCTION

In the face of well publicized urban problems in the North--riots and fiscal disparities in the 1960s and capital obsolescence and big city bankruptcies in the 1970s--the financial position and prospects of southern cities has not been paid much national attention. The Carter Administration's urban policy statement made a bow in the direction of being national, but it did not really reflect an understanding of the different forces that affect the budgetary position of northern and southern cities. In our federal system, which is supposed to have the virtue of being responsive to the varying needs and situations of different regions, an essential ingredient of good public policy is a recognition of these different forces. One goal in this paper is to describe more clearly the different setting in which northern and southern cities *typically* operate and to suggest what this might mean for national policy.[1]

*Professor of Economics and Public Administration, and Director, Metropolitan Studies Program, The Maxwell School, Syracuse University. Throughout this paper I draw from my earlier work on this subject, particularly from State and Local Government Finances and the Changing National Economy, Joint Economic Committee, forthcoming; and "Regional Shifts in Economic Activity and Government Finances in Growing and Declining States" in Tax Reform and Southern Economic Development, ed. Bernard Weinstein (Southern Growth Policies Board, May 1979). I am indebted to Anne Hoffman and William Montrone for their helpful research assistance.

[1]A regional breakdown such as "north" and "south" is subjective and can be misleading. Nevertheless, in order to facilitate this discussion, the "south" will be defined here to include Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, Oklahoma, South Carolina, Tennessee, Virginia, West Virginia, and Texas. When the analysis switches to urban areas, the sample will include all urban areas in those states which are numbered among the 74 largest urban areas in the country. We will take the "Northern Tier" to include the states in the New England, Mideast, and Great Lakes census regions.

A second purpose for this paper is to suggest what the changing national economy may mean for state and local governments in the urban south, and economy may mean for state and local governments in the urban south, and how southern governments might cope with these changes so as to avoid some of the serious fiscal problems that have plagued large cities in other regions.

The time is appropriate for this query into the fiscal prospects for southern cities, because it is likely that the rapid expansion in the state and local government sector in the South has yet to come. Public investments in infrastructure and human capital often lag behind the growth in population and income level and southern growth has been particularly rapid over the past five years. If the southern states are about to enter a fiscal growth period similar to that experienced in the north in the sixties, some of the painful fiscal lessons of that period might be well learned. Much of the financial problem now facing northern cities and states is a result of external pressures. The very rapid fiscal expansion in the mid and late 1960s and early 1970s was to a large extent the result of union pressures for higher employee compensation--a demand that was abetted by a high rate of inflation--and a crowding of high cost-low income citizens into the central cities. Much of this expenditure increase would have been difficult to avoid. Other aspects of the fiscal expansion, however, were more discretionary--the making of substantia long-term fixed debt and pension commitments, the addition of substantial numbers to the public employee rolls, and the buying into Federal programs to expand the scope of services offered.

The growing states with rapidly developing public sectors have much to learn from this experience. But the lessons are not so simplistic as to suggest that public employee unionization should be resisted at all costs, or that public services should be provided at modest levels. Rather, the important lesson is that the longer term consequences of fiscal decisions must be continuously and systematically monitored. What this amounts to is making certain that today's fiscal commitments can be carried by tomorrow's fiscal capacity.

This paper is presented in four sections. The different pressures on city finances in the south and differences in the ability to cope with these pressures are considered immediately below. We turn subsequently to the issue of whether southern cities are "fiscally distressed" and to a cursory study of the fiscal performance of urban governments in the south during the last decade. In a final section the fiscal outlook question is directly addressed, in a context of these considerations and the changing national economy. Time and data limitations prohibit either a comprehensive analysis of all southern cities or a detailed fiscal analysis of a few large cities. This paper is limited to a consideration of the largest southern cities and of the aggregate financial performance of state and local governments in the south.

II. THE FISCAL SETTING IN THE URBAN SOUTH

The fiscal prospects for southern cities need to be studied in a context of the very different setting in which they operate. Four general differences from cities in the north and industrial midwest are especially important as regards pressures on local government budgets: (a) intergovernmental arrangement in the south tends toward state government dominated fiscal systems, (b) central cities are much stronger in relation to their suburbs, (c) southern cities tend to be poorer on average and have a greater concentration of poor families, and (d) the budgetary problems of southern cities stem from their growth and newness. Though not subtle, these differences have too frequently been overlooked in policy analyses and even in the formulation of federal policy.[1] For example, if one equates "distress" with large city-suburb disparities, reliance on the property tax, population loss and age of city, he will have assumed (rather than found) that southern cities are less distressed than those in the north.

Fiscal Structure

Just in terms of spending level and composition, there are marked differences between the southern states and the rest of the nation. If we compare state and local government aggregates, the south spends less per capita, pays lower public employee wages and, surprisingly, employs more state and local government workers per capita (see Table 1). Tax

[1] A good discussion of such factors, and other north-south differences, may be found in Patricia Dusenbury, Regional Targeting (Research Triangle: Southern Growth Policies Board, February, 1979).

TABLE 1

SELECTED INDICATORS OF FISCAL STRUCTURE:
SOUTHERN STATE AND LOCAL GOVERNMENTS
AND THE NATION IN 1978

	Per Capita Direct General Expenditures	Employment per 10,000 Population	Average Public Employee Wage	Taxes as a Percent of Personal Income	Per Ca Long T Debt C standi
United States	$1355	492	$1139	11.3	$1234
Southern States (unweighted average)	1116	505	933	10.0	1001
North Carolina	1077	495	973	9.8	466
Virginia	1172	541	1011	9.9	810
South Carolina	1049	557	896	9.8	1069
Georgia	1133	548	893	10.0	1017
Florida	1169	511	1035	9.2	1066
West Virginia	1230	498	934	10.2	1062
Alabama	1098	501	989	9.0	970
Kentucky	1098	437	948	10.0	1501
Mississippi	1097	508	814	10.6	957
Tennessee	1089	492	938	9.4	1163
Arkansas	960	449	840	9.3	579
Louisiana	1265	524	890	10.7	1311
Oklahoma	1083	505	906	9.2	874
Texas	1112	500	989	9.2	1164

SOURCE: U.S. Bureau of the Census, Governmental Finances in 1977-78, Series GF78, No. 5 (Washington, D.C.: U.S. Government Printing Office, 1979); U.S. Department of Commerce, Survey of Current Business, Vol. 59, No. 8, Part II (Washington, D.C.: U.S. Government Printing Office, August 1979); and, U.S. Bureau of the Census, Public Employment in 1978, Series GE78, No. 1 (Washington, D.C.: U.S. Government Printing Office, 1979).

effort is low relative to the rest of the nation as is the per capita burden of long term debt. These patterns are surprisingly uniform. No southern state has a tax effort above the national average, none pay public employees a wage above the national average, and in no southern state are per capita aggregate state and local government expenditures above the national average.

A similar pattern holds when attention is turned to local governments. The data in Table 2 compare the expenditures and employment of overlapping local governments in the 22 largest southern *central counties* with that in the 52 largest non-southern *metropolitan areas*. On average, the southern local governments spend less per capita, have more employees per capita and pay lower wages. The patterns here are less uniform than in the case of state and local government aggregate expenditures and employment, but 21 of the 22 southern areas compensate their public employees at a rate below the national average. Only Miami departs from this trend of low compensation, which appears to hold for most functions.

These differences in fiscal structure are of great importance for understanding how state and local governments in the south might cope with the budgetary pressures they may face in the 1980s.

Intergovernmental Arrangement

Intergovernmental arrangement is not easily quantified and differentiated among states. However, one might argue that there are two approaches to identifying regional variations in the relative fiscal importance of

TABLE 2

INDICATORS OF EXPENDITURES STRUCTURE:
OVERLAPPING LOCAL GOVERNMENTS IN
LARGE SOUTHERN CENTRAL COUNTIES IN 1978

	Per Capita Expenditures		Full Time Equivalent Employment per 10,000 Population		Compensation per Employee			
	Common Functions[1]	Total Direct General	Common Functions	Total	Total	Police	Local Schools	Highways
52 Large Non-South SMSAs	$ 98	$ 970	43	348	$1361	$1527	$1417	$1185
22 Southern Central Counties (unweighted ave.)	91	791	52	397	1031	1141	1073	942
Birmingham (Jefferson)	82	644	54	311	1023	1166	1061	888
Ft. Lauderdale (Broward)	106	791	49	337	1095	1261	1112	966
Jacksonville (Duval)	90	805	28	423	1015	1182	1029	778
Miami (Dade)	125	1002	60	405	1383	1498	1627	1058
Orlando (Orange)	107	744	58	394	978	1084	989	831
Tampa (Hillsborough)	41	890	50	442	991	1059	1016	886
Tampa (Pinellas)	89	604	45	302	819	1157	646	873
Atlanta (DeKalb)	73	752	40	392	984	1131	999	937
Atlanta (Fulton)	115	1096	68	551	1053	1102	1064	968
Louisville (Jefferson)	78	661	45	333	1097	1222	1186	844
New Orleans (Jefferson)	71	631	29	310	927	898	1033	870
New Orleans (Orleans)	99	724	67	388	921	869	1082	680
Charlotte (Mecklenberg)	90	893	54	472	1005	1180	1051	1049
Greensboro (Forsyth)	86	967	46	498	989	1101	1026	863
Greensboro (Guilford)	91	794	52	381	1015	1039	1057	877
Memphis (Shelby)	127	770	75	444	1063	1182	1178	875
Nashville (Davidson)	98	840	62	403	1117	1033	1255	712
Dallas (Dallas)	101	756	55	385	1060	1248	1057	917
Houston (Harris)	83	804	43	322	1069	1310	1008	1140
San Antonio (Bexar)	63	650	36	403	963	1195	950	1357
Norfolk (Norfolk City)	82	582	55	379	1028	1008	1043	1317
Richmond (Richmond City)	114	977	66	451	1079	1186	1140	1038

[1] Police, Fire, and Sanitation other than Sewerage.

SOURCE: U.S. Bureau of the Census, Local Government Employment in Selected Metropolitan Areas and Large Counties: 1978, Series GE-78, No. 3 (Washington, D.C.: USGPO, 1980); U.S. Bureau of the Census, Local Government Finances in Selected Metropolitan Areas and Large Counties: 1977-78, Series GF-78, No. 6 (Washington, D.C.: USGPO, 1980).

state and local governments. One is to study the characteristics of southern and northern states and to present whatever pattern emerges. The other is to devise an objective system for classifying all states and to examine the results for the two regions. The latter approach was taken in an ACIR study which classified state fiscal systems.[1]

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

[1]Advisory Commission on Intergovernmental Relations, Federal Grants: Their Effects on State-Local Expenditures, Employment Levels, Wage Rates (Washington, D.C.: U.S. Government Printing Office, February 1977).

The fifty state fiscal systems described by these nine characteristics exhibit many varied and distinctive combinations of intergovernmental relationships. That some general patterns emerge indicates that although each state may be unique, certain common features of state and local fiscal relationships exist.

Based on this analysis, the fifty states were grouped into categories of high, moderate, and low financing responsibilities, expenditure shares, and per capita spending levels. These groupings were used to cross-classify state and local fiscal systems as one of three major types: *state government dominated* in terms of both expenditure responsibility and origin of financing; *local government dominated;* and *mixed systems*. These results are described in Table 3.

These data would seem to confirm the argument that southern states in general tend to have more state-dominated fiscal systems. Eight of the fourteen Southern Tier states exhibit a high state financing responsibility and a moderate to a high state expenditure responsibility. Only one southern state, Texas, is to be found in the locally-dominated group. By contrast, only two of the fourteen Northern Tier states--Rhode Island and Vermont--may be classified as state-dominated, while seven of the fourteen Northern Tier states may be classified as locally-dominated.

The importance of this different feature of intergovernmental arrangement in the south lies in the greater ability of state government to control the aggregate finances of state and local governments. A counter example may serve to illustrate the point. A state such as New York, characterized by a substantial importance of local government in state-local

TABLE 3

CLASSIFICATION OF STATE FISCAL SYSTEMS: NONWELFARE EXPENDITURES OF STATE AND LOCAL GOVERNMENTS, 1972

	High State Expenditure Responsibility[2]	Moderate State Expenditure Responsibility	Low State Expenditure Responsibility
High State Financing Responsibility[1,3]			
High Expenditure Per Capita[4]	Alaska Delaware Hawaii Vermont		
Moderate Expenditure Per Capita	Idaho Utah West Virginia	Louisiana New Mexico	
Low Expenditure Per Capita	Kentucky South Carolina	Arkansas Mississippi North Carolina Oklahoma	
Moderate State Financing Responsibility			
High Expenditure Per Capita	Montana Wyoming	Arizona Maryland Oregon Washington	Minnesota Wisconsin
Moderate Expenditure Per Capita	North Dakota New Hampshire	Connecticut Pennsylvanya	Florida
Low Expenditure Per Capita	Maine Rhode Island	Alabama Georgia Tennessee Virginia	Iowa

TABLE 3 (cont.)

	High State Expenditure Responsibility[2]	Moderate State Expenditure Responsibility	Low State Expenditure Responsibility
<u>Low State Financing Responsibility</u>			
High Expenditure Per Capita			California Nevada New York
Moderate Expenditure Per Capita		Colorado Kansas Nebraska South Dakota	Illinois Indiana Massachusetts Michigan Missouri New Jersey
Low Expenditure Per Capita			Ohio Texas

[1]High, moderate, and low designations for each category relate to whether the state placed in the top 15, middle 20, or bottom 15 among states.

[2]State expenditure responsibility is the state share of total state and local direct expenditures.

[3]State financial responsibility is the share of total state and local expenditures financed by the state.

[4]Per capita expenditures is total state and local expenditures per capita.

SOURCE: Advisory Commission on Intergovernmental Relations, <u>Federal Grants: Their Effects on State-Local Expenditures, Employment Levels, Wage Rates</u> (Washington, D.C.: Government Printing Office, February 1977).

finances, finds it quite difficult to control either the total level of taxes levied within the state or the variation in the quality of public services offered. As a result, state government fiscal policy, such as tax cuts to stimulate employment growth, may be simply offset by local government tax increases. A more centralized state, however, would be in a much more favorable position in terms of the possibility for controlling the aggregate level and distribution of fiscal activity.

A second advantage of state dominated systems is that there is less reliance on inelastic property taxes and greater reliance on more elastic sales and income taxes. As may be seen from the data reported in Table 4, southern states rely to a greater extent on sales and income taxes than do other states in the nation. The differences in Table 4 may not appear so great, but when only northern states are considered, southern states appear much less reliant on property taxes and much more dependent on state sales and income taxes.[1] Thus, state fiscal dominance makes problems of the property tax much less important in evaluating the fiscal prospects for southern cities. State to local grants and direct state financing are the issues more likely to hold the key to avoiding acute fiscal problems in the growing southern region.

City-Suburb Disparities

As far back as the mid-1960s urban fiscal problems have been closely identified with urban government fiscal disparities.[2] The concern has

[1] These differences are reported in Roy Bahl, "Regional Shifts in Economic Activity and Government Finances in Growing and Declining States," (Research Triangle: Southern Growth Policies Board, May 1979).

[2] Alan Campbell and Seymour Sacks, Metropolitan America (New York: The Free Press, 1979).

TABLE 4

REVENUE STRUCTURE OF STATE AND LOCAL GOVERNMENTS: THE SOUTH AND THE UNITED STATES FOR 1978

	Percent of Own Source Revenue From:					
	Property Taxes	Sales Taxes	Income Taxes	Per Capita Federal Aid	Federal Aid as Percent of Total General Revenue	State Government Expenditure as a Percent of State and Local Government Expenditures
United States	17.8	16.8	17.8	319	22.0	58.8
Southern States (unweighted average)	17.0	20.9	14.6	305	25.7	64.8
North Carolina	18.4	16.2	23.7	288	26.1	68.4
Virginia	21.8	13.1	20.8	290	23.1	64.1
South Carolina	16.6	19.3	19.3	293	25.8	71.6
Georgia	20.9	19.3	17.1	330	26.2	56.5
Florida	23.8	20.0	3.1	246	20.6	50.0
West Virginia	14.0	30.3	12.7	353	29.1	77.7
Alabama	8.4	21.5	13.8	310	27.4	66.7
Kentucky	14.1	17.7	22.5	306	26.3	74.3
Mississippi	15.3	27.1	10.5	354	29.7	69.7
Tennessee	17.7	29.2	5.4	290	25.8	48.9
Arkansas	15.9	19.4	17.7	327	30.3	72.2
Louisiana	9.7	24.3	9.5	339	25.4	69.6
Oklahoma	14.7	15.6	13.1	304	24.7	65.7
Texas	26.6	19.2	0.0	233	19.7	51.4

SOURCE: U.S. Bureau of the Census, Government Finances in 1977-78, Series GF-78, No. 5 (Washington, D.C.: U.S. Government Printing Office, 1977); and, U.S. Department of Commerce, Current Population Reports, "Annual Estimates of the Population of States," Series P-25, No. 868, November 1979.

continued into the 1970s[1] and has formed a basis for one version of the study of urban "distress." The standard stereotype would have central cities in a substantially worse position than their suburbs in terms of income level, public service levels, and concentration of the poor. In part because of differences in local government structure, this stereotype tends to be much less true in the south and the west than in the rest of the country. Sacks' latest compendium underlines this pattern of average behavior across regions (See Table 5). His more detailed data suggest that this pattern holds for most urban areas within the region. City population exceeds that in suburbs in 16 of 27 southern metropolitan areas, but in only 7 of 22 midwestern SMSAs and in none of the 18 northeastern metropolitan areas. He finds a similar pattern for per capita incomes--higher in cities than suburbs in 13 of 27 areas in the south, but higher in only 2 of 22 midwestern areas and in no metropolitan area in the northeast.[2]

This is not to suggest that all southern cities are equally well off. There is much variability among them. The small sample described in Table 6 demonstrates that at least five of the largest southern metropolitan areas show the classic northern pattern of fiscal disparities. While this underlines the problems with generalizing about regions, the fact still remains that southern cities, in general, do not fit the stereotype description of city-suburb disparities.

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[1] Department of Housing and Urban Development, Changing Conditions in Metropolitan Areas, Urban Data reports, Number 1, (Washington, D.C.: Office of Policy Development and Research, June 1979).

[2] Ibid.

TABLE 5

CITY-SUBURB DISPARITIES IN PER CAPITA INCOME: UNWEIGHTED AVERAGES

Region	Central City Per Capita Income (dollars)		Ratio of City to Suburb Per Capita Income		Percent Increase in Per Capita Income, 1970-75		Ratio of City to Suburb Population		Percent Increase in Population 1970-1976	
	1970	1975	1970	1975	Central City	Suburb	1970	1976	Central City	Suburb
East	3131	4313	0.83	0.81	37.8	41.0	0.74	0.66	-0.07	0.04
Midwest	3192	4567	0.91	0.90	43.0	45.0	0.64	0.65	0.16	0.15
South	2929	4423	1.03	1.01	51.0	54.3	1.31	1.15	0.03	0.15
West	3407	4987	1.03	1.02	46.4	47.8	0.70	0.68	0.06	0.09
United States	3145	4560	0.95	0.93	45.0	47.2	0.78	0.73	0.04	0.10

SOURCE: Department of Housing and Urban Development, Changing Conditions in Large Metropolitan Areas, Urban Data Reports, Number 1 (Washington, D.C.: Office of Policy Development and Research, June 1979), Tables 1 and 13.

TABLE 6

SOUTHERN CITIES CHARACTERIZED BY FISCAL DISPARITIES

	Ratio of Central City to Outside Central City Population (1976)	Ratio of Central City to Outside Central City Per Capita Income (1975)
Birmingham	0.57	0.87
Miami	0.34	0.77
Tampa	0.40	0.89
Atlanta	0.41	0.80
Louisville	0.67	0.87
27 Southern SMSAs[a]	1.15	0.81
18 Northern SMSAs[a]	0.66	0.90
22 Midwestern SMSAs[a]	0.65	1.01
18 Western SMSAs[a]	0.68	1.02

[a]Unweighted averages.

SOURCE: Department of Housing and Urban Development, Changing Conditions in Large Metropolitan Areas, Urban Data Reports, Number 1 (Washington, D.C.: Office of Policy Development and Research, June 1979), Tables 1 and 13.

Richard Nathan and his colleagues[1] have attempted to rank the distress of cities by developing a "hardship" index which compares cities both with their surrounding suburban areas and with each other. Their index is more complicated than a single measure of disparity, e.g., they used factors such as the age distribution of the population, education level of residents, per capita income, crowded housing, and concentration of poverty. They combine these factors, giving equal weight to each, to derive an index or ranking of urban condition. Of the fourteen cities scoring poorest on this hardship index, eleven are in the Northern Tier of states while only two, Atlanta and Richmond, are in the south. Of the ten cities scoring "best," five were in the Southern Tier and none in the north.

This advantaged position of southern central cities can be attributed in part to the newness of the cities and their local government structure, which often tends to encompass growing suburban areas. There would appear to be much less jurisdictional fragmentation in the south, in part because of the greater potential for annexation and consolidation during the rapid growth period of the past two decades. During the 1970-1977 period, 33 percent of all annexations occured in the southern states, 30 percent in Illinois and California, and 36 percent in the remaining 34 states. The south has also been more active in local government consolidation than any other region--of all city-county consolidations occuring in the contiguous United States, nearly half have been in the southern states.[2] To the contrary,

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[1]Richard P. Nathan and Paul R. Dommel, "The Strong Sunbelt Cities and t Weak Cold Belt Cities," Hearings before the Subcommittee on the City of the House Committee on Banking, Finance, and Urban Affairs, <u>Toward a National Urban Policy,</u> 95th Congress (Washington, D.C.: Government Printing Office, 1977), pp. 19-26; and "Understanding Central City Hardships," <u>Political Scie Quarterly,</u> Vol. 21, No. 1 (Spring 1976): 61-62.

[2]See, "1970-1978 Annexations in the Southern States," Southern Growth Policies Board, Unpublished paper, 1980.

northern cities, which are surrounded by older incorporated jurisdictions, find it all but impossible to expand jurisdictional boundaries.

Two lessons might be learned from this discussion, first, the absence of fiscal disparities in southern cities does not signal an absence of urban fiscal problems. This finding simply emphasizes the fact that the fiscal problems of southern cities are less likely to be caused by jurisdictional fragmentation. In effect slums and suburbs can both exist within a metropolitan government boundary. Second, all southern cities are not alike and some may be characterized by disparities very much like those which exist in the more distressed urban areas of the north.

Income Level

Southern cities have a lower per capita income than other U.S. cities, though the gap has been narrowing. Sacks' large city sample shows only a 3 percent difference between the south and the rest of the U.S. in 1975 (see Table 5). Some would argue that after cost-of-living adjustments, southern cities may actually have higher average incomes. Unfortunately, that computation can't be made because there is no reasonable, comparable measure of interurban variations in prices.

Another relevant measure of low income is the concentration of the poor within metropolitan areas. At the time of the 1970 census, this concentration was much greater in southern central cities than in the northeast and midwest. For example, 1970 census data show that 14.3 percent of the population of the 27 cities in Sacks' sample was below the poverty income line. The comparable figures for northeastern and midwestern cities are 10.8 percent and 9.2 percent respectively. Things may have changed markedly since 1970, but a heavier concentration of the poor within southern cities is not an unreasonable hypothesis.

Data problems notwithstanding, it is important to somehow answer the question about whether cities in the south have a greater capacity to finance public services, a smaller concentration of the poor, and a generally lower level of expenditure need. The answer is by no means clear.

Growth and Newness

Paradoxically, the fiscal problems of southern cities stem from their growth and their newness. The problem is essentially that the level of public services has not yet caught up to the growing demand of the resident population and to the requirements associated with industrial growth. Growth exerts a mixed effect on city budgets. On the one hand, it does appear to be associated with substantial increases in revenues. On the other hand, increasing per capita incomes raise demands for more and better public services, increasing job opportunities and industrial location raises requirements for infrastructure, the encroachment of population growth on the environment must be dealt with, and so it goes. The moral here is that growth is not without its fiscal problems and somehow should be taken into account in describing city fiscal conditions.

III. THE FISCAL HEALTH OF SOUTHERN GOVERNMENTS

Few, if any, City Councils would admit to having more revenue than they could usefully dispose of; i.e., all cities have a public servicing "gap." Yet some cities are able to reduce taxes while others must borrow to meet current obligations, some underfund their pension systems and allow their capital stock to deteriorate while others build city halls and stadiums, and still others allow their capital stock to deteriorate and build new stadiums. Even a cursory glance at city financial reports, the quality of city services provided, and the physical condition of cities suggests that some cities are better off than others. It seems only a natural response that some analysts have attempted to quantify the fiscal and economic health of cities with measures of what have come to be referred to as "fiscal distress."

Because distress measures are at least partly subjective, a lively debate has ensued over what constitutes fiscal need or distress. The stakes in this debate may be the allocation of some share of Federal aid--a substantial enough prize to stir controversy.[1] Nearly everyone believes

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[1] Indeed, Community Development Block grants are allocated on a formula basis where the elements of the formula reflect some attempt to measure the financial need of cities.

that federal assistance to governments ought to be "targeted" on the most needy governments, but there is little agreement as to what constitutes fiscal distress or how it ought to be measured. The problem, no matter how dressed up, boils down to the very subjective decision about what constitutes need. Some have pointed to the most troubled cities in the north and have understandably equated distress with measures such as the age of housing and population loss. Southerners counter with the argument that quality and crowding of housing would be better measures than age and that population *growth* can also pose serious problems. Unfortunately for purposes of using this information in formulating public policy, both positions are in some sense correct.

As in so many cases, the key is to formulate carefully the question, i.e., what are we trying to measure? For purposes of this paper we might turn the question toward whether there is some sense in which southern cities are relatively more distressed.

Two approaches have been taken. The first is comparison of indicators of need, economic health and fiscal performance to develop an overall "distress" ranking for cities. Here one would place the statistical comparisons of city condition and, perhaps, municipal bond ratings. The second focuses more directly on measurement and comparison of the short term financial position of individual cities.

Comparative Studies

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.

The comparative studies are plagued by a number of methodological problems. The key issue, of course, is "what is meant by financial distress or strain--in other words--what is a fiscally troubled city?" It might be argued that a proper set of indicators of the fiscal viability of a local government would have several characteristics: it would permit valid comparison with other cities; it would be derived from analysis of the past and current situation as well as that projected for the future; and it would reflect consideration of the economic and social structure of the local area in addition to the financial condition of its governments. Most importantly, it would be based on an underlying theoretical model which would enable evaluation of fiscal health with respect to clearly defined criteria. Though a number of the techniques commonly used address one or more of these issues in some fashion, none incorporates the full range of considerations suggested here. In particular, none of these studies explicitly considers prospects for the future though all seem to contain, however implicitly, some conclusion about future prospects.[1]

The cross-section, statistical studies of fiscal distress are an outgrowth of the traditional expenditure determinants literature. The

[1] We have considered these criteria at some length in Roy Bahl and Bernard Jump, Jr., "Measuring the Fiscal Viability of Cities," in Fiscal Choices, ed. by George Peterson (Washington, D.C.: The Urban Institute, forthcoming).

"determinants" studies attempt to find a statistical relationship between public expenditure levels and the social, economic, and demographic characteristics of the community.[1] The distress studies make some assumptions, often implicit, about the determinants of high and rising expenditure requirements and low or falling revenue yields, e.g., large concentrations of poor families, low per capita incomes, and declining populations. The analysis then involves determining outliers in terms of each of these indicators of need or capacity and somehow combining these to derive an overall measure of fiscal strain or distress. The answer one gets, however, depends on (a) the sample of cities chosen for the comparison, (b) the variables included in the analysis, (c) the method used to estimate an index and (d) the cutoff index selected for "distress."[2]

The samples have varied widely depending on the purposes of the analysis. In analyzing relative economic strength of urban areas, Nathan and Adams[3] studied SMSAs with populations over 500,000 and Nathan and

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[1]For recent reviews of these studies, see Roy Bahl, Marvin Johnson and Michael Wasylenko, "State and Local Government Expenditure Determinants: The Traditional View and a New Approach," in Public Employment and State and Local Government Finances, ed. by Roy Bahl, Jesse Burkhead and Bernard Jump, Jr. (Cambridge, Mass.: Ballinger Publishing Co., 1980); and Robert Inman, "The Fiscal Performance of Local Governments: An Interpretative Review," in Current Issues in Urban Economics, ed. by Peter Mieszkowski and Mahlon Straszheim (Baltimore, Maryland: Johns Hopkins University Press, 1979), pp. 270-321.

[2]A good analysis and critique of fiscal distress studies is Office of State and Local Government Finance, U.S. Treasury, "Responsiveness of State/Federal and Direct Federal Aid to Distressed Cities," Research Note IV, 1979.

[3]Nathan and Adams, "Understanding Central City Hardship."

and Fossett[1] studied the 55 largest cities. In research pointed more to analyzing fiscal stress, Clark has been studying a sample of 57 cities of varying sizes[2] while Touche-Ross analyzed a nonrandom sample of 66 cities.[3] The Institute for the Future studied a random sample of 40 cities with populations over 100,000 and 100 cities with populations between 25,000 and 100,000.[4] The most comprehensive study was done by HUD and included all United States cities with populations above 50,000.[5] Since distress in each of these studies is measured by a deviation from some sample average, "distressed conditions" are not independent of the sample chosen. For example, the 'normal' values, the variances,and therefore the findings of the Touche-Ross study might have been altered drastically if Pueblo, Colorado; Daly City, California; and St. Petersburg, Florida (included in their sample) had been replaced by New York City, Detroit, and Newark (not included in their sample). More generally, there

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[1]Richard Nathan and James Fossett, "Urban Conditions: The Future of the Federal Role," _Proceedings of the National Tax Association (1978)_ (Columbus, Ohio: National Tax Association, 1979), pp. 30-41; and "The Prospects for Urban Revival," _Urban Government Finance: Emerging Issues_ (Beverly Hills, California: Sage Publications, forthcoming).

[2]Terry Clark, _et al.,_ "How Many New Yorks? The New York Fiscal Crisis in Comparative Perspective," Report No. 72 of the Comparative Study of Community Decision-Making (Chicago: University of Chicago, 1976).

[3]Touche-Ross and Company and the First National Bank of Boston, _Urban Fiscal Stress: A Comparative Analysis of 66 U.S. Cities_ (New York: Touche-Ross and Company, 1979).

[4]Gregory Schneid, Hubert Lipinsky and Michael Palmer, _An Alternative Approach to General Revenue Sharing: A Needs Based Allocation Formula_ (Washington, D.C.: Institute for the Future, June 1975).

[5]Harold Bunce, _An Evaluation of the Community Development Block Grant Formula_ (Washington, D.C.: U.S. Department of Housing and Urban Development, December 1976).

can be little question but that any comparison of cities will lead to the finding of outliers in terms of social, economic and fiscal health, so it is not surprising that all studies of this type find some cities which are distressed. But it is not clear that being an outlier in such a comparison is evidence of fiscal distress. This would seem especially true in cases where the different "setting" is not fully accounted for, e.g., the south.

An important problem relates to the choice of variables used to measure hardship or distress. Particularly important is whether the indicators are of current condition (e.g., per capita income) or of changes in financial condition (percent increase in per capita income or in population). Moreover, the choice of a variable may in fact dictate the result of the comparison. For example, an index can show more 'distress' in the older northeastern cities if it begins by *assuming* that age of housing is an important indicator of distress.[1] A CBO survey of the distress studies describes the wide variation in the variable choices made as well as the biases inherent in these choices.[2]

Despite these very great differences in approach, there is some consistency in the findings of these studies. The comparison of outliers in six studies in Table 7 shows 14 cities as relatively "distressed"[3] in more than one of these studies.[4] All except Washington, D.C. are located

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[1]A useful discussion of "northern" and "southern" variables in distress is in Patricia Dusenbury and Thad Beyle, Southern Cities and National Urban Policy (Research Triangle: Southern Growth Policies Board, May 1979).

[2]Congressional Budget Office, City Need and the Responsiveness of Federal Grants Programs (Washington, D.C.: Government Printing Office, August 1978).

[3]"Distress" has been arbitrarily defined in Table 6 for purposes of exposition.

[4]This by no means exhausts the list of fiscal distress studies. See, for example, Linn Brown and Richard Syron, "Cities, Suburbs and Regions," New England Economic Review (January-February 1979): 41-61; and, Advisory Commission on Intergovernmental Relations, Trends in Metropolitan America (Washington, D.C.: Government Printing Office, 1977).

TABLE 7

COMPARISONS OF DISTRESSED CITIES IN SELECTED STUDIES

Criteria:	Nathan and Adams: Top Two Deciles	Nathan and Fossett: Top Two Deciles	Cucitti: High Social Economic or Fiscal Need	Institute For the Future: Five Cities Scoring Highest Fiscal Need	HUD: Five Cities Scoring Highest on Needs Index	Dearborn: Cumulative Budget Deficits
Newark	X	X	X	X		
Cleveland	X	X	X			
Hartford	X					
Baltimore	X		X	X		
Chicago	X					
St. Louis	X	X	X	X		
Atlanta	X					
Rochester	X					
Gary	X		X			
Dayton	X					
New York	X		X		X	X
Buffalo		X	X			X
Pittsburgh		X	X			X
Boston		X	X		X	
Detroit		X	X			
Philadelphia		X	X	X		X
Minneapolis		X				
Washington, D.C.			X		X	
Jersey City			X			
Chicago			X			
Birmingham			X			
Miami			X			
New Orleans			X			
Atlantic City				X	X	
Cambridge, Mass.					X	
Milwaukee						X
Columbus						X
Seattle						X
Tampa						

SOURCES: Richard Nathan and Charles Adams, "Understanding Central City Hardship," Political Science Quarterly 91 (1) (Spring 1976): 47-62; Nathan and James Fossett, "Urban Conditions--The Future of the Federal Role," Proceedings of the National Tax Association, 1978; Gregory Schneid, Hubert Lipinsky, and Michael Palmer, An Alternative Approach to General Revenue Sharing: A Needs Based Allocation Formula (Washington, D.C.: Institute for the Future, June 1975); Harold Bunce, An Evaluation of the Community Development Block Formula (Washington, D.C.: U.S. Department of Housing and Urban Development, December 1976); and Philip Dearborn, The Financial Health of Major U.S. Cities in Fiscal 1977. First Boston Corporation, 1978.

In the northeast and industrial midwest regions, the most comprehensive of the fiscal needs studies, the HUD analysis, resulted in a higher needs index for northeastern cities than for cities in any other region. The highest needs index found in that study was for northeastern cities with populations greater than 500,000.[1] Similarly, Nathan's hardship index is higher for northeast cities than for any other region. Southern cities are not usually high on the list of distressed places, though Atlanta, New Orleans, Birmingham, Miami and Tampa do come off as hardship cases by comparison with the rest of the south.

Some studies, more limited in their coverage, reach slightly to dramatically different conclusions. Kaplan, Gans and Kahn have noted that using the Nathan indicators and sample, New Orleans, Louisville, Miami, and Atlanta can rank as "worse" than New York, Boston, and Philadelphia under various definitions of distress.[2] Still, the 13 large southern cities in their comparison showed an average "urban conditions index" which was more than three times "better" than the five northeastern cities in their comparison. Clark has studied a smaller sample of 57 cities with

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[1] A special tabulation from the HUD study appears in City Need and the Responsiveness of Federal Grants Programs, (Washington, D.C.: U.S. Government Printing Office, 1978), p. 37.

[2] Marshall Kaplan, Gans and Kahn, Growth and the Cities of the South: A Study in Diversity (Washington, D.C.: White House Conference, 1978).

a broader population range. His findings are not inconsistent with the findings that the most distressed cities are in the northeast.[1] The recent study by Touche-Ross, though flawed in many ways, also reaches the conclusion that "... the most important financially pressed cities are in the industrially mature northeast."[2]

Another comparative approach may define a city's well-being not only in terms of other cities but also in terms of its own suburbs. Nathan and Adams have considered these disparities more systematically in developing an index of intercity hardship.[3] They compare city/suburb disparities in unemployment, age distribution of the population, education level, income level, crowded housing, and poverty. The results are not different from above; indeed, the older industrial cities compare even less favorably when city/suburb disparities are considered.

One should resist jumping too quickly to the conclusion that the consensus in these results allows us clearly to identify distressed local governments and formulate remedial public policy. There are strong arguments that these measures are biased against certain types of cities with certain

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[1] Clark et al., "How Many New Yorks? The New York Fiscal Crisis in Comparative Perspective," 1976.

[2] Touche-Ross and Co., Urban Fiscal Distress: A Comparative Analysis of 66 U.S. Cities, p. 109. A good critique of the Touche-Ross study is, Department of Housing and Urban Development, "The Urban Fiscal Crisis: Fact or Fantasy?" (Washington, D.C.: Office of Policy Development and Research, March 26, 1979).

[3] Nathan and Adams, "Understanding Central City Hardship," pp. 47-62.

types of fiscal problems. Southern and western cities, which have been able to expand boundaries through annexation and consolidation,[1] may seem less distressed because their suburbs are included in comparisons with northern cities whose suburbs are not included. The interesting point has been made that if San Antonio's boundaries had not changed since 1945, its rates of poverty and unemployment would be greater than those in Newark.[2] For this reason, results from comparisons of *cities* would be an incorrect basis for distributing federal assistance since it would penalize those cities which have done something about their boundary problems. The comparison of taxable capacity and population characteristics which ought to be made is of metropolitan areas. This would reduce the interregional disparity in economic well-being and expenditure needs, i.e., it would make the distressed cities of the north look less distressed--relative to the rest of the country--than they do now. This would imply a policy that some part of suburban wealth should be reallocated to central cities as a prerequisite to more federal help.

Even this adjustment, however, would leave the slower growing northern cities high on the distressed list and the measures used could still assume a northern view of distress--that age is a proxy for need, that growth creates fewer problems than decline, and that the *rate* of income growth is more important than the level of income. The "northern view" is not totally incorrect, but it is flawed and self-serving. The age of housing is not a good proxy for quality--old housing isn't always worse housing and there are not good statistics on the quality of older housing. Likewise,

[1]Vincent Marando describes the better record of southern and western cities in "The Policies of Metropolitan Reform," in State and Local Government: The Political Economy of Reform, Alan Campbell and Roy Bahl, eds. (New York: The Free Press, 1976), pp. 24-49.

[2]As reported in "Annexation," Southern Growth Policies Board, unpublished paper, 1980.

declining population is not necessarily bad because it may lessen fiscal pressures on some jurisdictions, e.g., fewer school age children may provide some breathing space for property tax financing of education. Growth, on the other hand, may be a mixed fiscal blessing because of pressures to expand infrastructure and finance new services.[1]

A third argument against the traditional measures is that there are pockets of poverty in the Houstons and Jacksonvilles which are every bit as bad as those in the north, and where wage rates and public service levels are at great disparity with the rest of the city. If distress studies make comparisons among areas (rather than cities), this bias is removed. The remaining disparities among residents within the area represent local choices about how to distribute public services, whether to have labor unions, etc. The results of these choices may well be distressing, but they should not be taken into account in measuring distress.[2]

What all of this amounts to is a conclusion that northern cities are *relatively* less distressed than these studies have shown. They may still be worse off and perhaps in more need of federal assistance during a transition period when they are losing jobs and population, but we have not yet captured this greater need in existing comparative measures of fiscal distress.

Case Studies of Financial Condition

Case studies of local government fiscal viability offer an alternative approach to measuring fiscal distress. They may be detailed

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[1] A good presentation of the view of 'growing' states is in David Peterson, The Relative Need of States and Regions for Federal Aid (Research Triangle Park: Southern Growth Policies Board, March 1979).

[2] For an interesting view of poverty in the urban south, see David Perry and Alfred Watkins, "People, Profit and the Rise of the Sunbelt Cities," in The Rise of the Sunbelt Cities, ed. by David Perry and Alfred Watkins, (Beverly Hills, Calif.: Sage Publications, 1977), pp. 277-306.

and take into account the factors important to a specific city, and they may consider both the short-term cash flow and long-term economic factors.[1] The shortcoming of the case study approach is that it does not easily provide a comparative dimension, i.e., we may be able to determine that Buffalo faces a revenue shortfall for the next three years, but we don't know if it will be worse than Atlanta's. Comparative case studies[2] are the intuitive but very difficult-to-accomplish answer to this dilemma.

The best work on comparing financial conditions has been done by Dearborn.[3] He analyzes the financial reports of the thirty largest cities on an annual basis. His analysis is focused on the short-term financial position of cities--their general fund revenue-expenditure shortfalls, and their liquidity. By this measure of very short-term financial health, his list of cities in financial trouble, or close to the edge, is not substantially different from those presented above (see Table 7). Again, southern cities do not rank high on the distressed city lists.

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[1]For good examples, see Advisory Commission on Intergovernmental Relations, City Financial Emergencies: The Intergovernmental Dimension (Washington, D.C.: U.S. Government Printing Office, July 1973); and, David Stanley, Cities in Trouble (Columbus, Ohio: Academy for Contemporary Problems, 1976).

[2]For attempts at comparative case studies, see Committee for Economic Development, Fiscal Issues in the Future of Federalism, Supplementary Paper Number 3 (New York: May 1968); and, Advisory Commission on Intergovernmental Relations, Fiscal Balance in the American Federal System, Vol. II, Metropolitan Fiscal Disparities (1968).

[3]Dearborn's initial work on this subject appeared as Advisory Commission on Intergovernmental Relations, City Financial Emergencies, 1973. During 1977 and 1978 he developed a set of indicators of financial emergencies which were published by the First Boston Corporation, Elements of Municipal Financial Analysis (New York: First Boston Corporation, 1978). His most recent extensions of this work appear in "The Financial Health of Major U.S. Cities in 1978", 1979.

Municipal Credit Analysis

Events of recent years have given rise to mounting concern with the ability of particular jurisdictions to service existing debt and to meet other obligations. This may be construed as another way to measure distress, i.e., rating agencies attempt to measure and compare the probability of default. The bond rating process is very similar to the comparative quantitative analysis discussed above. Governments are ranked by various measures, and outliers are identified. However, instead of being labeled "distressed" as in a scholarly study, they are given a lower credit grade (e.g., BBB) and face a higher borrowing cost in the market. Ironically, when a definitive distress measure is developed, it will likely be used by the federal government to reward distressed governments with higher grants and by the rating agencies to penalize them with higher interest costs.[1]

Until very recently, the analytic techniques used by the major rating agencies and other municipal analysts had not been articulated.[2] Historical analyses suggested that the most important determinant of credit rating differences was the level of debt burden relative to taxable capacity.[3] The more recent view is considerably more enlightened, e.g., Standard & Poor's notes in its Rating Guide that "We consider an issuer's

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[1]The concept of a bond rating as a tax or negative grant on local government is developed in Patrick Sullivan, Municipal Bond Ratings Viewed as Implicit Grant/Tax Mechanisms, Occasional Paper No. 30, Metropolitan Studies Program, The Maxwell School (Syracuse, NY: Syracuse University, Nov. 1976).

[2]Both Standard & Poor's and Moodys have recently described their rating procedures and systems. See Standard & Poor's Ratings Guide (New York: McGraw-Hill, 1979); and Wade Smith, The Appraisal of Municipal Credit Risk (New York: Moody's Investor Service, 1979).

[3]These analyses are surveyed and further evidence is presented in Roy Bahl, "Measuring the Creditworthiness of State and Local Governments: Municipal Bond Ratings," National Tax Association, Proceedings of Sixty-Fourth Annual Conference (1972), pp. 600-622. See also John E. Petersen, The Rating Game, Report of the Twentieth Century Fund Task Force on Municipal Bond Credit Ratings (New York: The Twentieth Century Fund, 1974).

economic base the most critical element in the determination of a municipal bond rating."[1] It is interesting to note that the debt burden variable, which is still of major import in determining credit risk, would not lead to the conclusion that northeastern cities are any more troubled than other cities. Indeed, southern and midwestern cities show the highest levels of debt outstanding relative to general revenues.[2] On the other hand, if more attention is paid to the growth potential of the economy, most southern cities will score as stronger credits.

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[1] Standard & Poor's, Ratings Guide, p. 260.

[2] City Need and the Responsiveness of Federal Grant Programs, p. 32.

IV. THE FISCAL PERFORMANCE OF SOUTHERN CITIES

Another approach to evaluating the relative fiscal health of southern cities is to examine their recent fiscal performance. Can one find evidence of distress in the recent taxing, spending, and borrowing decisions of local governments in the south and elsewhere? How different a pattern of fiscal behavior can we observe from a comparison of southern cities with those outside the south and particularly with those on the distressed city lists?

One way to begin such an evaluation is to raise the question about why city fiscal conditions have not been worse. Since the bottom of the 1974-75 recession, Cleveland, Wayne County, and the Chicago Schools have followed New York City to the point of being unable to meet debt service commitments. Otherwise, there have been no more New Yorks in the sense of major defaults, Federal emergency loan guarantees or the other trappings that accompany the collapse of a city's financial operations. Certainly, no state government has faced a financing problem so severe as that faced by New York State in 1975. Somehow, in the face of declining economic base, inflation, and rising public employment costs, states and cities have managed to stave off the ultimate financial crisis. Southern governments, in particular, weathered the last recession without suffering major fiscal ills.

It is important to understand the reasons why this current performance is not more dismal and whether this condition is more permanent than temporary. The most important of the compensating factors, which have allowed many of even the most distressed cities to remain solvent, are national economic recovery, increased federal assistance, and deferred expenditures. In the sections below we consider these factors in terms of their contribution to the favorable financial performance of cities in the past few years, and in terms of whether they might continue to shore up the financial position of these governments. We also attempt to determine how recovery, federal aid flows and deferrals might have had a differential effect on southern cities.

Economic Recovery

The recovery of the national economy, with lower rates of inflation and unemployment, played an important role in maintaining the fiscal viability of state-local governments since 1975. From a low annual increase of 7.2 percent in the recession (1974-1975), per capita state government revenues have registered annual increases of 10.5 (FY1976), 12.4 (FY1977) and 11.1 (FY1978) percent. Local governments show a similar pattern of bouyancy through the 1978 fiscal year (see Table 8). This is a direct result of real GNP growth rates in the 4 to 6 percent range for three years following the recession.

While this strong economic performance helped state and local governments everywhere, it should be pointed out that some regions of the country benefitted far more than others. The Northern Tier of states experienced a slower rate of income and employment growth than the Southern Tier and

TABLE 8

COMPARISONS OF STATE AND LOCAL GOVERNMENT
FISCAL ACTIVITY: 1969-1978

Average Annual Percent Increase in:	1969-1974	1974-1975	1975-1976	1976-1977	1977-1978
Per Capita Total Expenditures					
State Governments	10.3	15.8	10.2	7.2	7.8
Local Governments	10.1	13.9	10.7	5.3	7.1
Municipalities	9.0	11.4	11.0	3.2	7.1
Per Capita Current Expenditures					
State Governments	12.9	17.0	11.9	10.5	10.8
Local Governments	10.9	12.8	12.5	7.2	7.9
Municipalities	9.5	9.7	14.5	5.5	7.1
Long-Term Debt Outstanding					
State Governments	9.8	9.5	16.0	11.2	13.4
Local Governments	7.2	4.4	6.8	9.8	7.0
Municipalities	5.5	4.5	11.3	7.7	12.9
Employment					
State Governments	4.0	3.4	2.0	3.7	2.2
Local Governments	3.8	2.1	0.8	2.6	1.9
Municipalities	2.7	0.7	-1.7	1.6	1.0
Employee Compensation					
State Governments	11.0	10.0	9.2	10.6	8.8
Local Governments	10.8	9.5	6.8	8.2	7.1
Municipalities	10.7	7.3	5.0	6.7	6.2
Per Capita Tax Revenues					
State Governments	11.1	7.2	10.5	12.4	11.1
Local Governments	9.2	7.6	9.3	9.9	6.6
Municipalities	6.9	5.8	9.6	11.7	6.4

SOURCE: U.S. Department of Commerce, Bureau of the Census, Governmental Finances in 1968-69, 1973-74, 1975-76, 1976-77, 1977-78; U.S. Department of Commerce, Bureau of the Census, Public Employment in 1978; U.S. Department of Commerce, Bureau of the Census, City Government Finances in 1968-69, 1973-74, 1974-75, 1975-76, 1976-77, (1977-78 not yet available).

a corresponding slower rate of growth in aggregate state-local government revenues (See Table 9). Everyone got a little well during the recovery, but the south got a lot better.

A similar picture emerges when the economic and fiscal performance of large cities is examined. Even with the strong recovery, many central cities have not regained former levels of economic activity as rapidly as have suburban areas, and cities in the northeast and industrial midwest have recovered more slowly than cities in other parts of the country. Sacks' estimates for city employment (by place of employment) bear this pattern out. Of 15 large northeastern cities for which he has made estimates, 14 had employment declines between 1970 and 1977. This may be compared with 8 of 20 midwestern cities, 12 of 25 southern cities and 4 of 20 western cities.[1]

A comparison of per capita personal income growth in southern central counties with the nation and with the entire southeast shows the relatively strong performance of southern urban areas during the recovery (Table 10). Of 22 southern central counties, 14 grew faster than the nation while 10 grew faster than the rest of the southeast region. By contrast with the case in the northeast, the central portion of SMSA's in the south recovered strongly during the 1975-1978 period.

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[1] Department of Housing and Urban Development, Changing Conditions in Metropolitan Areas, Urban Data reports, Number 1 (Washington, D.C.: Office of Policy Development and Research, June 1979).

TABLE 9

OVERALL RESPONSIVENESS OF REVENUES TO ECONOMIC ACTIVITY: 1967-1978
(Unweighted Percentage Changes)

	United States			Southern States		
	1967-1972	1972-1975	1975-1978	1967-1972	1972-1975	1975-1978
Own Source Revenue	77.5	34.1	36.0	74.7	40.4	38.9
Personal Income	50.9	33.5	36.8	58.1	38.6	40.3
Own Source Revenue-Income Elasticity	1.52	1.02	0.98	1.29	1.05	0.97
Total Employment	12.0	4.4	11.5	19.1	7.7	14.4
Population	5.5	2.3	2.4	6.9	4.2	3.5

SOURCE: U.S. Bureau of the Census, Governmental Finances 1966-67, 1971-72, 1974-75, 1977-78. U.S. Bureau of the Census, Current Population Reports, Series P-25, No. 876 and No. 460. U.S. Bureau of Labor Statistics, Employment Earnings, United States 1909-78, Bulletin 1312-11, 1979. U.S. Department of Commerce, Survey of Current Business, Vol. 59 No. 8 Part II, August 1979.

TABLE 10

PERCENT CHANGE IN PER CAPITA
PERSONAL INCOME: 1974-1975 and 1975-1978
FOR SELECTED CENTRAL COUNTIES

	Per Capita Personal Income 1978	Average 1974-1975	Percent Increase 1975-1978
United States	$7840	7.6	32.8
Southeast	6810	6.6	34.7
Birmingham (Jefferson)	8020	9.0	34.2
Ft. Lauderdale (Broward)	8980	-0.3	38.9
Jacksonville (Duval)	7484	6.1	32.6
Miami (Dade)	8567	2.8	33.2
Orlando (Orange)	8043	5.4	36.7
Tampa (Hillsborough)	6955	5.9	32.8
Tampa (Pinellas)	7899	5.6	35.8
Atlanta (Dekalb)	9553	6.9	36.5
Atlanta (Fulton)	9186	5.2	43.2
Louisville (Jefferson)	8496	6.5	38.7
New Orleans (Jefferson)	7850	12.0	31.5
New Orleans (Orleans)	7744	11.4	37.5
Charlotte (Mecklenberg)	8499	6.8	32.2
Greensboro (Forsyth)	8304	7.6	30.2
Greensboro (Guilford)	8344	4.9	33.8
Memphis (Shelby)	7566	7.5	32.2
Nashville (Davidson)	8520	8.5	37.9
Dallas (Dallas)	9337	8.3	37.6
Houston (Harris)	9715	13.2	38.4
San Antonio (Bexar)	6623	8.8	29.6
Norfolk (Norfolk City)	6700	6.6	23.8
Richmond (Richmond City)	9247	9.0	32.4

SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis Survey of Current Business, Vol. 60, No. 4 April 1980, Table 2, Vol. 57, No. 4, April 1977, Table 2.

The upshot of this discussion is that while national recovery has helped the state and local government fiscal position, some cities--those typically thought of as "distressed"--have benefitted less than proportionately. These same cities were hurt most during the last recession, hence over the business cycle their competitive position has weakened. The fiscal prospects for cities which have economics which are hurt most by recession and helped least by recovery are not bright, especially in light of the likely performance of the U.S. economy over the next five years. By and large, such cities are not located in the southern region.

Federal Aid

A major reason why the finances central cities have performed above expectations since 1975 is the massive inflow of direct Federal aid. By 1978, direct Federal grants accounted for as much as one-third to one-half of the financing of total current expenditures as did revenues raised from own sources (see Table 11). Much of this increase in direct aid was the Administration's Economic Stimulus Package, the key elements of which were Anti-Recession Fiscal Assistance (ARFA), Local Public Works (LPW), and Public Service Employment (CETA). Though substantial in amount, the stimulus package is only a part of the long-term growth in Federal assistance to state-local governments. Federal grants increased through 1978,in total, as a share of the federal budget,and as a percent of total state-local government expenditures.

The reliance on direct federal grants increased in both the north and the south during the 1975-1978 period, but it increased relatively more in large cities in other regions than in the large central cities in the south.

TABLE 11

DIRECT FEDERAL AID AS A PERCENT OF OWN-SOURCE GENERAL REVENUE: FOR SELECTED CITY GOVERNMENTS IN FISCAL YEARS 1975 AND 1978

	1975	1978	Per Capita Federal Aid (1978)
United States (unweighted average)	19.3	29.1	$144
Non-South: (unweighted average)	23.1	41.1	167
St. Louis	17.4	34.1	146
Newark	12.3	30.4	137
Buffalo	26.2	77.4	259
Cleveland	32.3	57.9	165
Boston	16.2	20.8	173
Baltimore	30.7	53.7	264
Philadelphia	21.6	29.7	146
Detroit	35.4	44.1	170
Chicago	22.4	46.4	126
Denver	23.2	26.1	142
Los Angeles	16.4	31.3	110
South: (unweighted average)	24.9	33.9	101
Birmingham	26.0	32.0	110
Ft. Lauderdale	5.9	32.0	96
Jacksonville	27.3	27.4	74
Miami	12.7	19.4	43
Orlando	26.6	18.3	69
Tampa	38.3	35.8	98
Atlanta	27.1	19.7	80
Louisville	38.9	66.0	212
New Orleans	33.9	52.5	159
Charlotte	32.0	60.6	131
Greensboro	23.3	45.7	99
Memphis	20.4	39.5	99
Nashville	15.6	26.2	133
Dallas	13.0	13.3	41
Houston	17.3	15.3	40
San Antonio	38.5	49.2	68
Norfolk	29.9	37.2	145
Richmond	22.5	20.8	134

SOURCE: U.S. Department of Commerce, Bureau of the Census, City Government Finances in 1974-75 and 1977-78.

The implications of this lesser reliance may be an important and perhaps favorable factor affecting the fiscal outlook for southern cities.

A turning point in federal assistance to the state and local government sector seems to have been reached with the phasing down of the Stimulus Package between 1978 and 1980. The funding for these programs has been reduced from over $9 billion in FY 1979 to less than $3 billion in FY 1980. This trend does not auger well for cities, particularly those which might be labelled "distressed." They stand to lose in at least two ways. First, reductions in the flow of direct grants will seriously compromise their revenue position. Second, reductions in the overall flow of grants to state-local governments will increase pressures on state government resources, which will in turn compromise their ability to finance services provided in urban areas. The prospects are for less resources to flow to cities from higher level governments in the next half decade and certainly for less state-local government reliance on federal aid relative to all other revenue sources. The longer term effect will be a slower growth in per capita real local government spending but likely an increasing reliance on state government financing. This outcome should be much less painful for most southern cities, since they rely less on direct federal grants and because their state tax systems might more easily absorb the shortfall.

Deferrals and Cutbacks

If New York City spent itself into financial disaster by trying to maintain existing service levels when the revenues were not there, other "declining" cities may have warded off financial problems by cutting back some public programs and deferring expenditures on others. In attempting to explain the fiscal performance of state and local governments during the 1975-1978 recovery period, one might reasonably offer the following hypothesis: in the aftermath of the recession and with the New York City debacle still front page news, fiscal decision makers took a very conservative tack in formulating budgets. Public employment rolls were reduced either through layoffs or attrition, expenditure increases for new services and for pay raises were minimal, and capital maintenance and construction expenditures were being deferred.

If this deferral hypothesis is correct, one would expect to see a dampened growth rate in the per capita expenditures of state and local governments during the 1975-1978 period. As is shown in Table 8, local governments cut the rate of growth in per capita spending by nearly 40 percent between 1975 and 1978 while municipalities reduced their rate of increase in per capita expenditure by one-third between 1975 and 1978. Retrenchment and/or deferral may have taken place to a lesser extent in the south, as may be seen in Table 12. Per capita expenditures of these 18 large southern cities grew one-third faster than the large non-southern cities shown in Table 12 and faster than all local governments in the United States (see Table 8).

Employment Growth. Public employeemnt retrenchment appears to have been the case for many of the nation's largest cities. Between 1975 and 1978, outside the south, there were absolute declines in city government employment in 9 of the 15 largest cities and increases of less than 1 percent in 2 of the remaining 6 (see Table 12). On average, the 15 largest non-south cities had an employment reduction of 1.9 percent over this period.

TABLE 12

INDICATORS OF FINANCIAL PERFORMANCE OF CITY GOVERNMENTS: PERCENT INCREASE BETWEEN 1975 AND 1978

	Current Expenditures	Long Term General Obligation Debt Outstanding	Employment (Full-time Equivalent)	Payroll Per Employee	Taxes
Non-South:[a]	32.1	28.8	-1.9	18.4	30.8
Baltimore	6.3	-0.02	1.7	-14.8	16.9
Boston	30.7	29.0	0.06	26.7	30.9
Cleveland	46.0	76.6	-9.8	6.7	11.3
Chicago	32.2	6.4	-3.6	21.7	12.4
Detroit	40.4	-0.05	16.8	30.7	16.9
Honolulu	23.2	33.1	-19.8	57.4	22.8
Indianapolis	41.0	5.8	-1.9	38.7	26.3
Los Angeles	33.8	20.1	-6.2	12.6	37.8
Milwaukee	27.9	21.0	-4.6	23.2	27.4
New York	18.3	40.7	-8.4	13.8	26.6
Philadelphia	44.2	34.9	-4.1	15.2	53.5
Phoenix	55.0	71.0	12.9	25.8	39.4
San Diego	37.1	-0.02	0.3	15.6	41.7
San Francisco	24.5	50.4	1.3	6.9	42.0
Washington, D.C.	20.8	43.8	-2.9	25.1	55.9
South:[a]	39.8	27.7	10.3	18.4	27.2
Birmingham	33.3	55.9	6.0	27.3	35.1
Ft. Lauderdale	13.1	-4.5	-7.6	15.3	13.5
Jacksonville	39.7	24.3	5.2	23.0	34.2
Miami	48.3	25.9	22.7	4.7	31.3
Orlando	46.0	10.1	-1.6	18.3	38.2
Tampa	90.6	33.0	38.8	8.9	31.1
Atlanta	40.3	63.3	-0.9	17.9	16.3
Louisville	51.2	31.1	9.6	18.2	27.2
New Orleans	42.0	34.5	18.7	36.1	26.4
Charlotte	32.8	15.1	5.8	19.2	19.8
Greensboro	46.5	-20.8	-4.8	16.7	14.0
Memphis	34.7	42.1	7.7	25.1	28.6
Nashville	38.3	39.1	-2.5	38.6	23.4
Dallas	36.2	1.4	1.0	21.8	31.1
Houston	64.2	40.5	-3.7	32.4	50.6
San Antonio	51.9	100.8	12.3	20.8	29.1
Norfolk	-4.0	4.8	80.3	-32.0	19.2
Richmond	7.5	1.2	-2.1	18.1	20.9
	42.2[b]	29.0[b]	6.15[b]	21.3[b]	27.7[b]

[a]Unweighted average.

[b]Unweighted average for south, excluding Norfolk.

SOURCE: U.S. Bureau of the Census, City Employment in 1975; 1978, Series GE-75, No. 2, (Washington, D.C.: USGPO, 1976 and 1979); U.S. Bureau of the Census, City Government Finances in 1974-75; 1977-78, Series GF-75, No. 4 and GF-78, No. 4 (Washington, D.C.: USGPO, 1976 and 1980).

These reductions would seem to signal a cutback in services offered--to the extent public service and public employment levels vary proportionately. In any case, it is further evidence of fiscal retrenchment and perhaps a salvation to city budgets, i.e., downward adjustments in employment may cushion the public employee wage increases which surely lie ahead.

The situation was different in the larger southern cities. Of the 18 cities considered here, 7 cut employment. The average employment increase, at 6.15 percent, was much greater than that in the non-southern cities and exceeded that for all local governments in the U.S. (see Table 10). At least in most southern cities, there is no substantial evidence of deferrals or retrenchment in the form of program reductions.

Employee Compensation Growth. There appear to have been some cases of public employee compensation deferrals in the aftermath of the recession, but available data will not carry very broad generalizations. The comparisons in Table 12 show that payroll per employee grew at or above the inflation rate for about half of the non-south cities during the 1975-1978 period.[1] However, since employment was declining in many cities it may not be concluded that compensation increases were *not* deferred. To the extent that governments add fewer new employees or even affect reductions in workforce size, this is likely to have a disproportionate impact on younger, lower paid employees. By the nature of arithmetic averages, it is quite possible to reduce workforce size and to grant no wage increases to remaining employees and still end up with a higher average wage for the workforce.

[1]The CPI rose by 9.2 percent in calendar 1975, 5.7 percent in 1976, 6.5 percent in 1977, and 7.6 in 1978. If we take the average of the 1975 and 1976 CPI increases to roughly estimate the rate of inflation for FY 1975-76, and perform similar computations for 1976-77 and 1977-78, we can approximate a 1975-1978 inflation factor of about 22 percent.

The situation was not so different in the southern cities. All except Norfolk showed increases in average compensation. Still, the average increase (even excluding Norfolk) was slightly below the inflation rate. If these data suggest a deferral of public employee compensation increases during the 1975-1978 period, the deferral would seem to be as true of southern as of non-southern cities.

Deferred Capital Investment. A politically convenient and administratively expedient way to pare expenditure programs is to postpone capital project investments or to defer maintenance on the existing capital stock. Capital spending cutbacks require no bargaining with unions and (sometimes) no major hassle with public interest groups, and can be carried out quickly and without major layoffs. Hence, when the budget situation becomes tight and cutbacks are necessary, capital project postponement usually stands somewhere higher in the pecking order than employee layoffs and lower wage rate increases. During the last decade, with inflation driving up public sector costs and two recessions creating uncertainties about future revenue growth, the budget position and outlook was tight enough to prompt such deferrals. In fact, capital expenditures of state and local governments have declined in real terms and as a share of the total budget. Peterson reports that gross capital investment has fallen from 29 percent of total state and local spending in 1965 to 14 percent in 1977.[1]

[1]George Peterson, "Capital Spending and Capital Obsolescence: The Outlook for Cities," in The Fiscal Outlook for Cities, ed. by Roy W. Bahl (Syracuse, New York: Syracuse University Press, 1979).

While some of this decline might be attributed to the near completion of the interstate highway system, much of it would appear to be due to the postponement of capital project investments and the deferral of maintenance and renovation. Such deferrals have made the financial position of state-local governments appear stronger than it is, i.e., what is the meaning of an annual budget surplus in a case where necessary capital expenditures have been put off? We can't answer this question other than by relying on cliches to imply that some governments with low levels of capital spending may have their debt in the streets, and impressionistic evidence about the inadequacies of the existing capital stock.

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

Unfortunately, few state or local governments do any kind of accounting that would enable a tracking of the quality of the local infrastructure, and therefore "serious" capital obsolescence problems are not easily identified. Some idea of the magnitude of the problem might be gained from a series of recent case studies. Two studies of the condition of the New York City infrastructure indicate a substantial deficit, and one that is far beyond the City's financial capacity.[1]

The Urban Institute studies of Cleveland,[2] Cincinnati,[3] and Dallas[4] provide some further (but mixed) evidence on the deferral question. Cleveland certainly fits the pattern with a badly deteriorated capital stock and declining real capital spending since 1968. The estimated backlog in needed basic improvements to its infrastructure system is $700 million,[5] i.e., nearly twice the level of total current expenditures. As in the case of New York City, Cleveland's infrastructure problems have been long in the making, but have been helped along by recent deferrals.

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[1] The Condition of Urban Infrastructure in the New York-New Jersey Region: A Survival Issue for the 1980s. (New York: The Port Authority of New York and New Jersey, May 1979); and David A. Grossman, The Future of New York City's Capital Plant (Washington, D.C.: The Urban Institute, 1979).

[2] Nancy Humphrey, George Peterson, and Peter Wilson, The Future of Cleveland's Capital Plant (Washington, D.C.: The Urban Institute, 1979).

[3] Nancy Humphrey, George Peterson, and Peter Wilson, The Future of Cincinnati's Capital Plant (Washington, D.C.: The Urban Institute, 1979).

[4] Nancy Humphrey, George Peterson, and Peter Wilson, The Future of Dallas' Capital Plant (Washington, D.C.: The Urban Institute, 1979).

[5] Humphrey, Peterson and Wilson, The Future of Cleveland's Capital Plant, p. 75.

Dallas and Cincinnati provide stories of more success with maintaining the capital stock. Dallas is fiscally strong, with a low tax rate and the ability to finance capital projects with a substantially greater federal assistance share. There was a slowdown in real capital spending after the recession--a deferral--but it could be accomodated because of the newness of the capital stock. Cincinnati presents the opposite picture: an old, declining city that has managed its capital assets carefully. The infrastructure backlog is moderate by comparison with other older cities, and does not appear to have been compromised by recent spending deferrals.

V. THE OUTLOOK FOR THE 1980s

There can be little doubt but that some southern cities will face financial problems in the 1980s, and that most local governments in this region will be far more pressed than in the 1970s. The notion that all governments in the region will be flush with oil and natural gas revenues is a myth. On the other hand, there is more reason to be optimistic about the financial outlook for southern than northern cities. The relatively faster economic growth in the southern region should continue, some state governments will derive substantial revenue benefits from natural resource taxation, cutbacks in federal aid will be less detrimental to southern governments since they are less reliant on grant revenues, the existing capital stock in southern urban areas is probably in better shape, southern governments have more latitude for tax increases, and, in general, the financial future of newer cities in the south is much more controllable through state and local government policy actions.

The major concerns about southern city finances lies in two areas: (a) expenditures must be made to satisfy a backlog of needs resulting from recent population growth and (b) the fiscal situation facing cities in the 1980s will be much less controllable than it was in the 1970s. The intent in the sections below is to flesh out these problem areas.

The National Economy

The prognosis for the 1980s is for real GNP to grow more slowly than in the 1960s and 1970s. Between 1970 and the first quarter of 1980, real GNP growth was positive in seven years and averaged 4.5 percent.

For the ten years of positive growth rates in the 1960s, the average was 4.1 percent. Certainly the next two years will not begin to approach this rate. The administration has projected a real GNP decline in 1980 and a real growth of only 2.0 percent in 1981.[1]

Few will hazard outright projections of GNP five or ten years in the future, but some indirect evidence casts doubt on the believability of 4 to 5 percent real growth rates for the early 1980s. The Administration estimates that in order to achieve a 4 percent unemployment rate by 1985 and a 3 percent inflation rate by 1988, annual productivity increases of 2.5 percent and real GNP growth rates in the 4.5 to 5.0 percent range will be required. To the extent these long-term inflation and unemployment targets are not attainable, slower real income growth will result.

The Bureau of Labor Statistics has made baseline projections of a 3.2 to 3.6 percent annual real growth rate in GNP for the 1980s. These projections require that inflation slow to 5.5 percent in the early 1980s and to 4.4 percent by the end of the decade, and that the unemployment rate gradually fall from a projected 5.3 percent level in 1981 to 4.5 percent by 1990.[2]

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[1] Congressional Budget Office, Five-Year Budget Projections: Fiscal Years 1981-1985, part II (Washington, D.C.: U.S. Government Printing Office, 1980), p. 3.

[2] Norman C. Saunders, "The U.S. Economy to 1990: Two Projections for Growth," in Employment Projections for the 1980s, Bureau of Labor Statistics, U.S. Department of Labor, Bulletin 2030 (Washington, D.C.: U.S. Government Printing Office, 1979), pp. 12-24.

CBO has simply assumed (calculated) a 3.8 percent growth rate "...so that by 1985 the unemployment rate would return to approximately the current level (5.9 percent)."[1] The Joint Economic Committee, assuming productivity increases in the 1.5 to 2 percent range, sees the long-term rate of real GNP growth to be in the 3 to 3.5 percent range.[2] From almost every vantage the conclusion seems to be the same. For at least a few years, the U.S. economy is going to grow more slowly than it did during the past two decades.

This combination of slower real growth and inflation will put new pressures on state and local government budgets. Forecasts for the state and local government sector are not generally available, though the BLS projection model is an exception. Under their baseline employment expansion assumptions, they expect the sector to decline between 1980 and 1985 in terms of employment (12 percent of total employment to 11.6 percent), purchases of goods and services (12.6 percent of GNP to 11.1 percent) and personal taxes (3.2 to 2.9 percent of GNP.)[3] Whether or not the relative declines in state and local government activity will be this steep, it would seem reasonable to assume that taxes will be off their post-1975 annual real growth rate of 4.3 percent. If the past few years is representative and if tax limitation movements do not further slow tax revenue growth, a 3.5 to 4 percent real GNP growth could imply a state and local government tax revenue growth of 2.7 to 3.1 percent per year.

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[1]Congressional Budget Office, Five Year Budget Projections: Fiscal Years 1981-1985, A Report to the Senate and House Committees on the Budget: Part II (Washington, D.C.: Government Printing Office, February 1980), pp 2-5.

[2]Joint Economic Committee, The 1980 Joint Economic Report (Washington, D.C.: Government Printing Office, February 28, 1980), pp. 30-32.

[3]Saunders, "The U.S. Economy to 1990: Two Projections for Growth."

The resulting revenue gap will not likely be made up by increased federal assistance. To the contrary, if the federal grant share of GNP remains constant, a 3.5 to 4.0 percent real GNP growth will bring a 4.6 to 5.3 percent annual increase in federal grants. Even this projection, which seems on the optimistic side, is for a growth well below the 7.3 percent annual real increase of the 1975-1978 period.

The import of all this seems clear. State and local governments will have less resources available in the 1980s--the overall rate of revenue increase could fall by as much as one-fourth if the real GNP growth rate stays in the 3.5 to 4 percent range.

What are the implications of such an outlook for cities in the south? It would seem clear that some areas of the country will be hit harder than others by this slow national growth and by the cutbacks in the real amount of federal aid to state and local governments. The slower growing industrialized states in the northeast and midwest could experience very little real growth under this scenario and central cities in those regions will be the hardest pressed. Governments in this region could well face revenue growth rates lower than the national rate of inflation--a result of slow real national growth and declining regional shares.

The situation in the south should be much better. A slowing rate of national growth will be partly offset by continued shifts of population and economic activity into the region, i.e., the south will continue to gain an increasing share of a smaller pie. Moreover, the greater reliance of southern states on income and sales taxes should make it easier to keep public budgets in step with real and inflation-induced increases in income.

Still there will be problems. First, many of the growing states will not escape from the revenue effects of the national slowdown. Those growing states without substantial energy resources will face a more drastic reduction in their *rate* of revenue increase than will many of the northern states who have already entered a period of fiscal austerity. This slowdown will pose interesting and difficult adjustment problems. Second, with the spread of manufacturing to the south, the region has become much more susceptible to recession. This susceptibility will spread to the public sector more easily in southern states with their heavy reliance on sales and income taxes.

Pressures on Southern Budgets

There are three important sets of pressures on urban government budgets which southern local governments will face in the 1980s: population and employment growth, public employee wage demands, and inflation. Rapid population and employment growth have created major deficiencies in the public infrastructure and in some cases have generated a sprawling and costly pattern of urban expansion. Natural resource constraints are placing an effective limit on growth. Another growth factor which pressures budgets is growing per capita income and migration, which may jointly act to change the preferences of local voters, e.g., in the direction of a better quality (and more costly) education system. Finally, there is the question of meeting the needs of the urban poor--a segment of the population which does not disappear with rapid economic growth.

Another set of pressures on the budgets of southern cities will come from public employees. Average wages are low in the south and have remained low even during the rapid growth period of the 1970s. It is inevitable that there will be pressure for a "catch-up" with the private sector and with the public sector in other regions. These pressures will be compounded by the inevitable growth of unions and by inflation.

Finally, there is the general problem of inflationary pressures on local government budgets. These pressures will be most felt in terms of labor costs but will also have an important impact on capital spending through effects on interest costs.

Constraints on Policy Options

What is the ability of southern cities to formulate a policy response to these pressures? Even with continued sunbelt shifts, resource growth will be slower hence there will be need to adjust revenues with tax increases or increased aid flows, or to slow the rate of expenditure growth. The constraints are not as severe as those on northern cities but they will be more severe in the south than during the last decade.

Tax Increases. Southern states always could adjust to resource gaps by raising taxes because of a traditionally low tax effort. State and local government taxes per $1000 in personal income are still (1978) about 14 percent lower in the south than the rest of the nation. Indeed, no southeastern or southwestern state had a tax-income ratio above the national average. This suggests that southern states have a good deal of latitude to raise taxes and remain well in line with the rest of the country. The energy rich states within the south face an even easier time of it, especially in light of their ability to export tax increases.

There are caveats to this reasoning. First, because the state government has "excess" taxing capacity, it does not necessarily follow that city governments have the same latitude to raise taxes, or that they would be the beneficiaries of state government tax increases. As we learned from the experience of the late 1970s, large state surpluses can exist alongside urban public service deficits and urban fiscal problems.

Second, the existence of excess taxing capacity is no guarantee that the state or local governments can raise taxes. It is not likely that the tax revolt movements of 1978 and 1979 signal a permanent reversal in the growing share of government in GNP, but it seems clear that fiscal limitations of one kind or another will be a significant influence on state and local government budgets during the next five years. By mid-1979, thirty state legislatures were considering balanced budget amendments as was the U.S. Congress. Some 14 states passed some form of tax or expenditure limitation between 1978 and 1980.[1] The mood is clearly in the direction of slowing the growth of government at all levels.

The explanations for the limitation movement are numerous. It seems plausible that raising taxes would be especially objectionable during inflationary times when real spendable earnings for most

[1]These are reviewed in Deborah Matz, "The Tax and Expenditure Limitation Movement," Urban Government Finance: Emerging Issues ed by Roy Bahl, (Beverly Hills, California: Sage Publications, forthcoming).

American families have hardly increased. As long as the rate of inflation is high, the objections from this group of voters will remain substantial and growth in government will be resisted. In particular, rising property tax rates place onerous burdens on homeowners in that accrued worth may differ markedly from annual income. Shapiro, Puryear and Ross argue that the high and rising property tax burden was at the heart of the Proposition 13 movement.[1] Yet Matz has pointed out that limits have been adopted in states which were *not* experiencing high or rapidly escalating taxes or expenditures.[2] Another source of discontent is what is perceived of as an inefficient public sector--one that is thought to be overpaid, underworked, and not responsive to citizen needs. Whatever the reasons for this dissatisfaction, it seems likely that some state and local governments will be tied to personal income growth in terms of what they are allowed to spend.

The effects of fiscal limitations, if they stick, will be to reduce the discretion of government decision makers in formulating new programs and taxes and in altering the timing of their own fiscal expansions and contractions. Even though there is an option to switch to user charge financing (a compensating device used in the aftermath of California's Proposition 13), it is clear that local fiscal planning

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[1] Perry Shapiro, David Puryear and John Ross, "Tax and Expenditure Limitations in Retrospect and in Prospect," National Tax Journal, Supplement, Vol. XXXII, No. 2 (June 1979): 1.

[2] Matz, "The Tax and Expenditure Limitation Movement."

will be more constrained and new spending initiatives will likely be bypassed to meet increased spending for "less controllable" budget items.

Federal Assistance. The inflow of federal aid has made an important contribution to financing the growth of southern state and local governments. As noted above, federal aids have grown to an amount equivalent to about one-third of that raised from all sources by southern cities. This is bound to change in the future as fewer federal dollars will be available.

Indeed, perhaps a more significant effect than state tax limitations on the budgets of state and local governments is the possibility of limitations at the federal level. The proposals in this direction have ranged from a fixed maximum percent increase in federal outlays to a ceiling on the ratio of federal outlays to GNP, but all would slow the growth in federal spending. Even without a legal indexing of federal expenditures, the tax revolt movement will bring pressure to balance the federal budget more frequently than has been the case in the past. Some of this balancing will inevitably result in reduced resources available for the more controllable federal grant-in-aid programs and in a further dampening effect on state and local government revenues.

A slowdown in federal assistance will be felt to some extent by all state and local governments, including those in the south. The regional burden of such cuts will depend in large on the nature of the cuts and will vary from city to city. Still, some cities will be more insulated from the cuts than others, e.g., those less reliant on grants, those which use CETA grants for supplementary activities rather than as substitute funding for ordinary positions, those located in states with large surpluses, etc.

Expenditure Control. The fiscal pressures on local governments in the south may call for a measure of expenditure control that will be less easily provided than in the 1970s. A key problem may be the relatively lower wages and greater employment levels of state and local governments in the south. The ability to hold down wage rates in the future will be more hampered by a higher inflation rate, growing real wages in the private sector and increasing unionization in the private and public sectors. Not only will expenditure growth be more difficult to control, but expenditure growth during a "catch-up" period will be much more due to wage rate increases than to service level increases. The prospects for part of the 1980s is for expenditures to grow much faster than public service levels because of this catch-up effect.

Policy Implications

Even local governments in the growing regions face serious adjustment problems which will require them to carefully plan the growth in their budgets. The problems are essentially how much should a government grow and how fast should this growth occur. The mistakes of governments in the older region might be avoided if the long-term expenditure implications of fiscal decisions are evaluated against the potential long-term growth in the local resource base. Fiscal planning and forecasting is a relatively new art and science, but is being used effectively in many cities, especially those in the growing region.[1]

The most pressing of the fiscal adjustment problems is keeping the infrastructure development in step with population and employment growth. With rising material and capital costs, and the prospects for less federal aid, this could become a serious bottleneck to growth. At the same time there is the danger of overexpanding capital investments to a point where debt repayment claims on revenues are onerous. A similar caution holds with respect to current expenditures. Increases in public employment rolls are not easily reversed. Similarly, public employee pension arrangements are long-term commitments which, once made, become an uncontrollable element of governmental expenditures.

In this regard, state and local governments in the south would do well to think through two other policy areas: the development of a 'proper' state/local government split of financial resources and expenditure responsibility, and some decision about what role state and local governments will play in matters related to income redistribution.

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[1] Roy Bahl and Larry Schroeder Forecasting Local Government Budgets, Occasional Paper No. 38, Metropolitan Studies Program, The Maxwell School (Syracuse, New York: Syracuse University, December, 1979).

The future in urban government finance in the south will be largely shaped by how well the state government role is defined in providing and financing urban services. Whereas local government in the rest of the country must worry over how to make the property tax more responsive, the issue in the south is to assure a proper pass thru of funds from a productive state tax system. The second issue relates to how far state and local governments should go in attempting to address the problems of the urban poor and in attempting to maintain a tax system which is not regressive. New York City's and New York State's fiscal problems were in no small measure due to their attempt to redistribute income through a progressive personal income tax and a wide spectrum of relatively well-financed social service programs.

The South and National Urban Policy

The federal policy war between the states which heated up in the mid-1970s--over such issues as how should aid be distributed among cities, and what should be the regional distribution of federal taxation and disbursements--will continue into the 1980s. There will be two differences this time around. First, the national economy will be growing more slowly hence the amount of federal money available will be even more limited. The smaller the pie, the more heated the debate over its distribution. Second, the balance of political power has swung away from the older northern region.

What should be the posture of southern states and cities, and their advocates, on matters related to the allocation of federal funds? Of course, self-interest should be the dominant consideration. Any other course of action in as fragmented a federal system as ours would be folly. Yet it may be that self-interest motives dictate a concern for developing a reasoned national urban policy. No one really has an immunity from big city or big state bankruptcies--the unemployed migrate to other regions to find jobs or are covered by some assistance program which is partly federally funded, bond investors lose confidence in state and local government issues, "emergency" loans replace grants that otherwise may have been available for the state and local government sector, social problems grow in depressed cities and must eventually be dealt with, etc.

One might offer the following as a reasonable position for southern city advocates to take. It shifts the general concern away from getting a greater share of the pie next year and toward developing a less ambivalent national position on urban problems. One probably ought to begin by recognizing that most of the major *financial* emergencies are going to be in the north and the industrial midwest. Regardless of the underlying reasons for this problem, these are the cities most likely to default either in terms of not paying off debt obligations allowing more infrastructure to deteriorate or in terms of further reductions in already deficient service levels. In any case their distress, or need, would appear to be greater--at least as things stand in 1980.

The prospects are that more money will eventually flow to the large cities in financial trouble, but in an ad hoc way rather than as part of a coherent national urban policy. Southern governments and their advocates, acting in both self interest and the national interest, should see the reasonableness of this assistance and agree to it, but should argue that aid flows to distressed cities be used to lever reforms to deal with the underlying problems. Here, several principles might be suggested.

- A condition of aid flows to a distressed city should be a better distribution of fiscal resources between cities and suburbs. Why should another region of the country be called on to support the inequitable fragmented government structure that exists in the northeast and midwest, e.g., if suburban residents in Syracuse are not interested in doing anything about the distress of the central city, why then should Nashville residents have an interest? The notion of using federal assistance to generate this kind of structural change is not new, it was part of the Humphrey-Reuss early thinking on general revenue sharing.

- National urban policy should be very clear about when, or if, special city financial emergencies will be recognized with loan guarantees etc. Two questions are essential in formulating federal policy on this question. The first involves defining the conditions necessary for initial federal intervention, i.e., what avenues must be exhausted before emergency federal subsidy is warranted? The second is what adjustments must the city make as a condition of receiving aid. Neither question seems to have been clearly thought through and neither is to be found in the Carter administration's Urban Policy Statement.

- Third, a federal urban policy ought to recognize the difference between a program of compensation and a program of revitalization. The former reflects a belief that declining economies can be revitalized i.e., that federal subsidies can be used to hold people and economic activity in the declining region. A compensation strategy suggests that such subsidies are inefficient, that the country would be better off if labor and capital moved to where its return was higher, and that the role of federal policy is to compensate the most financially pressed governments and families which are caught in this transition period. The goal of a compensation policy would be to protect particularly the low income by subsiding both the provision of public services and temporary job opportunities while the emptying out process goes on. The important element here is that states which have an overdeveloped public sector--one that their income base will no longer support--should have a firm retrenchment plan.

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