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Fiscal Paternalism and New England Cities: A Policy for the Year 2000

Mark S. Ferber and Elizabeth A. Ferber

The following commentary explores the future of urban public finance by focusing on the fiscal ills of New England’s major cities. The impact of general revenue sharing, categorical grants, federal tax policy, state aid, and own-source city revenues is assessed in light of a city’s ability to support itself. The authors conclude that a pattern of “fiscal paternalism”—the past and present policies for annual financial assistance to narrow the expenditure-revenue budget gap—must be altered if cities are to enter the twenty-first century as fiscally stable governments capable of providing the necessary services for a varied constituency.

In 1969, as a candidate for mayor of New York City, writer Norman Mailer suggested that the most likely method of resolving the City’s well-publicized fiscal problems would be for it to secede from New York State and apply for independent statehood status. Mailer reasoned that secession would increase the direct flow of federal dollars to the City, would eliminate the costs of compliance with state regulations and the implementation of state-mandated programs, would permit the City to retain 100 percent of the revenues generated within its borders, and would preclude the potential for suburban legislators, unsympathetic to the City’s needs, to exercise their political power at the expense of the City. On its face, the proposal seemed somewhat absurd. Yet, twenty years later, it appears that a number of New England’s largest cities might contemplate the same course of action to obtain the same benefits.

The vision that Mailer’s proposal sought to address in 1969 was one of urban fiscal independence. The prospect of statehood for New York City represented then what a policy aimed at fiscal independence for New England’s cities would represent now—an end to fiscal paternalism on the part of federal and state governments toward urban centers.

Fiscal paternalism can be defined as an unhealthy dependence by urban centers on state and federal financial policies and programs for the purpose of ensuring...
those cities' financial stability. Eliminate state and federal assistance, and New England's major cities would be burdened by budget deficits that would force a wholesale redefinition of city government in order for debts to be paid. Reduce state and federal assistance, as some legislators now contemplate, without an attendant financial plan for the now-dependent cities, and programmatic chaos should not be unexpected. Like a child who is learning to be independent after being taught to manage money by application of a parent-supplied weekly allowance, cities dependent on state and federal allowances must be allotted a period of transition in order to adjust to the prospects of a future without the nest of funds that policies of fiscal paternalism have provided.

It is important to understand that this problem did not appear overnight but rather evolved over two decades to its present point. During the late sixties and early seventies, cities were the primary beneficiaries of the "Age of Entitlement"—so named because of the federal policy whereby grants-in-aid were heaped on almost any jurisdiction regardless of whether they were necessary. All that was really necessary was a properly filed grant application. In retrospect, however, the price of these grants was actually quite high, for cities' acceptance of such monies opened the door to federal interference in local policy planning.

Today, in view of its own soaring deficit, the federal government has proclaimed an Age of Fiscal Enlightenment. The federal financial commitment to cities has been dramatically reduced, and cities face mounting financial pressures. The process of directing national urban policy away from extravagant provision for nonessential programs and toward seemingly random cuts in now-essential services has found cities relinquishing their reins of control over the breadth and depth of services to be provided. In terms of setting urban priorities, policy has followed the purse rather than the other way around.

Since the future we frequently define as the year 2000 is only fifteen years away, it behooves us to consider steps that can be taken by our cities to improve their prospects for financial independence in the years ahead. Such a review should begin with a glance at the policies that delineated the parameters of what we now call fiscal paternalism.

An Overview

From 1960 to 1968, the number of federal grant programs exploded from 45 to 435, without a concomitant explosion of social satisfaction resulting from the expenditures. America had recognized that it was an urban nation with a need to support the development of its cities. Yet no national urban policy existed. A paternalistic federal funding policy, referred to as the Great Society, attempted to solve all ills by throwing money at them. The federal government provided a range of programs that permitted it to intrude on the management of cities and to define, in part, the quality of life which cities could afford their residents. Local officials welcomed an array of programs for the elderly, the disadvantaged, and the unemployed in large measure because the programs generated political support from local constituencies without asking local taxpayers to pay the bill directly.

Federal aid accounted for 30 percent of general revenues for cities in the late fifties; by fiscal 1971 federal aid was responsible for 37 percent of local budgets.
Still, one of the most important sources of federal assistance did not appear until 1972. In that year, the general revenue sharing plan, discussed in more detail later, was introduced. Unlike the categorical grant programs that preceded it, general revenue sharing was intended to help counteract the expenditure-revenue imbalance that cities were experiencing by providing unrestricted cash support for city programs.³

Unrestricted federal grants to cities totaled $4.6 billion in 1972. In 1985, the White House determined that it could shave $23.8 billion off the federal deficit between 1986 and 1990 by eliminating the general revenue sharing program altogether.⁴ Although the federal government apparently found it acceptable to recommend elimination of the program, mayors and city dwellers alike found it unusually difficult to accept the cuts because more than ever, general revenue sharing funds were being used to support essential city services. The federal effort of 1972, far from reducing the expenditure-revenue imbalance, had created an even greater imbalance, masked only by the annual infusion of these dollars.

Policies of fiscal paternalism advanced unabated throughout the sixties and seventies. The relationship between the federal government and American cities became increasingly dependent and structured, providing the former with the opportunity to dictate both the breadth and depth of municipal services. This intervention was paternalism at its worst: a veritable intrusion into every City Hall that either willingly received or was politically pressured into accepting a portion of the federal largesse. Now, in 1985, cities are witnessing the federal government’s withdrawal of municipal financial assistance, and they are being left without an independent means of raising revenues to replace the lost dollars.

The rhetoric of the seventies focused congressional attention on the need to develop a national urban policy. It appears now that the most prominent benefits we have to show for those policy efforts are downtown revitalization projects and their most frequent patrons, center-city Yuppies. After two decades of undirected urban programs, the future of our cities remains in peril: not from conflicts within urban centers themselves but from the insidious, undermining effects of fiscal paternalism. During the twenty-odd years in which there was a steady flow of revenues from the federal government, city officials were led to believe that such funds would be forever forthcoming; today, they are learning that nothing—not even fiscal paternalism—is forever.

The more money urban America accepted from the federal government, the more federal urbanologists believed their programs were succeeding. But federal money was only camouflaging some urban ills while it was actually creating others. None of the federal funds were used to assist cities in planning for a future independent of federal assistance; instead, federal programs were becoming an integral part of the new menu of urban services, complete with their own vociferous, dependent constituencies.

In the late 1970s, as federal programs lapsed, state governments were asked to cover the shortfall lest the momentum of municipal revitalization be stifled. Fiscal dependence was transferred from federal funds alone to a mix of federal and state monies. There were now two fiscal parents for cities to look to for guidance and to depend on for funds.
General Revenue Sharing

By and large, what revenue sharing tends to do is give a lesser amount of money in a more politically palatable form.

— Paul N. Ylvisaker, Professor of Education
Former Dean, Harvard Graduate School of Education

New England’s largest cities suffer from many of the problems experienced by senior citizens who are on fixed incomes and who are dependent on the federal government for their Social Security checks. These citizens recognize that the nation has a bulging deficit, but they vigorously fight Social Security benefit cutbacks because they have grown to rely on their no-strings entitlement stipend. What was once a supplemental payment to enhance has now become basic income on which to survive.

The General Revenue Sharing program (GRS), enacted as part of the State and Local Fiscal Assistance Act of 1972, was heralded as a means of resolving the structural expenditure-revenue imbalance that had begun to plague many of the nation’s older, poorer cities.6 Ironically, some “neoliberal” Democrats who remain staunch defenders of Social Security have sided with the Reagan Administration’s policy of monetary cutbacks in our cities’ Social Security system—that is, general revenue sharing. Proponents of the cuts argue that the impact on local fiscal conditions would be moderate,6 since general revenue sharing represents less than 2 percent of the total revenues of local governments, but this is not so for New England’s older communities.

Boston, which found itself a scavenger for state aid in order to close a $55 million revenue gap predicted for fiscal 1986, received $18 to $19.5 million annually in revenue sharing monies from 1982 to 1985.7 Burlington, Vermont, and Portland, Maine, depend on intergovernmental aid for more than 15 percent of their operating revenues. After direct state assistance, general revenue sharing represents the largest single component of these operating budget lifelines. Providence relies on intergovernmental assistance for more than 25 percent of its budget, while Hartford requires state and federal transfer payments to supply more than 30 percent of its annual budget.8

Older cities accepted the advent of general revenue sharing with guarded optimism. The optimism was fostered by the belief that revenue sharing funds would not be accompanied by the programmatic restrictions of categorical aid and block-grant monies. On the negative side, there was skepticism because revenue sharing represented a net reduction in dollars transferred to cities by the federal government. New England cities were designating revenue sharing monies for the staples of government service—police, fire, education—and therefore were disturbed by the decrease in federal assistance that general revenue sharing represented.

The federal government’s decision in 1981 to eliminate state government participation in the revenue sharing program was predicated on the conclusion that the fiscal condition of state governments no longer warranted federal subsidies.9 The same can hardly be said of New England’s major cities in 1985.

In our view, the federal government accepted certain “parental” responsibilities in 1972 when it created the general revenue sharing program, among them the
commitment to nurture cities' use of this money and to create an atmosphere of fiscal strength at the city level, rather than further the urban addiction to federal funds. The task of weaning urban America away from the flow of federal funds cannot be accomplished overnight. While some may see a strategy reminiscent of triage as an acceptable approach to federal deficit-cutting policies, we do not, since it means certain regression for older cities that are just beginning to recover from the burdens of a severe recession, record inflation, and increased pressures to provide social services for a dependent population of urban poor.

With an eye toward its own goal of deficit reduction, the federal government should promote a policy of phased reduction in general revenue sharing rather than one of drastic cuts. In the scenario we envision, phased reduction would:

*postpone the termination of the fiscal general revenue sharing grants* into the next decade;

*provide grants on a revised need-based formula* that would consider: (1) the income level of the population, (2) the ability of the city to use its own-source revenues, other than the local property tax, to replace the GRS share of revenues, and (3) the ability of the state and county governments to provide supplemental assistance specifically to mitigate the fiscal hardship induced by the elimination of GRS; and

*require the dedication of any continued GRS funds for programs that will be terminated when GRS ends* unless new revenue sources are developed.

**Federal Grants**

*The Carter Administration had a very good urban policy until it announced it was going to develop one.*

— Richard Nathan
The Brookings Institution

When Richard Nixon was president, the federal share of city government revenues was 5 percent. By 1978, midway through the Carter Administration and before President Carter enacted his new national urban policy, the federal share of city government revenues reached its peak at 15 percent. It is little wonder that urban leaders preferred the earlier Carter urban aid flow to the more bureaucratic grantsmanship policies of Carter's New Partnership national urban policy. Despite Carter's best efforts, the New Partnership represented more paperwork, more politics, fewer projects, and less cash.

A brief review of how the use of federal funds shaped the urban fiscal landscape illustrates why the proposed reductions in federal grants in the fiscal 1986 budget will be certain to cause service disruptions and disorganization in the urban financial planning process. Federal aid to state and local governments, which was less than $1 billion in the early 1940s, grew to $7 billion by 1960, $23 billion by 1970, and more than $96 billion by 1981. As the dollars grew, so did the programs through which they were funneled. Barely a dozen programs in the mid-forties swelled to nearly 200 by the mid-sixties and then doubled to more than 400 by 1970.

Not only was federal domestic spending growing, but so was the federal government's direct involvement in local government affairs. The federal government
was responsible for providing funds and operating guidelines for the War on Poverty, Model Cities, the Elementary and Secondary Education Act, the Urban Mass Transit Administration, and the Urban Development Action Grants, as well as for coalescing constituencies for each of these programs. These constituencies, which evolved into sources of urban electoral power, first developed a taste for the money, then an expectation of more money, and, finally, a dependence on every dollar received.

The massive infusion of federal money created almost as many problems as it solved. Federal grants for capital projects were frequently biased in favor of new construction. As a result, some local priorities were deferred in favor of projects that were targeted for federal support. From 1957 to 1977, as the federal share of capital project funding increased from 10 to 40 percent of total project costs, the existing infrastructure—roads, bridges, water and sewer systems, and public buildings—eroded, owing to a lack of funding for repair and replacement of constructed projects. By 1979, as policymakers began to focus their attention on the need for maintenance of the existing infrastructure, federal funding for these local projects had begun to decline in response to federal budgetary pressures.13

Even the Final Report of the Urban and Regional Policy Group, chaired by then Secretary of Housing and Urban Development Patricia Roberts Harris, commented on the serious shortcomings of federal urban aid programs:

Programs have evolved in a piecemeal fashion, causing problems of administration and coordination. While efforts at funding innovative programs like urban renewal have helped cities redevelop deteriorated areas, they have also ended up deteriorating more low-income housing than they have replaced. . . . They have weakened the neighborhoods and encouraged suburban sprawl. . . . The Federal Government has supported the development of industry outside the central cities while funding training programs in the central cities for jobs that did not exist.14

Though the report was intended to serve as a framework for the New Partnership subsequently proposed by President Carter, it is questionable whether the administration fully appreciated the report's significance. The administration should have concluded from it that local governments needed to strengthen their independent capacities to accurately determine their own project priorities and to establish the means of funding their desired projects and programs. Instead, the president's speech announcing the new urban policy demonstrated the administration's deduction that further federal intervention in local priority-setting was not only desirable, but actually required:

During this period, the early 1970s, the Federal government retreated from its responsibilities, leaving states and localities with insufficient resources, interest or leadership to accomplish all that needed to be done. We learned that states and localities cannot solve the problems by themselves. . . . These experiences taught us that a successful urban policy must build a partnership that involves the leadership of the Federal government and the participation of all levels of governments, the private sector, neighborhood and voluntary organizations and individual citizens.15

The New Federalism of the Reagan Administration, which followed on the heels of Carter's lackluster urban effort, took a dramatically different course. Instead of continuing the policy of interposing the federal government in local affairs, it
enacted programmatic reductions that resulted in a loss of 13.3 percent of federal aid in a single year to cities with populations of more than 250,000. The Urban Institute estimated that the policy of New Federalism, if fully implemented, would mean that the federal government’s share of state and local budgets would be reduced from 25 percent in 1984 to 4 percent by 1997.\textsuperscript{16}

This feast-to-famine cycle of federal funding for urban America does not provide the basis for a sound policy of urban fiscal independence. For those New England cities that had made especially good use of federal grants to spur the revitalization of downtown areas, the reversal in federal funding policies represents a particular hardship. In fact, the reduction of funds for Urban Development Action Grants (UDAGs) will especially affect New England, because this region of the country has established an exceptionally broad-based success record as a result of UDAG projects.

In Boston alone, UDAG funds of more than $60 million have spurred development of some twenty projects since 1978, while Community Development Block Grants (CDBGs) provided an average of $28.3 million per year between 1976 and 1980 and have been providing about $22 million per year since then. Portland, Maine, has also utilized UDAG and CDBG funds creatively to help finance the revitalization of its central business district. Private capital to support the development of the important waterfront area and the redevelopment of the major Bath Iron Works facility was obtained as a result of the seed monies made available by the selective use of these federal programs to match city-selected priorities. Providence is another city with a successful, major downtown redevelopment program, the Capital Center Project, which plans to relocate the city’s train station in order to free approximately thirty-two acres for commercial real estate development.\textsuperscript{17} Like Boston and Portland, Providence has made excellent use of its federal grant monies to elicit private participation in public capital projects that otherwise would have had great difficulty meeting start-up cost requirements.

Based on the many media accounts of groundbreaking ceremonies for federally funded downtown development sites, the employment benefits of these grant programs are quite significant. (In fact, quantifying job-generation potential is a standard requirement on federal grant applications.) Although less easily quantified, the positive impact on local economic development from Urban Mass Transit Authority improvement monies and Environmental Protection Agency technical assistance funds is no less important. Federal grant programs have been responsible not only for original projects but also for the amelioration of already existing facilities. Thus, by improving the general quality of life in urban centers, the programs have increased their ability to attract both new and expanding businesses.

The decision of the Reagan Administration greatly to restrict the allocation of monies for future development projects will retard but not irreparably cripple the development process. However, the reduction in grants for development projects already beyond the planning process stage may be responsible for the reversal of the most positive economic development trends that these cities have witnessed since the outset of the federal grant programs. The administration’s recent willingness to create “enterprise zones” as examples of an urban assistance program designed to replace the direct funding of priority projects is admirable, but this mechanism will not provide sufficient assistance for cities trying to sustain their urban economic recovery.
What Cities Can Do

Having reviewed the history and current status of federal grants, we can now turn our attention to an assessment of what New England's major cities can do to foster their transition to fiscal stability and independence by the year 2000. Based on Congress's approach to the fiscal 1986 budget, it is clear that the federal government's past role in urban economic development will be altered in response to the national priority of federal budget cutting. New England cities, therefore, should consider amending their own financial planning processes to reflect a newfound awareness of the federal government's eroding commitment to its older cities:

*Cities should not continue to apply for federal grants that mandate levels of programmatic service the total annual costs for which cannot be provided in the year the grant is received.* In short, older cities cannot afford to accept federal money if they cannot go along with the federal strings that accompany it. Cities should assume that henceforth seed money will be just that and follow-up funds for continuation of programs will not be awarded.

*Cities should not apply for federal grants that require matching monies unless these monies can be placed on reserve at the time the grant applications are submitted.* Older cities cannot afford to continue seeking federal money like the already debt-burdened bargain hunter who makes unnecessary purchases merely because an attractive discount is available.

*Cities must refocus the efforts of their national lobbying organizations, the U.S. Conference of Mayors and the National League of Cities.* The request for future federal funds should be restricted to development monies that will provide leverage to obtain private capital, and should not include programmatic funds that eventually will place a further drain on municipal treasuries. Through their lobbying activities, older cities in particular must assert publicly that federal intrusions into municipal priority-setting are at an end because the flow of federal funds is at its end.

In the coming decade, cities should use the federal grants system to acquire the tools they will need for their economic independence instead of merely seeking a continuation of funding for the programs that fostered the fiscal paternalism responsible for bigger municipal deficits.

Federal Tax Policy

Two specific elements of federal tax policy have had a significant impact on the ability of city governments to provide for themselves. The first element is the provision allowing municipal governments to raise funds by soliciting monies from capital markets on a tax-exempt basis. The second element is the directive preventing municipal governments from raising funds by taxing property owned by education institutions, hospitals, churches, and state and federal governments.

The use of tax-exempt debt by municipalities has increased sevenfold since 1959. Access to the capital markets has been a positive source of assistance to municipal governments seeking long-term funds for new projects or short-term
funds to ease cash-flow burdens. Big-city mayors have also recognized the usefulness of private-purpose tax-exempt bonds as tools to aid economic development and to promote industrial diversification. As the Advisory Committee on Intergovernmental Relations recently commented, "The use of tax-exempt bonds for economic development becomes increasingly important . . . as federal grants are cut back and officials are hard put to find economic incentives to lure industries to their areas." 19

With the federal government moving ahead in its deficit-cutting efforts, increased attention has been paid to the drain on the federal Treasury caused by the record level of long-term debt—surpassing $90 billion in 1983—that has been issued. In their efforts to reduce the overall volume of debt, federal policymakers have attempted to redefine the purposes for which tax-exempt debt may be issued. 20 If changes restricting tax-exempt debt are enacted by the Congress, debt-spurred economic development of convention centers, retail areas, resource recovery plants, warehouse expansions, private educational facilities, port authorities, airports, and public housing may be adversely affected. The tax reforms of 1984 have already begun to curtail local plans for repairs to and expansion of a number of job-generating capital projects: state governments and public authorities have been limited in the issuance of industrial development bonds to a predetermined annual allocation of tax-exempt debt, based on a per-capita formula.

While the federal government is restricting the access of municipalities to tax-exempt capital markets, it is doing nothing to restrict the expansion of public educational facilities, hospitals, and state and federal government buildings within New England's major cities. Though the new construction may temporarily add workers to employment rolls, it permanently removes real estate parcels of significant value from the property tax rolls, which further aggravates an already existing problem. In Boston, where 47 percent of all property remains entirely untaxed, there is the largest proportion of tax-exempt property in any major U.S. city other than in Washington, D.C. 21 Hartford suffers not only because 36 percent of its property is tax-exempt but also because this commitment of property in preferred locations restricts the physical space available for further commercial development capable of generating substantial property tax revenues. 22

One of the remedies for this problem that is acceptable to state and municipal governments is the use of PILOTS—Payment in Lieu of Taxes—by tax-exempt institutions. These negotiated payments are clearly not the equivalent of a property tax payment, which by its very nature grows as the wealth of the land and its appurtenances increases. Nevertheless, PILOTS provide one avenue to ease the burden of tax-exempt properties.

Federal tax policy has been utilized for years to provide indirect subsidies for special interest groups or to encourage development in sectors of the economy that otherwise would not expand, owing to the lack of monies required for start-up activities. Previously, much of the tax aid provided was concentrated on assisting business growth focused primarily on new development and on the Sun Belt area. Both the investment tax credit and accelerated depreciation for new industrial or commercial plants encouraged investments in new structures and in growing areas, rather than in the older, more settled cities of New England. 23 Now that the initial exodus from the Northeast to the Sun Belt has taken place, it
is critical for New England cities to utilize every economic development tool available to encourage existing business expansion and the spawning of new companies through venture capital operations, thereby creating new jobs.

There are several aspects of pending federal tax reform legislation that cities must aggressively fight if they do not want to risk losing some badly needed financial opportunities:

*Cities must lobby in opposition to those tax simplification proposals that would eliminate the federal income tax deduction for state and local taxes.* Though such tax law change would save almost $30 billion for the U.S. Treasury, it would be doing so at the direct expense of municipal governments already hurt by previously mentioned cutbacks of federal aid.

*Cities must lobby to prevent tax reform proposals from further restricting the volume of tax-exempt revenue bonds.* With estimates for the cost of required upgrades of municipal water and sewerage systems by the year 1990 exceeding $90 billion, municipalities can hardly afford to increase their cost of borrowing to improve these systems.\(^\text{24}\)

*Cities must begin to lobby for the extension of legislation that permits the issuance of tax-exempt debt to subsidize single- and multifamily housing development.* Making center city housing affordable is as important to attracting young families to the city as any element of a sound urban plan for the future.

### State Aid

*Just as the twig is bent, the tree’s inclined.*

— Alexander Pope, *Moral Essays*

Despite what some state legislators may think, no big-city mayor enjoys the annual ritual of going to the state capital, hat in hand, to pander for state aid. This process is frequently accompanied by stern lectures from suburban legislators on how increased state assistance would not be necessary if urban governments would control their profligate spending habits.

It is a myth of public finance that New England’s major cities need more state aid because they cannot control their expenditures. It is a fact, though, that increased state aid is required almost annually because city governments in New England cannot control their own means of revenue generation. For example, Boston’s economic resurgence has been good for its business leaders but of little help to its government. At times when the state prospers, Boston may receive a share of its newfound largesse, but a disproportionately small share. Yet when state growth is limited, Boston is in trouble. The reason is simple: with only the local property tax to rely on and with an overabundance of tax-exempt properties, Boston must look to Massachusetts to pay for an ever-increasing percentage of city services. Boston claims that it generates about $1.1 billion in state revenues; yet it receives only 21 percent of that amount in direct state assistance.\(^\text{25}\)

In fiscal 1985, state aid represented 34.8 percent of all Boston revenues. In the same year, Connecticut’s assistance represented 37 percent of Hartford’s revenues. Both cities are state capitals, both serve as the economic growth centers for their states, and both are annually dependent on their state governments to define the
parameters of service and the potential for excellence in their municipal governments. For both cities, the success of the appeal for funds to the state legislature is more likely to be a measure of mayoral job performance than of either the municipal economy or the municipal budget. “Good” mayors are those who get along well with powerful state leaders. Whether such mayors are strong in personal leadership or adroit as personnel managers or creative as program engineers becomes quite secondary, and it is easy to see that this is not the most efficient way to run a government. A mayor of a major New England city in 1985 should be judged on more than the lobbying skills required to garner sufficient state aid once again to temporarily bridge the gap between expenditures and revenues.

If cities are to remain viable as governmental entities providing services and policy direction for their constituencies, they need to have the fiscal independence which only a diversified revenue base can provide. As author Ray Bahl has observed, “City governments could argue that state governments regulate their fiscal decisions and constrain their fiscal options.” To alter that present-day scenario, city governments should:

seek independent revenue-generating powers in lieu of additional state aid;
dedicate state aid to specific categories of services, such as police, fire, and snow removal, in order to develop a more clearly articulated public argument for more money; and

seek to increase the PILOTS made by state government for tax-exempt state properties owned within the city’s limits.

**Property Taxes**

In terms of public finance, New England’s major cities share one glaring weakness: a revenue base that is far too dependent on the local property tax. This overdependence is particularly problematical in New England because the property tax does not respond well to economic growth in older cities, given the limited areas available for new construction and for extensive expansions. Additionally, the property tax is regressive and places a disproportionate share of the burden of central city costs on the working poor residents of the city. As a result, increased levels of city services that are paid for by local property taxes effectively represent a transfer of real income from the lower- to the middle-income population of a city.

For example, in Boston the property tax represents 37.6 percent of the city’s total revenues. State and federal subsidies aside, the property tax provides more than 90 percent of all city-derived revenues. At the onset of Proposition 2½, Boston was collecting $518 million annually in property tax payments, an amount which dropped by some 30 percent, to $363 million, only four years later.

In Burlington, Vermont, 68.2 percent of all city-based revenues are derived from the property tax. Manchester, New Hampshire, similarly receives 69.6 percent of its revenues from the property tax, and Portland, Maine, receives 73.3 percent. Portland has taken a number of steps to reduce government personnel levels and to develop sewerage system, airport, and port facility revenues, thereby beginning the process of reducing the city’s dependence on the property tax.
During the early 1980s, reliance on property tax was a chief factor contributing to the financial problems that beset several New England cities. In 1982, with 62.5 percent of city revenues coming from the tax, Providence could not adjust its expenditure pattern to a 10 percent delinquency rate in collection of the tax.\(^\text{30}\) In 1981 the property tax provided 58.1 percent of all revenues in Hartford, but with 36 percent of that city’s property being tax-exempt, it was estimated that about $41 million in potential revenues from property taxes was lost.\(^\text{31}\)

A number of New England’s larger cities have been enjoying a building boom of late that has helped to increase the property tax base without penalizing central city residents. As that period of new construction and redevelopment subsides, greater attention must be focused on how to expand the tax base without creating disincentives for business growth or more roadblocks to homeowner-ship. Regardless of the quality of city services or the reputation of a city’s school system, property taxes can create economic barriers for young families wishing to enter a neighborhood.

Mayoral plans or state government directives for city assessors to conduct comprehensive revaluation efforts do not solve the property tax problem. Such actions merely affirm that the existing tax, no matter how burdensome, will be apportioned more equitably. Recommendations to enact city sales taxes or income taxes for city commuters have been analyzed correctly as disincentives for business growth. The potential for regional income or sales taxes, however, has not been comprehensively reviewed.

While a localized commuter income tax could encourage business to relocate to suburban office park sites where feasible, a regional commuter income tax surcharge would incorporate both the central city and the suburban business locations. The tax would be set and collected by the state. The proceeds would be used to pay for the state’s assumption of central city costs peculiar to the operation of the downtown area, that is, transportation, police, fire, and redevelopment-agency overhead expenses. By allocating business district costs to an employment-related tax—that is, by instituting a commuter income tax surcharge—cities would be able to apportion the cost of neighborhood operations to residents through their property taxes. The property tax would then be returned to its role as the primary tax to support city services for city residents, in lieu of the current requirement that it pay not only for neighborhood residents’ service costs but also for those of the city’s visitors, businesses, and nonresident business employees.

User Fees and Other Revenue Sources

*It appears unlikely that user charges can play a major role in the fiscal rejuvenation of the central cities.*

— Colin C. Blaydon and Steven R. Gilford


Violators can now pay their City of Boston parking tickets by using Visa or MasterCard, which shows that New England’s largest city is taking imaginative and even extreme steps to capture every available dollar of nontax revenues. While
almost 13 percent of city revenues in 1957 were raised from user charges, by 1975 only 18 percent of these revenues were derived from this source,\textsuperscript{32} reflecting the comparatively limited growth in this area of taxation. While transportation, water, sewer, and inspectional services, along with the costs of document production, can be passed on directly to the service-recipient public, the city's most costly services—education, fire, and police—cannot be budgeted as successfully on a user-charge basis. Consequently, though user charges can help fill city revenue coffers, they really cannot be relied on to close major revenue gaps caused by increasing personnel costs for essential city services. In fact, licenses and fees, because of their regressive nature, are usually restricted to the amount required to repay government for the cost of their administration and collection. The urban centers of New England, already home to a disproportionate number of the poor, would not be assisting their own tax-paying constituencies by further taxing them in this fashion. Taxes on services rather than on wealth are not an answer to urban ills; they are merely a reminder to all city residents that every segment of the population is being called upon to support city services.

The politics of revenue generation become most difficult when small, incremental fees and charges are levied on the average city resident instead of on corporations doing business in the city or on suburban residents utilizing the city as a center for education, entertainment, health care, and employment opportunity.

In fiscal 1985, Boston's user fees provided 4.4 percent of its total revenues, while in Hartford they provided 5 percent of revenues in the same year.\textsuperscript{33} Given the determined efforts of both cities with regard to user fees, it would appear that no matter how successfully these taxes are selected for application and then collected, they will never amount to a sum sufficient to pay for the most significant costs of government operation.

While New England cities should be vigilant in their pursuit of user-fee revenues, each one of them should conduct an updated evaluation of the potential for enhancing this source of revenue. Instead of focusing on user fees, major cities should direct their efforts toward per-capita taxes that can be exported to those visitors to the city or to business-district employees who, while they benefit from the quality of city services, are not required to pay for the cost of these services when they return to their own state or suburban bedroom community. These export taxes would include surcharges on entertainment and sporting events, student dormitory occupancy, parking spaces, hotel-motel occupancy, hospital bed occupancy, and airport departure fees. Since taxes and fees of this sort, unlike traditionally defined user fees, could generate revenues from a mostly nonresident tax-paying public, they would create more politically palatable sources of financial independence, as well as fiscally more rewarding ones.

\section*{Looking to the Future}

\textit{It was the inability to grasp the totality that permitted officials to walk straight ahead, eyes wide open, and plunge directly off the financial cliffs.}

— Charles R. Morris, describing the circumstances surrounding the 1975 default by New York City in \textit{The Cost of Good Intentions}
Most people are still able to fantasize about the possibilities for an enhanced quality of life in the year 2000, but city governments look to the future with an abiding sense of insecurity as to the role cities will be able to play in the system of governance. Under the present municipal finance structure, which requires cities to look to higher-tier governments to direct their mandates, coalesce their constituencies, and foot their bills, the best urban New England can hope for is the status quo.

Our premise is simple: the status quo does not provide an acceptable urban policy course for the future. Policies of fiscal paternalism must not be allowed to continue unabated and unchallenged. Urban financial planning must replace urban grantsmanship in defining the programs that cities can provide to their residents. Own-source city revenues must grow as urban economies improve. City residents should be able to garner the financial support of suburban residents who derive benefits from the economic vitality of urban commercial centers. City residents should be expected to bear the fiscal burdens of their own neighborhoods, but they should not be asked to pay for the maintenance and development of the widely utilized downtown areas.

Cities must assess the effect of current fiscal policies on their ability to determine their course outside the policy initiatives of the White House or the State House. Only through such realistic appraisal can they plan adequately for the future. Having made such appraisals, cities could take the following steps toward assuring their financial independence for the future.

Create New Revenue Sources
For revenue diversification to be successful, sources for funds must meet certain criteria beyond the ability initially to provide enough monies.

Collection of the revenue source must lend itself to easy administration with a low rate of default and at a cost that allows a net revenue yield of sufficient size. The new source must have growth potential that will enable it to augment in response to positive economic trends. It must also have a formula or a taxpayer group that can be varied, in either case enabling the revenue yield to increase during times of economic downturn.

Finally, the public must find the tax acceptable, despite its reticence to support any tax increase. The revenue source must equally affect taxpayers who are receiving an equivalent service or who own property of equal value. Efficiency, expandability, equity, and acceptability are the elements that are key to a revenue program’s success in satisfying political requirements the day it is enacted and in fulfilling public finance requirements decades later.  

Redefine Municipal Services
Given the financial limitations that cities face, city governments must work to redefine what business they should be in and what segments of the population they should be certain to serve. The financing and delivery of public services should be reevaluated with an eye toward shifting duplicative, unnecessary, or too broadly defined functions to a higher tier of government, if necessary.

Cities must look to the formation of regional service districts to provide services such as transportation, resource recovery, water and sewer maintenance, and port and airport operations, all of which benefit a general user community that is larger than the city’s own resident population. Further, cities should not
be reluctant to assess property in the downtown or central business district or to implement a property tax surcharge that would cover the expense of providing costly fire services to high-rise buildings, repairs to frequently traveled streets in retail districts or warehouse areas, and police services for visiting dignitaries, conventions, sports events, and other public gatherings.

**Lobby for State Assumption of Costs**

By providing annual formula-based financial assistance to cities, state governments do not help to break the pattern of fiscal paternalism that seems endlessly to require more aid. By contrast, when state governments, as part of an accepted redefinition of municipal services, permanently assume the costs of programs currently provided by cities, they are creating a path for financial stability and independence that cities may follow.

Why should the cost of correctional facilities be borne by cities instead of by state governments, which enact the criminal laws and operate the courts? Why should the cost of educational services be borne by cities and not by state governments, when minimum standards of proficiency are established by state departments of education and requirements for special programming are imposed by state and federal courts? Why should the cost of publicly subsidized housing be borne by cities, when state governments have greater access to the tax-exempt capital markets for housing revenue bonds? Why should the cost of social services for the elderly, the handicapped, and the poor be borne by cities, when standards for service and minimum support are established by the federal Constitution or by federal or state legislation? Cities could better cope with the cost of services particular to their own municipalities if state governments would assume the cost for these areas of service, rather than merely provide annual subsidies. As authors Colin Blaydon and Steve Gilford have observed:

> Whatever course of action is ultimately selected, it seems clear that the states must assume a more active role in maintaining the financial strength of America’s cities. The recent period of increasing federal responsibility for financing the cities has come to a close, and the problems of financing municipal services can no longer be left to local officials. A new era of vigorous state action is now required.\(^{36}\)

**Proceed with Politically Imperfect Proposals**

However we define the causes of the existing problem, the solutions all require taxes. Those who are using but not paying for a city’s services today will be asked to pay for them tomorrow. Such a concept, no matter how gracefully articulated, carefully presented, or skillfully politicked, will not meet with the grateful approval of the electorate. Suburban voters do not view themselves as direct beneficiaries of central city services, and it is not surprising that they do not want to pay for that which they feel they do not receive. Urban politicians, whose opportunity to obtain higher office may depend on suburban votes, are not quick to alienate their constituents.

For years, the ritual dance for dollars performed by big-city mayors before state house audiences has been a carefully orchestrated plea for help at the budgetary breaking point. Dialogue about establishing urban financial independence has been lacking without the klieg lights that accompany a crisis. It is vital that proposals, though politically imperfect, be offered well in advance of the time
when solutions are required. Consensus building is a painstaking, arduous, educational process. It will take years, not several meetings or several months, to reacquaint suburban taxpayers with the sense that they do in fact derive direct benefits from their central cities and therefore have responsibilities to them.

New England’s cities need a new direction for the management of their intergovernmental financial relationships. They need an opportunity to manage the programs for which they should be held responsible without being burdened by additional mandates and without being denied the state and federal benefits on which they have been led to rely. In anticipation of the year 2000, city governments—in partnership with their states—should begin to define the role they will play in the twenty-first century and to determine how their responsibilities will be financed. New England, as a region, does not need a national urban policy. New England’s cities do need to shape a new urban policy for themselves. In recognition of how long it took for that policy to evolve to its present state, the task of redefining it should begin today. As McGee’s First Law states in *The Book of Murphy’s Laws*, “It’s amazing how long it takes to complete something you are not working on.”

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**Notes**

3. Ibid., 36.
12. Ibid., 169.

17. *Moody's Reports, City of Boston, Massachusetts, November 12, 1984.* *Moody's Reports, City of Providence, Rhode Island, April 27, 1982.*


