The Urban Fiscal Problem

Thirteenth Annual Wherrett Lecture
On Local Government

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1967

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The thirteenth in a series of annual lectures under the auspices of the Institute of Local Government made possible through a grant from the Wherrett Memorial Fund of the Pittsburgh Foundation.

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The Urban Fiscal Problem

The urban fiscal problem is usually described in terms of its symptoms, and striking symptoms they are. Public expenditures for the provision of public services in urban areas have risen rapidly, universally and without interruption for two decades. Expenditures have grown a good deal more rapidly than has the national economy and considerably more rapidly than the tax bases available to finance urban public services. This has led to frequent and widespread increases in the tax rates levied by state and local public agencies and the frequent imposition of new forms of taxation, during a period in which — more often than not — Federal tax rates have been reduced.

From the viewpoint of legislators, public officials and taxpayers alike, this is indeed a painful symptom. The pain has been most acute for the local governments serving the larger and older metropolitan areas of the country — the older of the nation's three dozen or so metropolitan areas with populations of more than three-quarters of a million, located mostly but not entirely in the Northeast and Midwest.

This seems anomalous, since so much of the country's income and income-generating assets are concentrated in the larger urban areas. An explanation of the apparent paradox leads one to a definition of fiscal problems in terms of causes, rather than symptoms. What are the major causes?

There are, I believe, three major causes. First, the larger and older metropolitan areas operate with diverse and fragmented structures of local government. Ideally, diversity — in local government, as in so many other aspects of contemporary life — can act to expand the range of individual choice, which is good, not bad. But, in practice, this form of diversity has opposite effects. More to the point here, it greatly inhibits the capacity of urban governments to tap the income and wealth of the metropolitan economies. It does this in part because the individual units of local government typically are in competition with one another for sources of taxpaying capacity — property values, personal income, retail sales, etc. — and therefore are fearful of tax rate differentials which can spur migration of taxable capacity to other taxing jurisdictions. Moreover, often the benefits from one local government's spending cannot (and should not) be confined to the residents of that jurisdiction; its taxpayers are understandably reluctant to tax themselves heavily to produce benefits which accrue to others.

A second explanation for the apparent greater severity of the fiscal difficulties in the larger urban areas lies in the heavy concentration of urban poverty and race problems, with their attendant requirements for large and increasing dosages of public services, within the large older central cities. In such cities, local-tax-financed outlays for services directly linked to poverty (in the health and welfare fields) have been rising steeply in recent years; the central cities of the twelve largest metropolitan areas account for an eighth of the country's population, but nearly 40 percent of health and welfare outlays financed from local taxes. For central city governments, the problems associated with poverty and race are by far the most urgent of public problems, and not just fiscal ones.

Few would argue that poverty or racial disabilities can be overcome by actions of local government, or even by actions of all levels of government combined. But in the American system of government, local governments are assigned important responsibilities connected with race and poverty. After all, local governments are responsible for providing educational services that over time will have a major bearing on the chances the poor and racially disadvantaged have to overcome their disadvantages. Local governments are also responsible for a wide range of health and welfare services, which are almost entirely oriented toward the poor in American cities. They have had, since the late Forties, major responsibilities in connection with the housing of the poor. They are now intimately involved with the administration of a variety of anti-poverty programs, which seem likely to require increasing financial responsibilities over time.

Third, the age of most of the larger American cities itself creates difficulties with fiscal consequences. Their physical plant — both housing and public facilities of all kinds — is old, often decaying and even more often functionally obsolete. Replacement is administratively complex and costly in financial terms.

Of course, we, as a nation, could accept continued deterioration of the older parts of the older cities, with gradual depopulation of these sections. This would be in keeping with long historical trends in American cities and with our historic ideology — the ideology of the frontier, beyond which there are virtually limitless supplies of land and other natural resources, waiting to be exploited, as a cheaper alternative to redevelopment and more intensive utilization of land inside the frontier. In this case, of course, the "frontier" is the rural fringe to which urbanization just barely extends. Why not, one line of argument goes, accept the decline of the urban core as a technological inevitability and simply build anew beyond the present urban frontiers?

One reason not to do so lies in the plight of those who, because they are poor, or Negro, or both, have little chance to escape the deteriorating areas. Amelioration, for these hundreds of thousands of people, is both politically and morally necessary. Quite apart from moral issues, most cities and the Federal

government appear to have decided that it is necessary to replace obsolete social capital and to compete for residents and businesses in an atmosphere of rising expectations. I suspect that this decision has two bases, one tangible and the other less tangible but nonetheless real.

First, the continued gradual decline of the urban core will involve very large economic losses, on the part of firms whose geographic spheres of operation are more or less immovable (ranging from utilities to local retail stores), their employees and the governments which depend on such economic activity for tax revenues. To be sure, if the transition could occur overnight — if the core areas could be emptied and new investment and residential locations put in place on the fringes overnight — the economic losses might be minimized or even overcome completely. But the transition is a slow and painful one, with heavy losses incurred during the decades it requires.

The less tangible explanation relates to the sense of community. As mobile as our society is, and as obnoxious as central city conditions frequently are, our cities consist of a complex web of institutional affiliations, group identifications and social attachments. These are valued above and beyond the physical plant and the economic values which reside in the urban core. Appeals to civic pride are not merely desperate euphemisms uttered when monetary loss threatens.

As will be argued shortly, in most cases, the large cities do have the fiscal capacity to cope with obsolescence, *with or without* large amounts of external aid. They do not have any such capacity to cope with the needs for poverty-linked public services. Indeed, my contention is that *the* urban fiscal problem for most large cities, and really for the nation as a whole, consists of this basic inability to finance the responsibilities connected with improving the lot of the urban poor, responsibilities which most large-city governments are called upon to perform.

Of course, the central cities, like all American urban governments, confront fiscal demands arising from sources other than poverty and obsolescence — those which have as their origin quite the opposite, the affluence of our society. Private affluence, and the expectation of continual increases in private affluence, creates the demand for more and better public services. A wide range of improved public services is necessary to adequately exploit the available objects of private consumption — more water supply, waste disposal and highway facilities, to mention only the most obvious. Even more important is the clear relationship between rising income levels and the demand for more lengthy and higher quality education. Looking back over the past two decades, the improvement in the overall standards of public services, for all their continued deficiencies, has been impressive indeed. The greatest improvement, perhaps, has occurred in the high-income suburbs of our larger cities. But these high standards are the ones to which nearly all other suburban communities, and central cities as well, aspire.

In these days of public employee unionization and strikes, it is worth noting yet another source of fiscal pressure, although one which is not independent of the factors previously mentioned — the rapid increases in the salaries of public employees. The public sector has been expanding in many directions. If local governments are to command resources, they must pay prices for these resources which are competitive with those prevailing in the economy, notably salaries of public employees. If they are to expand *more rapidly* than the private sector, they must bid away resources by paying even more, which largely explains the rapid increase in urban government salary levels, especially for occupational groups whose talents are in heavy demand in the private sector.

Some Recent Trends

In recent years, as throughout the twenty post-World-War-II years, local (and state government) public expenditures in fact have been increasing substantially more rapidly than has the nation's total output and income (see Table 1).[1] Public expenditures in urban areas have always been significantly higher, in relative terms, than those in non-urban areas, and recently have been increasing slightly faster, in dollar terms, within the urban areas. This is to be expected, since nearly all the nation's population growth has been occurring in urban areas. But urban population growth alone does not explain the rate of increase in public spending. Indeed, the increase in *per capita* local government expenditures in metropolitan areas has been more rapid than the increase in *aggregate* gross national product.

The Pittsburgh area is not immune to these trends. In actual dollar terms, local government expenditures have increased somewhat less than in other large metropolitan areas. However, there has been very little population growth here. In per capita terms, the increase has been very little smaller than elsewhere — 55 percent between 1957 and 1964-65 for the whole area and 53 percent for Allegheny County local units.

In fact, this is the most striking of recent developments in urban public finance: public expenditures in the larger central cities have been climbing steeply, despite their losses or slow growth in population. In the most recent eight-year period for which data are available, expenditures of municipal governments in the larger cities rose by 53 percent (see Table 1), about two-thirds as rapidly as expenditures of all other local governments combined. Consider the 38 largest metropolitan areas (1965 population over 700 thousand). In the eight-year period, 1957 to 1965, local government expenditures rose by 78 percent for these entire areas. In their central portions, the rise was well over 50 percent.[2] But there has been little population growth in the central portions. In

[1]The dates used here are related to data availability. A Census of Governments was conducted in 1962 and in 1957; the preceding Census of Governments occurred in 1942.

[2]"Central portions" are the counties which include the central cities.

Table 1

PERCENTAGE INCREASES IN NON-FEDERAL PUBLIC EXPENDITURES, 1957 TO 1964-65

Gross National Product[a]	54
Total Expenditures:	
All State and Local Governments	82
All Local Governments	79
Local Governments in 38 Largest Metropolitan Areas[b]	78
Central City Governments in Large Cities[c]	53
Per Capita Expenditures:[d]	
All State and Local Governments	60
All Local Governments	57
Local Governments in 38 Largest Metropolitan Areas	56

[a] For calendar years 1957 and 1965.

[b] Metropolitan areas as defined in 1965, with populations of 700,000 or more.

[c] Includes only the municipal governments per se (i.e., excluding overlapping but separate county, school district and special district governments; for the 42 cities with a 1960 population of more than 300,000, excluding Honolulu).

[d] Based on estimated 1957 and 1965 populations.

Sources: Adapted from various Governments Division, U. S. Census Bureau publications.

percentage terms, the largest local government function, schools, has also been one of the most rapidly growing, in the large metropolitan areas as in the rest of the country. But, in the larger areas, the other very rapidly growing activities are those which have much more of a distinctive central city character, like the poverty-linked services of welfare, health and hospitals, housing and renewal, parks and recreation and transit.

To some extent, the expanding scope of urban public services has been financed by substantial increases in external aid to central cities. State and Federal aid to central city governments has risen considerably more rapidly than have central city expenditures. Also, the *direct* role of state governments in the provision of public services in and for the central cities has expanded considerably. For example, since the passage of the Interstate Highway Act in 1956, the states have been far more active in the construction of central city highways than previously. In a growing number of states, the state government is directly involved in urban mass transportation, in park and open space activities, and in housing programs. In some states in the Northeast, expansion of state higher education programs has had an important effect on central city populations. But despite all this, the taxes imposed by central city governments, collected from static populations and slowly growing central city economies, continue to rise sharply.

The Poverty-Linked Services

Let us examine the fiscal problems associated with poverty in the cities somewhat more closely and consider how these problems might best be resolved in an ideal world. It might be argued that the proposition that the financing of services to the poor is *the* urban fiscal problem of the larger cities is invalid, simply because the states and the Federal government do finance so large a share of the costs of public welfare, health and hospital services, as well as significant shares of school costs. This is true, but there *is* a substantial residual local government tax burden connected with the financing of poverty-linked services, a burden which exists for many local governments but is especially important in the older central cities.

Take public assistance, which is the most obvious poverty-linked public service. The Federal government provides substantial amounts of funds for this, roughly 55 percent of the total spent in 1965. In most states in the United States, the remaining funds are provided entirely from state government sources, and indeed the state government administers public assistance programs itself. However, there are urban states with large *local* public assistance expenditures. They include California, Ohio, Indiana, Minnesota, Wisconsin, New York, New Jersey, and Massachusetts. In fact, in all except six of the metropolitan areas with a population of over one million, there are significant locally financed outlays for public assistance. For the country as a whole, roughly one-sixth of the funds are provided from local financial resources. Similarly, there are significant health expenditures (which in cities are primarily directed to the poor) and hospital expenditures financed from local tax funds. In 1965, the locally financed welfare expenditures, locally financed current expenditures for health purposes, and locally financed current expenditures for hospitals (net of charges received from hospital patients), totalled well over $2 billion.

This was about 10 percent of total local government property tax revenues in that year. The ratio is much higher for the governments of the largest American cities. In 1965, locally financed services which are directly linked to poverty absorbed about one-fourth of the property tax revenues of city governments in places with populations over 300,000, and one-sixth of their collections of taxes of all types. In New York City, which perhaps is an extreme case in this as in so many other things, an estimated one-third of the City's operating budget of $4.5 billion (in the fiscal year 1966-67) is devoted to poverty-linked services. Of the $1.5 billion for poverty-related services, about $1.0 billion is financed from external aids and about $500 million from City tax collections. This $500 million is one-sixth of total City revenues from its own taxes and charges. In the New

York situation, as in a number of other larger metropolitan areas, if the local tax drain due to central city financing of social services were equalized over the entire area, central city tax loads would be well below those elsewhere in the metropolitan area, rather than well above, which is the more usual case.

A major aspect of the poverty-related fiscal problem is connected with the financing of schools in the older central cities. Typically, the big city school systems receive relatively little in the way of state school aid. This is because the usual state aid programs are based on the numbers of children in public schools and the local property tax base per pupil. The big cities tend to have relatively high *per pupil* (although relatively low *per capita*) property values, because they have low ratios of school-age children to total population and large proportions of even these children in non-public schools.

But the conventional state aid formulas tend to ignore something now accepted as fact: that the disadvantages under which children of poor and minority-group families suffer produce requirements in the way of special services, very small classes and the like to assure a performance in school equivalent to that of the suburban middle-class child. Therefore, the cost of providing a given quality of education is not uniform throughout a state. The provision of education of a quality equivalent to that received in the better suburban schools would cost enormously more in the slum schools in the big cities.

I say "would cost" rather than "costs" because, in the absence of state aid formulas which recognize cost differentials, big city school systems at present simply do not have the resources to attempt to provide equivalent-quality education. True, the 1965 Federal Aid to Education Act is specifically addressed to the problem of children from poorer families. It thus provides substantial aid for large central city schools, and partially makes up for the inadequacies of the state-aid formulas. This is all to the good, but the big city school systems even now spend several hundred million dollars, from their own tax resources, because of these differential costs; if the problems arising from poverty and racial disabilities are really to be effectively attacked, hundreds of millions more should be spent, and will *not* be, under present fiscal arrangements.

It seems clear that, in an ideal world, the financial burden of public services which exist primarily to cope with these problems would not rest on particular local governments with small geographic coverage. Poor people tend to be concentrated in the central cities of metropolitan areas for good reasons. The central cities have the supply of housing that the poor can afford, the kinds of jobs to which their limited skills give them access, and the variety of social services which they require. Indeed, it is probably in the national interest that the poor be concentrated in central cities, for it is rather unlikely that their needs would ever be sufficiently attended to were they not so conspicuous.

Another factor in the geographic location of the poor, and even more in the geographic location of those in racial minority groups, is national in character.

This is a very mobile society which has over the years undergone rapid economic changes. There have been, in response to these economic changes, massive migrations of people from rural areas to urban areas, from central cities of urban areas to the suburbs, from the urban areas of the North and Midwest to the Southwest and West. The poor and the racially disadvantaged have migrated to the cities in response to pressures in their older locations and attractions in the newer locations, but all these have been essentially national economic and social forces. This being the case, it seems appropriate that the costs of attending to the needs of such people should be spread over a fairly wide geographic area. And since it is the economies or, rather, the economic prosperity of the larger metropolitan areas which has been the attraction for the poor and the disadvantaged, it could be argued that the metropolitan areas as a whole ought to finance the poverty-linked social services.

There is a good case for this, for the great bulk of the wealth and income of the country is concentrated in metropolitan areas. But almost nowhere is there a governmental structure such that taxes can be levied throughout the metropolitan area on the economic base of the entire metropolitan area for the support of such services. In some places, in states which are overwhelmingly urban and metropolitan in character, the state government may be a reasonable substitute for metropolitan area government. But this is not true of all states, and, moreover, some metropolitan areas straddle state boundary lines. Also, the migration of the poor among the states has not been an even, proportional movement; some states, like New York, have been the recipients of very large numbers of poor in-migrants because of accidents of geography (access to Puerto Rico), rather than economic strength.

The state governments, like those of the large central cities, face serious fiscal difficulties of their own, arising from rapidly increasing demands for public services of the kinds usually provided at the state government level (e.g., higher education) combined with inhibitions on their taxing powers related to concern about possible effects on the location of economic activity. Many states even today finance very large portions of public assistance costs; but the evidence suggests the states which do the most adequate job in this respect compensate (under fiscal pressures) by doing a less adequate job with respect to aid to big city school systems. Illinois and Connecticut, for example, finance nearly all public assistance costs at the state level, in sharp contrast to New York, but provide much less state school aid than does New York State.

All this suggests that the national government is the proper source of support for the bulk of poverty-linked services provided in urban areas. In addition, it could be argued that some of the poverty-linked services actually provided by urban local governments should be directly *provided* as well as *financed* by governments covering a wider area. One example of this is the suggested negative income tax which would supplant state and local public assistance expenditures.

There is a legitimate question about this line of argument. Why all the concern now? Has it not always been the role of the large American city to serve as a haven for unskilled, poorly educated and unassimilated migrants? This is true, but things have changed, in two important respects. First, in the past a very large share of the costs and agony of the assimilation process was borne by the newcomers themselves. We are very much less willing to tolerate this now, and, as a society, very much better able to afford to be more humane. Second, in the past, the central city was better able to afford, in a relative sense, to provide such services as it did offer, since the central city had a virtual monopoly on taxable capacity. Nearly all the economic activity in metropolitan areas was concentrated in the central cities and could be reached by central city taxes. Today, taxable wealth and capacity have dispersed throughout metropolitan areas — beyond the reach of central city taxes — while needs for special public services continue to be concentrated within the central cities.

The evidence on this is striking: in nearly all the larger metropolitan areas in the Northeast and Midwest, per capita taxable property values (corrected for differences in assessment levels) in the central cities are well below those in the outlying parts of the same metropolitan areas.[3] In my book on the property tax, I was able to find some data on the deterioration of the relative position of some central cities over time:[4]

> In the Baltimore area, for example, suburban property values per capita were only 81 percent of those in the central city in 1950, but had risen to 110 percent by 1960. In the nine counties of northeastern New Jersey, 22 of the 279 municipalities have central city characteristics; in 1951, real property values per capita in the 257 outlying places averaged 169 percent of those in the 22 core communities; and by 1960, the figure had risen to 186 percent. In suburban Cook County, real property values per capita were 119 percent of those in Chicago in the 1928 reassessment completed in 1930; but, in 1961, they were 136 percent. And in Milwaukee County, suburban property values per capita were 105 percent of those in the central city in 1935, 120 percent by 1940, and 138 percent by 1960. The Milwaukee data suggest what probably has been generally true: from the earliest years in this period, residential property values per capita were higher in the suburbs than in the central city, but this differential was partly offset by substantially higher nonresidential property values in the city. In the postwar period, however, while the spread in residential values widened somewhat, there was a reversal in the business property relationship; in 1960, per capita business property values were significantly higher in the suburbs.

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[3]Dick Netzer, *Economics of the Property Tax* (Brookings, 1966), Table 5-7, p. 118.
[4]*Ibid.*, pp. 119-120.

Urban sociologists, beginning with Ernest W. Burgess in 1924, generally have held that these economic and fiscal trends are consistent with trends in socio-economic status. That is, as Burgess hypothesized, the urban area grows outward in concentric rings, with people of greater means successively moving further out from the core and eventually residing beyond the central city boundaries, while the closer-in areas become residences of the less well-off. More recently, sociological investigators have pointed out that this pattern is *not* true of most smaller and newer cities; this, too, is consistent with my evidence that central city taxable values per capita tend to be *higher* than in their suburbs, in such areas, rather than the reverse. However, the most elaborate empirical inquiry along these lines, by Professor Leo Schnore of the University of Wisconsin, suggests the strong likelihood that these cities, too, as they grow and age, will follow the pattern found elsewhere.[5] Thus, the fiscal problems I describe are perhaps more generalized than it seems.

The long-term consequences of this situation, in addition to the likely under-supply of poverty-linked services, are fairly obvious. If the central cities must impose higher tax rates on their more limited tax bases in order to finance special services to the poor, there is likely to be some inducement to residents and businesses (at least to those able to do so) to move to lower-tax jurisdictions in the same metropolitan areas. Given the highly fragmented structure of local government, there are likely to be a fair number of such jurisdictions, which satisfy their other locational requirements, in any given metropolitan area. This migration in turn further weakens central city tax bases, setting the stage for a new descent on the fiscal and economic spiral. This, then, is the essence of my earlier conclusion, that the large cities simply are incapable of fiscally coping with the needs for poverty-linked public services.

Rebuilding the Central Cities

I do not believe that the preceding arguments apply to the problem of physical rebuilding of the central cities and the provision of public services at standards which are sufficiently high to make the central cities attractive and efficient places in which to live and conduct business activities. Assume that Federal and state aids and direct spending programs have relieved the fiscal pressures associated with the poverty-linked services, and that such services are being provided at a level sufficient to gradually reduce the dimensions of poverty itself over time — to make an increasing proportion of the present poor and their children self-supporting, high-consuming members of American urban society. In such a situation, it is difficult to see why a city rebuilding program (in the broadest sense of that term) presents any inherent fiscal difficulties.

[5]See "Urban Structure and Suburban Selectivity," *Demography*, Vol. 1 (1964), pp. 164-176.

This is because, if a central city has sensible redevelopment policies and strategies, ones which actually provide a good payoff in social terms relative to the funds invested, the cities themselves should be able to finance the costs fairly readily. That is, the additional public expenditures in time will improve the environment of the city sufficiently so that its tax base — broadly defined — will be enhanced considerably. Or looking at it another way, from the standpoint of taxpayers rather than city government, the new investment provided and public services offered are a quid pro quo for the taxes and charges imposed to finance them. This is unlike higher taxes imposed to finance welfare and similar costs unique to central cities, for middle- and upper-income residents are unlikely to be able to secure public service amenities at much lower tax costs elsewhere in the metropolitan area. For example, suppose a city redevelopment strategy involves greatly improving park and recreational facilities and services. Increased taxes for this purpose will not stimulate net migration, as long as there are substantial numbers of families who place a high value on the improved facilities and services.

The real fiscal problems connected with city rebuilding programs — assuming a sensible set of program priorities — relate to the choice of fiscal instruments used for the financing, rather than to fiscal capacity pure and simple. High central city taxes on business activity may make the central cities much less attractive locations for business capable of operating elsewhere. Equally important, high taxes based on the value of real property can discourage private investment which raises real property values. In old cities which are full of obsolete private structures, an ideal fiscal solution would avoid taxes that deter private rebuilding. Instead, such a solution would involve taxes which either encourage the needed rebuilding or are neutral in their effect.

In practice, there are two major defects in the choice of revenue measures by large American cities. One is the under-utilization of charges and taxes closely related to the use of specific facilities and services. A second is the over-utilization of the property tax. The latter is more serious. The main problem is the extremely heavy taxation of housing, which works at cross-purposes with the desire to rebuild and renew central cities. In the United States, local property taxes on housing equal roughly 20 percent of the rental value of housing. That is, they are equivalent to a 25 percent excise tax on housing expenditures. In the larger metropolitan areas, particularly in the northeastern part of the United States, the excise tax rate is more like 30 percent, and for some of the central cities well over 30 percent. There is no other type of consumer product, aside from liquor, tobacco, and gasoline, which is as heavily taxed in the United States today. The effect of this very heavy taxation, other things being equal, is to deter people from spending their incomes for better housing.

Note the "other things being equal" clause. In suburban communities, particularly bedroom suburbs, the public services that a family receives or has access to are very closely tied to the local taxes that the same family pays. Therefore, in a sense, the property tax in many suburbs is analogous to a general charge for the use of public services. It is unlikely to be a deterrent to consumption of housing, that is, to the expenditure of consumer income for housing. For the central cities, this is not the case. Central cities provide a wide variety of services and tax a wide variety of property types. Individuals cannot reasonably assume that the prices of housing confronting them include an identifiable tax component which is in effect a charge for a preferred package of public services. What they do observe is that housing is expensive in the central city. It may not be any more expensive in the central city than in the suburbs. But an effective city-rebuilding strategy requires that the central cities encourage more private expenditure for housing, and this may in turn require that housing be much cheaper in the central city than in the suburbs.

There is another element to the "other things being equal" clause. In the United States, taxes are imposed at the Federal and state levels of government, as well as at the local level. The impact of heavy local taxation of housing consumption has to be weighed against the tax treatment of this object of consumption by the other levels of government, which rely mainly on income and sales taxation. Both of these forms of taxation are highly favorable to housing consumption: state sales taxes seldom apply to any but trivial aspects of housing costs and Federal and state income taxes generally provide major tax incentives to home owners (but not to tenants).

The net result for the country's overall tax system is this: the tax system on balance does not discourage consumption of owner-occupied housing but it bears very heavily indeed on the consumption of tenant-occupied housing. Among homeowners, the overall tax system is highly favorable if one's income is high and highly unfavorable if one's income is low, looking at national averages.

All this suggests a very unfavorable picture for central cities. They have much rental housing, which is tax-discouraged. They have many relatively low income homeowners, who are also *not* tax-favored. And they have above-average property tax rates, making the situation even worse.

It may be argued that any tax paid by individuals and families in a central city will have some discouraging effect on their choice of the central city as a residence. This is true, as is the argument that any tax which reduces incomes will have some bearing on housing expenditures. However, a tax specifically related to housing expenditure is much more of a deterrent to the needed rebuilding of the central cities than a tax on income in general, for example. It is also far more of a deterrent than are charges and taxes related to specific use of public services.

User Charges

Aside from education and the services related to poverty, much of the activity of local government bears a strong family resemblance to the services provided by public utility companies. Many urban public services are offered in distinguishable quantities and qualities to individual families, who consume the services in accord with personal preferences; this is in contrast to the provision of, say, public schools to the entire population. For example, not all families use the same amount of water, not all use the same amount of highway transportation, and so on. There is a strong case for financing such services in the same way that public utility services are financed — that is, via user charges which are like prices, rather than through general taxes.

If the purpose of providing the public service is to offer different consumers the services they want, and place some value on, then they ought to pay for such services in proportion to the costs their use occasions. Otherwise, governments will be called upon to provide a great deal more of the service than people would be willing to consume if they did have to pay for it, which is a wasteful use of resources, when measured by the standards used in the private sector of the economy; or the service will be in such short supply that a form of non-price rationing will be employed to allocate the service among consumers. The outstanding example of this is street congestion in cities: users pay for highways in the aggregate but not for specific individual uses of the streets, and therefore, not surprisingly, treat highways as a free good. The only deterrent to use of the streets at the most crowded times and in the most crowded places is the value one places on time; the rationing in effect then results in those who place a low value on time preempting the street space from those who place a high value on time. Ordinarily, in our society, rationing is on the basis of price. Somebody who values a service highly bids it away from someone who places a lower value on that service and would rather use his income for alternative kinds of consumption.

There are at least three advantages to the application of user charges to finance urban public services wherever this is feasible (clearly, it is not sensible for any services with an income redistribution purpose, nor feasible for services consumed collectively by the population in general, like the courts, city planning, financial administration or other administrative overhead activities). One is a broad economic advantage: use of price-like mechanisms, where appropriate, is likely to lead to a more sensible allocation of resources in urban areas. The second is the economic neutrality of prices. People do not exchange money for services or goods unless they consider the value of the services or goods they receive at least equal to the money they surrender. If they do not so value the service, the exchange does not occur; but, unlike general taxes, leads neither to migration to another community nor to lower consumption of housing. Third, the application of user charges permits a local government to recover costs from users regardless of their place of residence, if they are actual users; this avoids the frequent city-suburb conflict over taxes which often are said to be designed to recover the costs commuters impose upon the central city.

In reality, user charges frequently are not applied at all in cases where they *can* be sensibly employed. They are also frequently used in a most inept fashion. Air and water pollution is an excellent example of failure to apply user charges where they clearly make sense. By and large, the construction and operation of sewerage systems and sewage treatment facilities is financed in the United States by local property taxes. Some places have sewer service charges of one kind or another, but they are by no means the majority. Yet here is a case where it is rather easy to identify the specific people who give rise to public costs. The benefits of water pollution control or air pollution control may be very broad, but the sources of public costs are highly individual. Moreover, it is not impractical to apply charges that have some relationship to the costs occasioned. This has been done in the Ruhr basin in Germany for many years; there is an elaborate system of pollution charges designed to apportion the costs of treatment facilities among the industrial establishments which actually occasion those costs and also to deter firms from polluting.

As noted earlier, conventional highway financing illustrates the inept use of user charges. Gasoline taxes and licenses have some relationship to the amounts of use of the highways by all users as a group and by individual users over long periods of time. But flat charges of this kind cannot possibly discourage people from freely using the very high-cost roads at the very high-cost periods. There is no discrimination among the parts of the road system depending on the cost to the public of those road systems, including the costs of congestion.

Another example of inept use of user charges is in connection with the common structure of transit fares in cities. The flat fare is a time-hallowed principle, although the structure of costs would dictate a substantially higher fare in the peak hours than in the off-peak hours, differentials between predominant and reverse direction riding and perhaps differentials based on distance in the larger cities. The use of parking meters as a user charge is also rather inept in most cases. Flat, low charges are the most commonly found kind of arrangement with relatively little discrimination among locations and times of day. As a result, in most places in central business districts metered curb space is cheaper but harder to find than less convenient off-street parking facilities. Moreover, since many cities use parking meter revenues to subsidize their own off-street parking facilities, they are to some extent competing with themselves by inept parking meter charge policies.

Conclusions

There are all sorts of issues in urban public finance which have not been covered by this review, issues which are of importance to many individuals, businesses and governments. These include: intra-suburban fiscal disparities; the

pressures to control land use for fiscal ends; the need for provision of some public services on an area-wide basis in metropolitan areas; the low quality of property tax administration in most of the country; the possible desirability of radical reform of the substance of the property tax (notably, in the direction of much more effective differential land value taxation than is done in Pittsburgh); the relative merits of various forms of local income and sales taxation; state constitutional and statutory restrictions on local government taxing and borrowing powers; the nature and forms of state grants in aid; the merits of various proposed and actual programs of Federal aid to the cities.

Instead, I have focussed on what seems to me, and to many in public life, to be the real locus of malaise in our urban society, the large central cities, and on the critical fiscal difficulties therein. Perhaps the most notable omission is the failure to deal explicitly with central city-suburban fiscal conflict and with metropolitan-area-wide solutions. The omission is deliberate. I do not believe that area-wide solutions are even remotely likely in connection with poverty-linked services; instead, the role of external and superior governments must, and will, be expanded. I do not believe that area-wide solutions or external financial assistance is necessary for a wide range of other urban public services. There is, of course, a place for area-wide arrangements, in connection with services like transportation, regional planning, air and water pollution control and water supply, services which for the most part cannot effectively be provided by individual local governments within metropolitan areas. The considerations here are essentially technological. And they are compelling enough to have produced a real trend toward actual adoption of area-wide arrangements for the resolution of the problems involved.

Of the three main propositions advanced here, two need no further elaboration: the necessity for concern about high central city taxes on housing and the desirability of better utilization of user charges. Somewhat more should be said about intergovernmental fiscal relations, in connection with the poverty-linked services. As noted earlier, the only real solution is complete Federal financing (and/or administration, via income guarantee schemes, etc.). But note that *this* plea for more Federal funds for the cities is not quite the same as the more usual one these days — that the cities need huge doses of additional Federal money, because they can't balance their budgets and have desperate but generalized fiscal problems. This is a plea of *municipal* poverty, not a specific argument that the existence of poverty *within* the cities presents special problems.

It is hard to believe that members of Congress, or indeed anyone who does not have a vested interest in a particular large central city, will ever be persuaded that the central cities need and deserve Federal subsidization in general. Instead, the case for increased Federal aid to the cities probably must be made along the usual lines: pointing to the existence of *specific* program areas in which there is a national interest, deserving of *specific* Federal aid. Any other strategy is both unconventional and unpromising.

And if the usual strategy is to be followed, it seems to me that it is important to focus on the main chance, that is, the real problem area and the one which involves really significant amounts of money — the poverty-linked services. City officials have a great and understandable temptation to produce a record of success at the state capitals and in Washington, by pleading for and obtaining an ever-increasing array of external aids of minor financial consequence — aids for activities which they can and should finance themselves. Such aids may perhaps be significant for smaller places, but the big cities run a real risk — the risk that they will succeed in obtaining dozens of million-dollar grants and fail to get the hundreds of millions for which the real case is much stronger.

Finally, a word about the state role in all this. State governments can be called upon to act as substitutes for metropolitan government to a far greater extent than most of them do now. I believe that there is a clear trend toward expansion of the state's role in urban affairs and that all the political pressures point in this direction. In addition, pending the Federal government's acceptance of its proper responsibility for the poverty-linked services, the central cities have no choice but to press for the state governments to substitute for Federal responsibility. And to do this, the states themselves need more money, money which can be most easily made available from some sort of Federal-state fiscal cooperation scheme, whether it is the Heller plan or some other one. The conflict between the cities and the states about Federal revenue sharing proposals is, therefore, unnecessary and misguided, in my view. If one believes in state government at all — in its relevance for the last third of this century — one must also believe that if additional Federal funds flow to state governments, this will help, not hurt, the large cities.