City Fiscal Challenges, Trends, and Strategies

Financial and Policy Challenges
Facing State and Local Governments

Governmental Research Association
Federal Reserve Bank of Chicago
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View From 18th Street Bridge, a watercolor by Pat Wright

Four Municipal Fiscal Eras

I. pre-Great Depression: Property-tax dependence of local governments; ownership of real estate signified wealth.

II. 1929 and extending until the end of the Great Society expansion of federal programs: municipalities diversified their tax base to include retail sales; the federal government provided an unprecedented amount of funding.

III. the advent of the 'tax revolt' of the late 1970s: a sudden decline in the share of property taxes; the dramatic reduction of direct federal aid to cities; rapid increase in user fees.

IV. The fourth era is unfolding at this very moment: from financial markets and real estate collapse an emerging new normal.

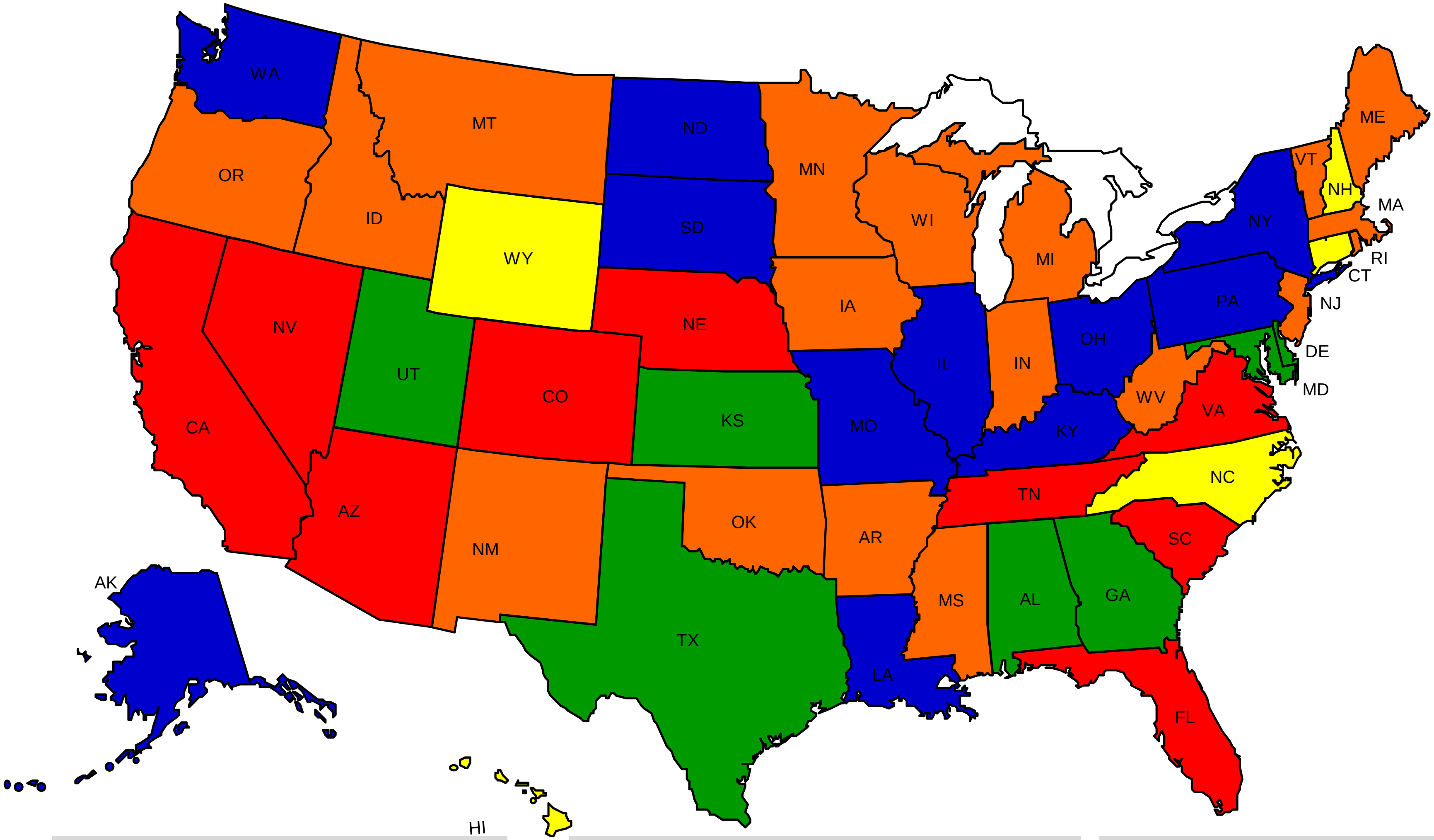
Michael A. Pagano, "Creative Designs of the Patchwork Quilt of Municipal Finance," in Gregory K. Ingram and Yu-Hung Hong, *The Changing Landscape of Local Public Revenues* (Cambridge, MA: Lincoln Institute of Land Policy, 2010), pp. 116-140.

It's not the Great Depression

- ✓~10% unemployment today *v.* ~25% in 1929-1933
- ✓DJIA down 20-30% *v.* decline of 89%, 1929-1933
- ✓No riots *v.* urban and rural riots during 1930s
- ✓Prices steady *v.* price decline of around 25%, 1929-33
- ✓Bank foreclosures around 10% *v.* 50% between 1929-33
- ✓***Municipal defaults very few v. 4,770 in1930s***

but …

- Real estate market will be slow to recover
- Consumer spending beginning to rise
- Wages steady or declining
- Household savings up
- Employment shifts. Services and 501-c-3
- State fiscal crises



1=Relatively autonomous

2=No TEL, 2-revenue Sources

3=Property Tax, No TELs

4= One Revenue, but TEL constrained

: State Clusters (5)

5=Straightjacket

Source: Michael A. Pagano and Christopher Hoene, "States and the Fiscal Policy Space of Cities" in Michael Bell, David Brunori, and Joan Youngman, eds. *The Property Tax and Local Autonomy* (Cambridge, MA: Lincoln Institute of Land Policy, 2010), pp. 243-284

NATIONAL LEAGUE of CITIES | Research Brief on America's Cities

By Christopher W. Hoene & Michael A. Pagano[1]

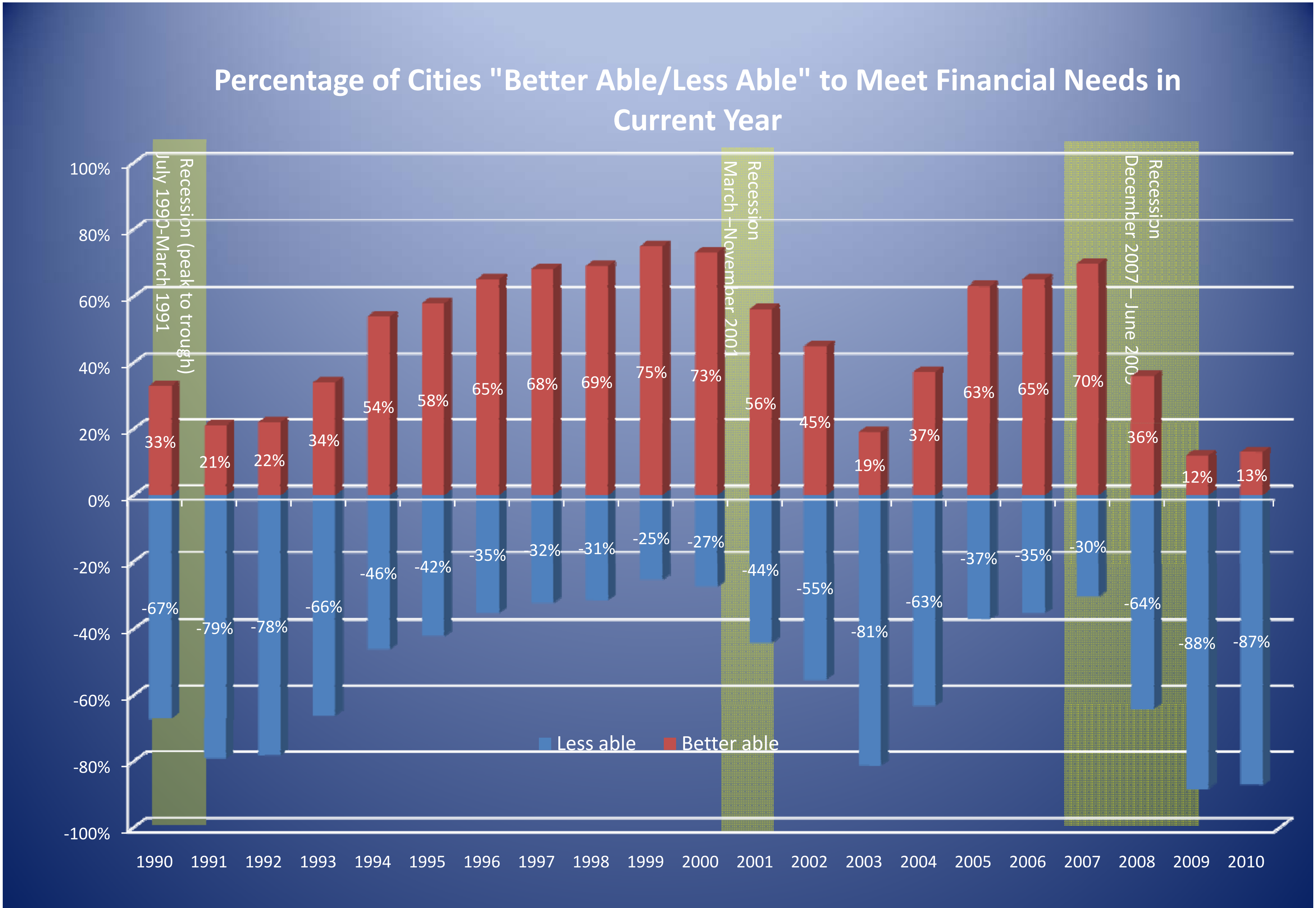
OCTOBER 2010

City Fiscal Conditions in 2010

The nation's city finance officers report that the fiscal condition of the nation's cities continues to weaken in 2010 as cities confront the effects of the economic downturn.[2] Local and regional economies characterized by struggling housing markets, slow consumer spending, and high levels of unemployment are driving declines in city revenues. In response, cities are cutting personnel, infrastructure investments and key services. Findings from the National League of Cities' latest annual survey of city finance officers include:

- Nearly nine in ten city finance officers report that their cities are less able to meet fiscal needs in 2010 than in the previous year;
- As finance officers look to the close of 2010, they report declining revenues and spending cutbacks in response to the economic downturn;
- Property tax revenues are beginning to decline in 2010, after years of annual growth, reflecting the gradual, but inevitable, impact of housing market declines in recent years;
- City sales tax revenues declined dramatically in 2009 and are declining further in 2010;
- Fiscal pressures confronting cities include declining local economic health, public safety and infrastructure costs, employee-related costs for health care, pensions, and wages, and cuts in state aid;
- To cover budget shortfalls and balance annual budgets, cities are making a variety of personnel cuts, delaying or cancelling infrastructure projects, and cutting basic city services; and,
- Ending balances, or "reserves," while still at high levels, decreased for the second year in a row as cities used these balances to weather the effects of the downturn.

MEETING FISCAL NEEDS



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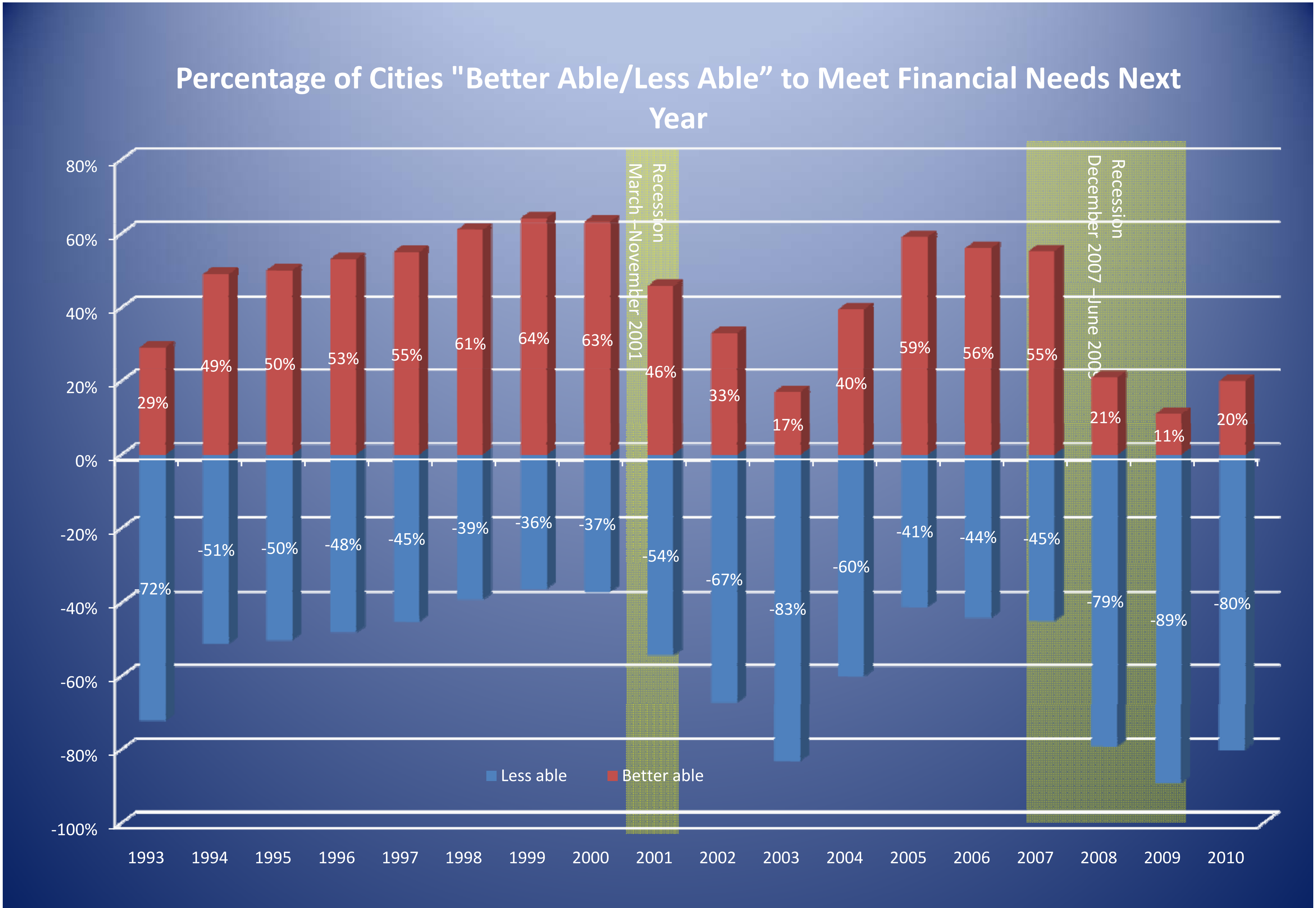
Source: Christopher Hoene and Michael Pagano , *City Fiscal Conditions in 2010* (Washington, DC: National League of Cities, 2010)



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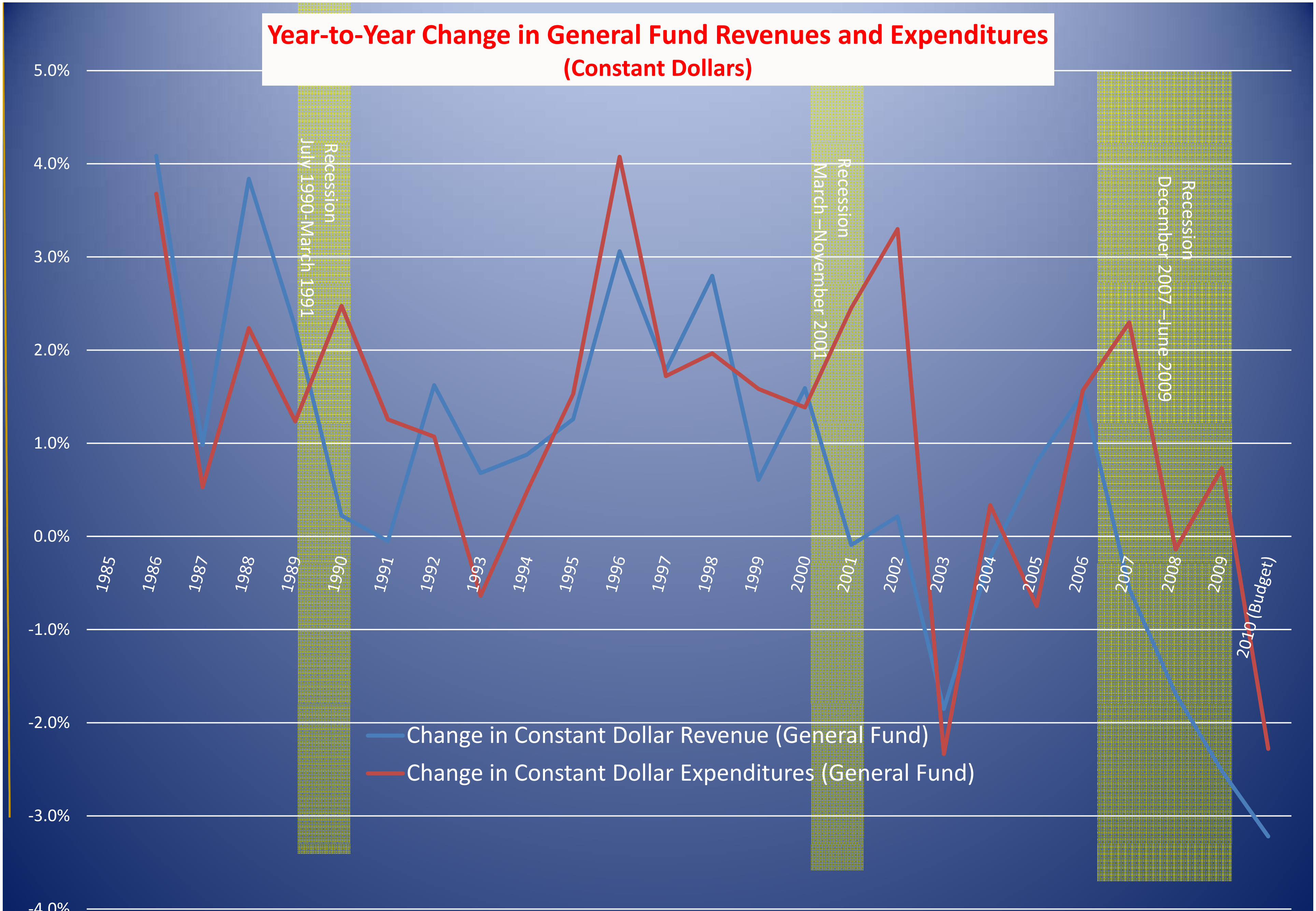

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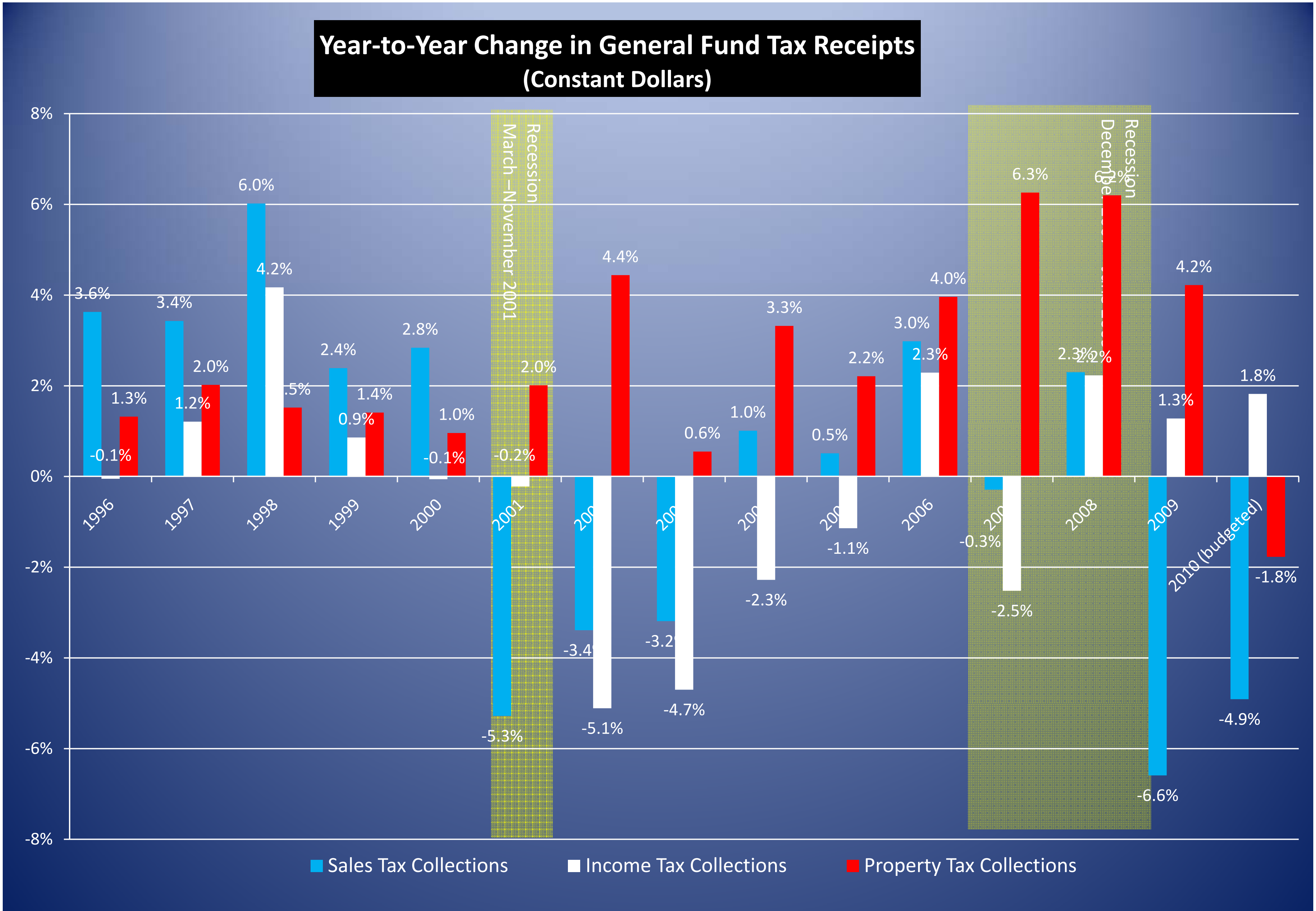

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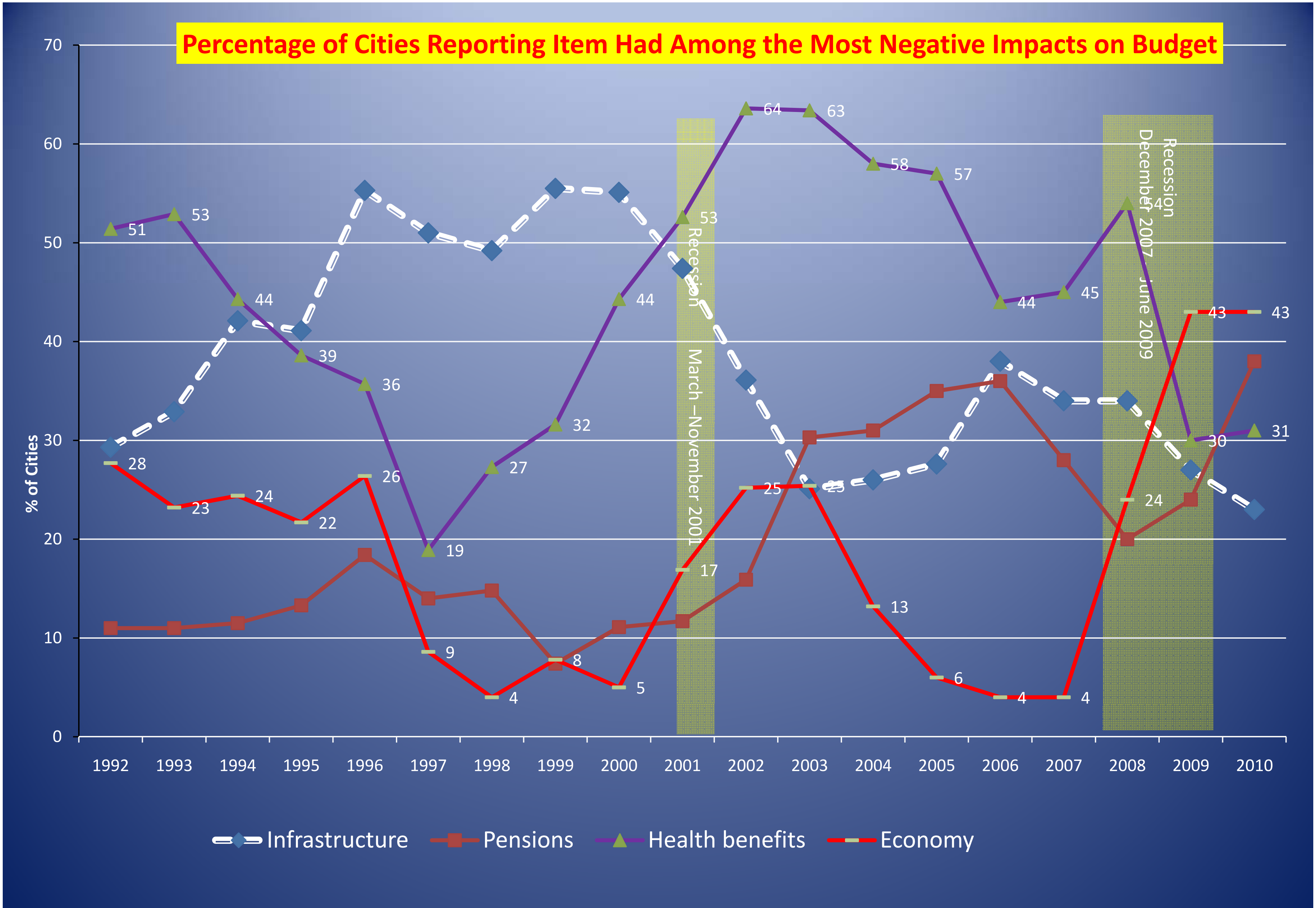

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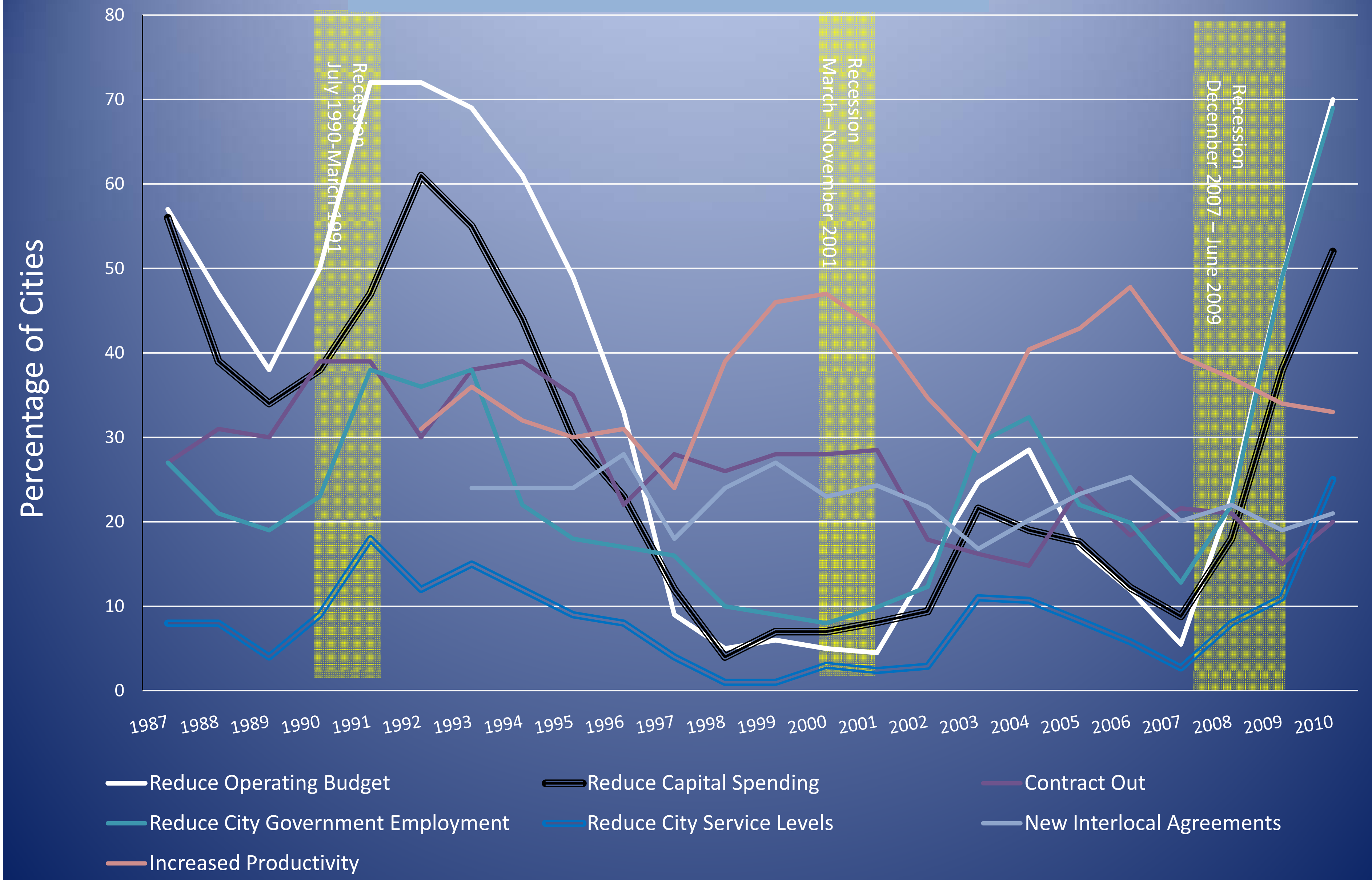
Selected City Actions



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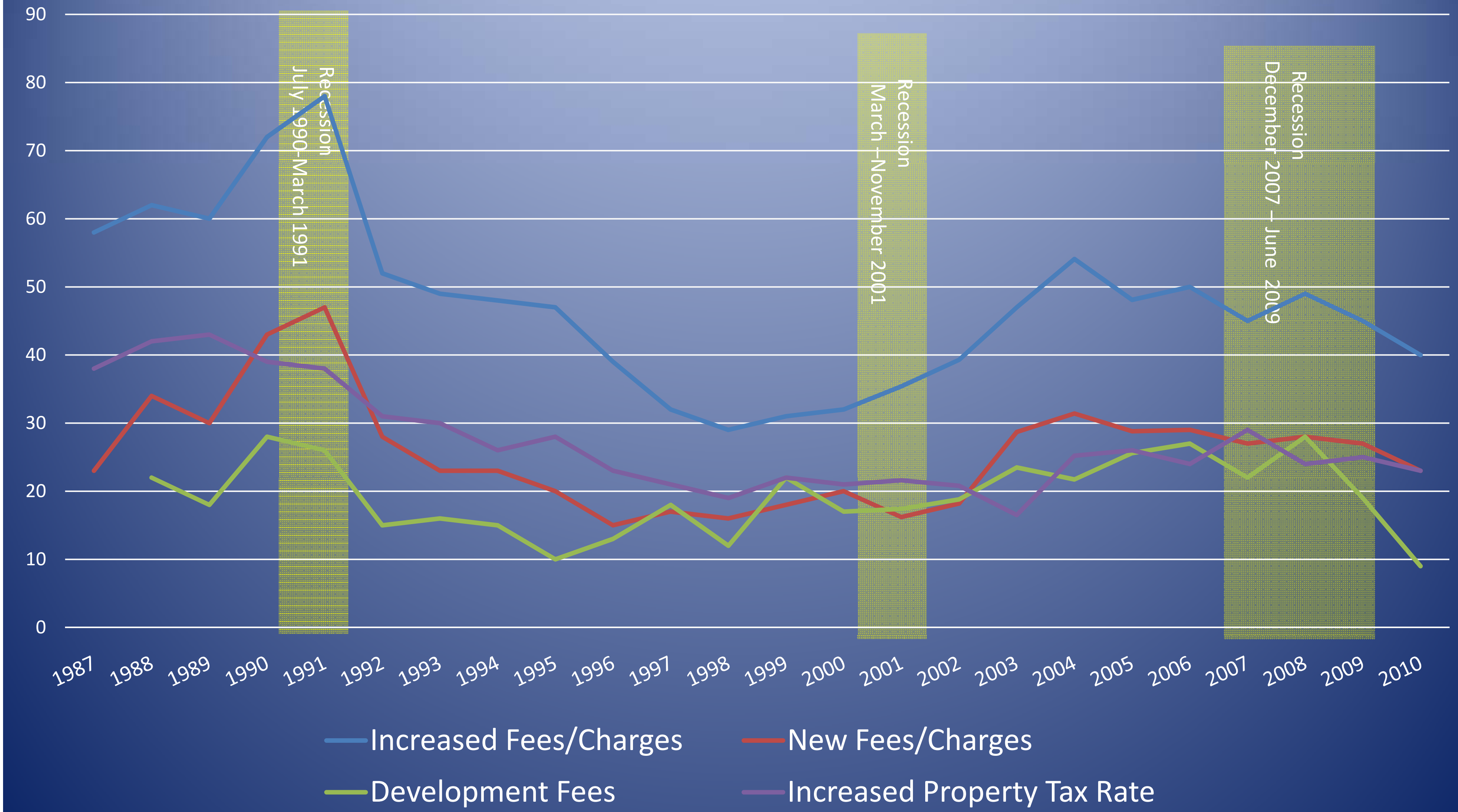
Percentage of Cities Adopting Fee or Property Increases



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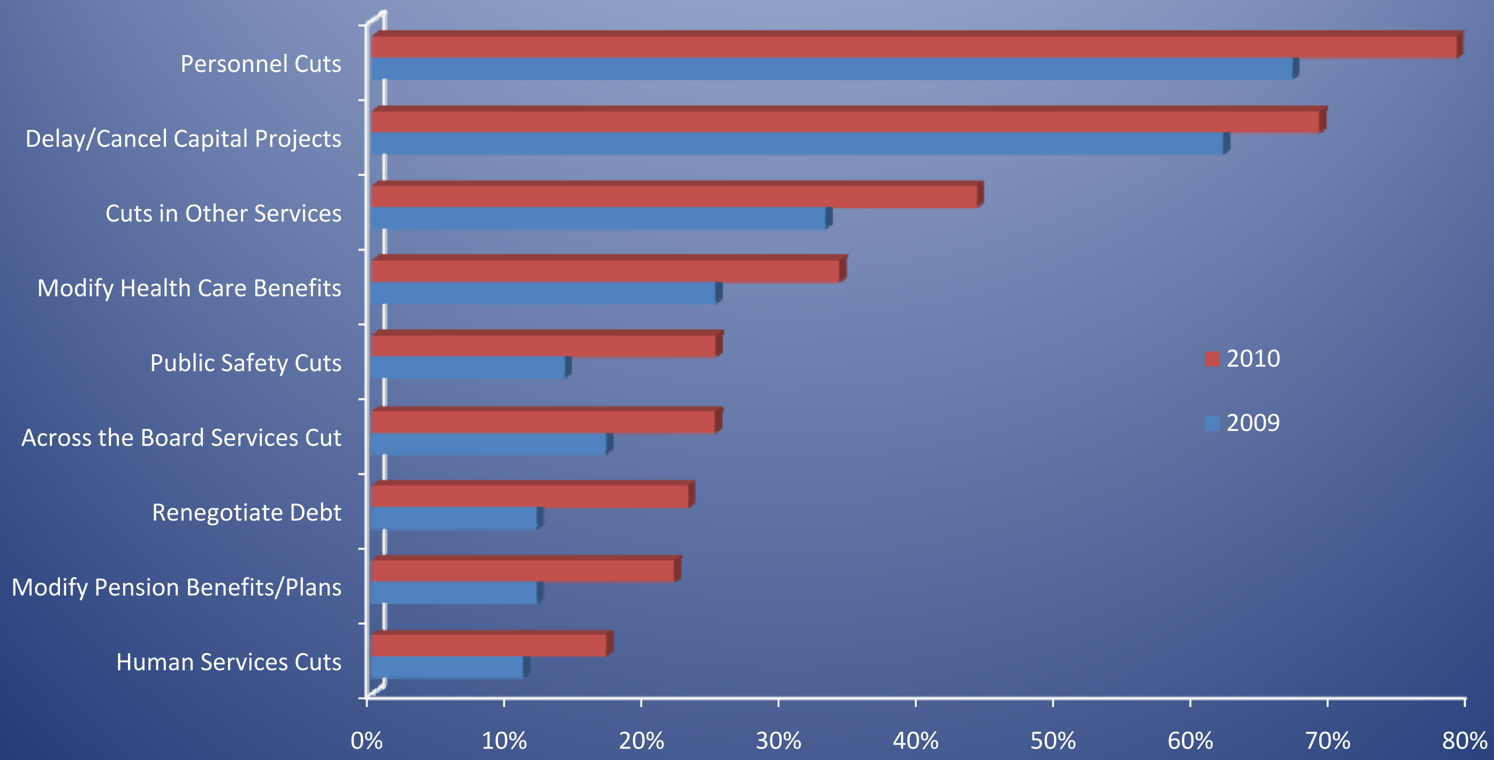
Expenditure Actions

(% of city finance officers listing factor)

City Spending Cuts in 2009 and 2010



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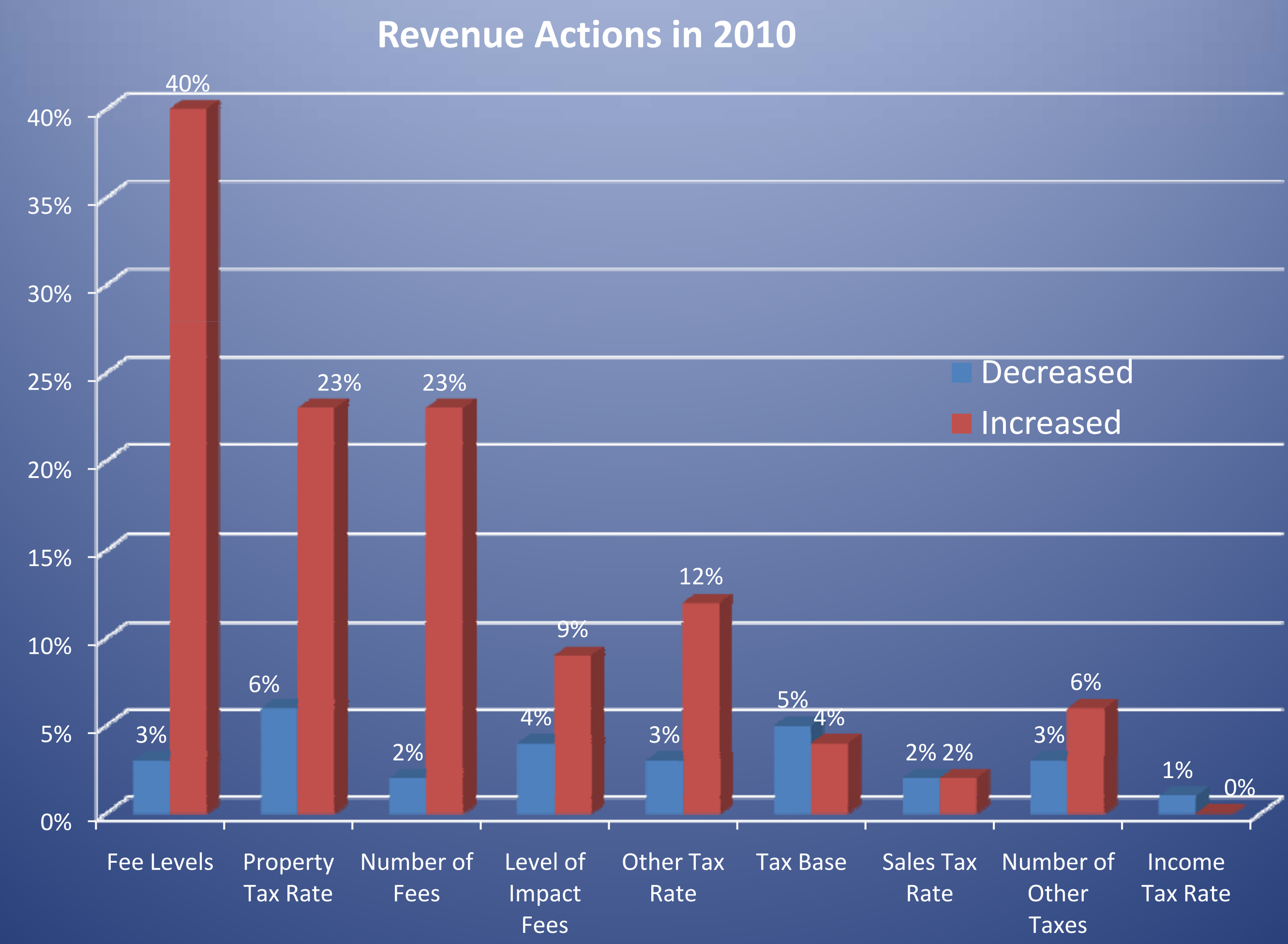
Source: Christopher Hoene and Michael Pagano, *City Fiscal Conditions in 2010* (Washington, DC: National League of Cities, 2010)

Revenue Actions

(% of city finance officers listing factor)



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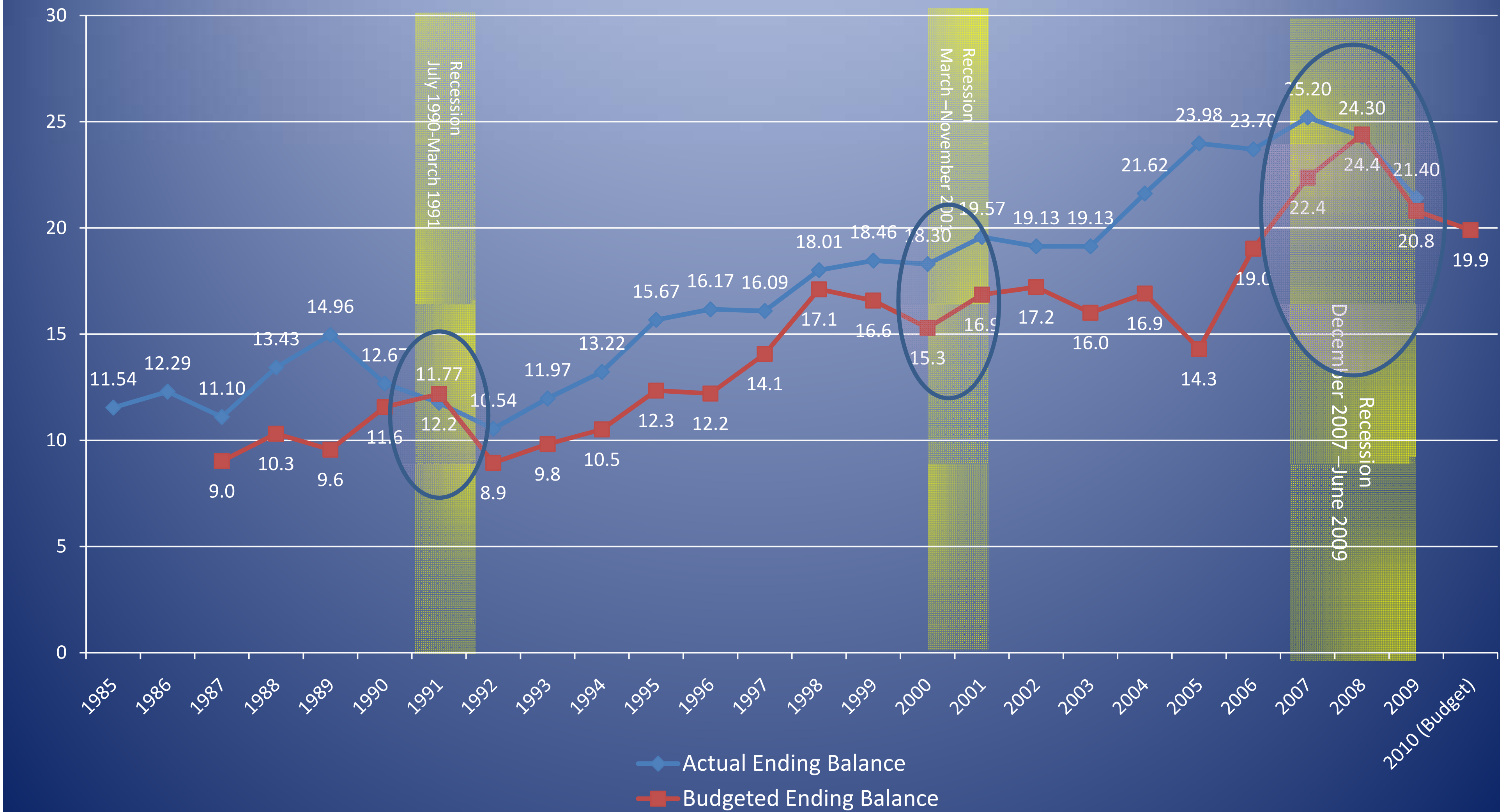
Ending Balances as a Percentage of Expenditures (General Fund)



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Opportunities for Re-Thinking the "fiscal architecture" of Cities

The economic shock of 2007 to the present ought to encourage a political discourse about reforming the fiscal architecture of municipalities:

1. **Reform the tax structure:** Tax structures might be designed that link closer to cities' underlying engines of growth or to income and wealth.

   Tax on income/wages. Is a tax on income at the place of employment (such as Ohio's, Kentucky's) or a gross receipts tax (such as Washington state's Business and Occupation Tax) a more accurate measure and reflection of a city's tax base?

Broaden the sales tax base. As the retail sales tax base has narrowed as a percent of consumer spending, is it time to reconsider a sales tax on services?

Restructure the property tax. As real estate loses much of its value, as vacant properties lie fallow, and as the number and value of tax-exempt properties increase, might cities consider moving from a uniform to a split-rate system? What's lost and gained by exempting so much property from the tax roles?

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2. **Create regional taxing powers**. Municipalities will be looking for regional partners and allies in designing a system that is less destructive to the region's long-term interests and fairer in distributing the costs to the users.

3. **Pricing Drives Behavior.** Approximating the market value of city-delivered services would possibly reduce subsidies to free-riders. Mileage fee? Fee for service?

4. **Revisit the Social Compact.** The social compact of the last century that bound generations, socio-economic classes, neighborhoods, cities and regions needs to be reconsidered in light of demographic shifts, the transformation of the underlying economy, the forces of globalization, and an irrepressible resolve to enhance the human condition.

- fairness of revenue systems;
- Benefits principle v. ability-to-pay;
- pro-cyclical nature of local and state budget practice;
- accumulated long-term liabilities (pensions, OPEBs, and infrastructure);
- definition of “core services”;
- pricing infrastructure and services;
- partnerships in service delivery.
- ……

THANK YOU

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