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Introduction to Urban Government Finance: Emerging Trends

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Emerging Trends

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Introduction

☐ THE OUTLOOK FOR STATE AND LOCAL GOVERNMENT finance at the end of the 1960s must have been reasonably optimistic. The economy had grown steadily throughout the decade, the inflation rate remained low, general revenue sharing had been institutionalized as an important local revenue source, and the most serious of city fiscal problems were softened by state and local government revenue growth. The major problem was what to do about the decaying inner cities in the older region and the centerpieces of an implicit national urban policy were new towns and urban renewal.

In fact, the 1970s brought major crises in state and local government finance and a substantial change in the structure of federal-state-local relations. The decade was characterized by two recessions—the second far more serious than the first—and a high rate of inflation. The recessions and recoveries had uneven effects on the people and governments in the urban areas of the North and South and the movement of population and economic activity to the sunbelt continued. For the first time since the Great Depression, cities defaulted and other state and local governments teetered on the brink.

In response to the fiscal crises of the 1970s, the fiscal policies of state and local governments, as well as federal intergovernmental policy, changed dramatically from the pattern in the previous decade. Public employee layoffs were one response; public employee compensation deferrals, the postponing of capital projects, and the elimination of government programs were others. By the end of the 1970s, retrenchment had become the watchword of state and local government budgeting in the declining region. The growing region, healthier and less affected by national economic changes—but perhaps wary of the fiscal implications of continued growth—moved to adopt fiscal limitations.

Federal policy toward the state and local government sector during the decade was ambiguous, often contradictory, and generally ill-conceived. Total grants-in-aid quadrupled, but the net fiscal relief and economic stimulus effects of the hundreds of grant programs could not be evaluated. A "stimulus package" of federal grants shifted the focus to federal-local relations with the large public employment (CETA), counter-cyclical (ARFA), and public works programs. But by the end of the decade, the federal government was at least thinking about balanced budgets, and the rapid growth in grants-in-aid was over, at least temporarily.

What of the outlook for state and local government finances in the 1980s? The essays in this volume assess the prospects and speculate at the possible policy responses in a context of the recent history outlined above.

Robert Reischauer considers the national economic and federal budget prospects for the 1980s and their implications for the state and local government sector. His prognosis is gloomy—most forecasts suggest that the 1980s will be characterized by relatively slow economic growth, extremely high rates of inflation, high levels of unemployment, rapid nominal wage growth, and high interest rates. This poor performance of the economy plus the possible success of efforts to curb federal spending and shift budget priorities away from social programs could have profound effects on the fiscal health of state and local governments. Shawna Grosskopf discusses one aspect of this effect—that on the growth of public employment and public employee compensation. She finds the existing theoretical models not particularly helpful in explaining the behavior of public employment during the 1970s or for predicting behavior in the 1980s, because they were constructed to explain sectoral behavior in periods of growth rather than decline. From historical trends, however, she has sorted out some aspects of the behavior of state and local government employment over the business cycle and during the slow growth period of the 1970s: the state and local sector was mildly employment stabilizing, and compensation rates have fallen behind those in the private sector during the last half of the 1970s. She reads these trends to suggest that there will be a continued shift away from public employment within the broader "service" sector.

The next two chapters consider a major policy issue for the 1980s: defining and measuring fiscal distress. James Fossett and Richard Nathan index urban hardship by concentrating on city age, population loss, and poverty. Their resulting "urban condition" indices show that the older cities of the Northeast and industrial midwest are generally worse off, and that their *relative* position has actually worsened. An alternate construct, an economic performance index based on value added, gross sales, and employment structure, reaches a similar conclusion. The implications of their findings are that with slow-growing economies, the fiscal outlook for such cities is grim. Bernard Weinstein and Robert Clark take a different view in an essay on the fiscal outlook for growing cities. They develop the case that declining populations and economic bases do not necessarily result in fiscal distress, and that cities experiencing demographic and economic improvements may well be in financial troubles precisely because of this growth. They speculate that the growing metropolitan areas of the South and West may realize slow or negative population growth and increased fiscal pressures during the 1980s. The controversy over what causes fiscal distress and over how federal monies ought to be targeted, promises to be an important and lively debate in the coming years.

Deborah Matz and Michael Wasylenko consider two of the major state and local government tax policy responses to the fiscal problems of the 80s. Matz reviews the fiscal limitation movements of the late 1970s and offers a useful analysis of how they are likely to affect aggregate state and local government spending and service levels in the coming decade. She points out that the limitation movement has been concentrated in the growing region, that limits are usually tied to income growth, and that, therefore, a drastic reduction in the overall level of state and local government spending is unlikely. Still, she expects the effects in the 1980s to be a minimizing of the implementation of new programs and an increase of the use of user charges. Wasylenko takes on the equally important issue of the role of taxes and fiscal incentives in firms location. He concludes that taxes play relatively little role in interregional migration but may play a more important role in intraregional business location decisions. More importantly, he points out that states should not ignore business location considerations in making tax policy, because the lack of any fiscal inducements may cause firms to suspect a bad business climate. In all likelihood, the 1980s will see further competition among the states in using fiscal incentives to attract industry.

I attempt to put together the list of factors affecting the outlook for state and local government finance and the possible national urban policy response, in order to discuss the difficult adjustments that surely lie ahead. The 1980s will be a time of substantial adjustment as the older cities of the North continue to retrench, reduce *relative* public service levels, and, at least for the time being, reduce their dependence on federal grant revenues. On the other hand, the growing regions will be involved in a "catch up" when they have to face backlogs of public services, the demands for better services from new residents, and the demands of state and local government employees whose wages are low. All of this will be compounded by inflation. National urban policy ought to define the federal response to these problems, in particular with respect to four issues: whether a revitalization or a compensation strategy will be followed in assisting cities, whether the business cycle will be explicitly recognized in federal intergovernmental policy, how the federal government will intervene in the face of big-city financial emergencies, and what future role will be given to state government.

The two final chapters offer a comparative dimension by considering urban fiscal structure and problems elsewhere in the world. Joergen Lotz describes some striking similarities between the problems of American cities and those of the large Scandanavian cities. Interestingly, however, he describes a response to central city decline that has long been advocated by urban scholars in the United States—the taxation of local income and the creation of a needs-based grant system. Johannes Linn provides an excellent description of the relatively unknown area of urban government finances in developing countries. Though the Third World cities have their substantial population size in common with American urban areas, their problems are quite different. The principle issue seems to be the almost impossible backlog of public services to be filled and the very great restrictions on local fiscal autonomy. An interesting lesson from the developing country experience, however, is that where this central governmental control has been relaxed, innovative and imaginative local governmental fiscal policies have sometimes emerged.

These essays only scratch the surface of a long list of important issues to be dealt with in formulating policy for the state and local government sector in the 1980s. It is important to realize that many of the issues to be considered will be new—at least for a few years. The state and local government sector will be much less the growth industry than it has been in the past.

—Roy Bahl