

# “Painting the Town Red”: Cities' Fiscal Position As If It Were 1935

*The Crisis in Real Estate and its Impact  
in Public Finance*

***Federal Reserve Bank of Atlanta***

24 September 2010

Atlanta, Georgia

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# Cities Fiscal Position Since 1929

**1929-1933:**      Unemployment nearly 1 in 4  
                     DJIA drops 89%.  
                     Bank failures: ~50%.  
                     Riots in cities and agricultural areas.  
                     Prices decline by ~ 25%

## **The Changing Fiscal Environment:**

- ✓ 1930-1939: 4,770 municipal defaults.
- ✓ Revenue diversification: New York City enacted the first sales tax in 1934, followed by New Orleans in 1936. Cities in California and Illinois were granted access to the sales tax in the 1940s. By 1962, 12 states had authorized sales tax access to local governments.
- ✓ By 1960s, sales tax as a proportion of cities' general revenue reached ~12% of own-source revenues, while the property tax declined in relative significance from ~75% in the 1930s to around 50% in the 1960s.

# And the Fiscal Changes continued:

- Fees and Property Tax

- constant-dollar property tax revenue per capita for municipalities declined by 45% from \$456 per capita in 1942 to \$255 in 1977, while constant-dollar user fees (including enterprise funds) increased from \$252 to \$349 or a 38% increase
- user fees jumped from 30% to 40% of own-source revenues between 1977 and 2002;
- property tax revenue accounts for less than 30% of own-source revenue

- Variation in Revenue Reliance Today: cities with populations > 50,000: roughly 34% have access to the property tax only, 8% have access to the income/earnings/payroll tax (in addition to having access to the property tax), and nearly 58% have some retail sales-taxing authority.

## Changing Composition of Municipal Own-Source Revenues

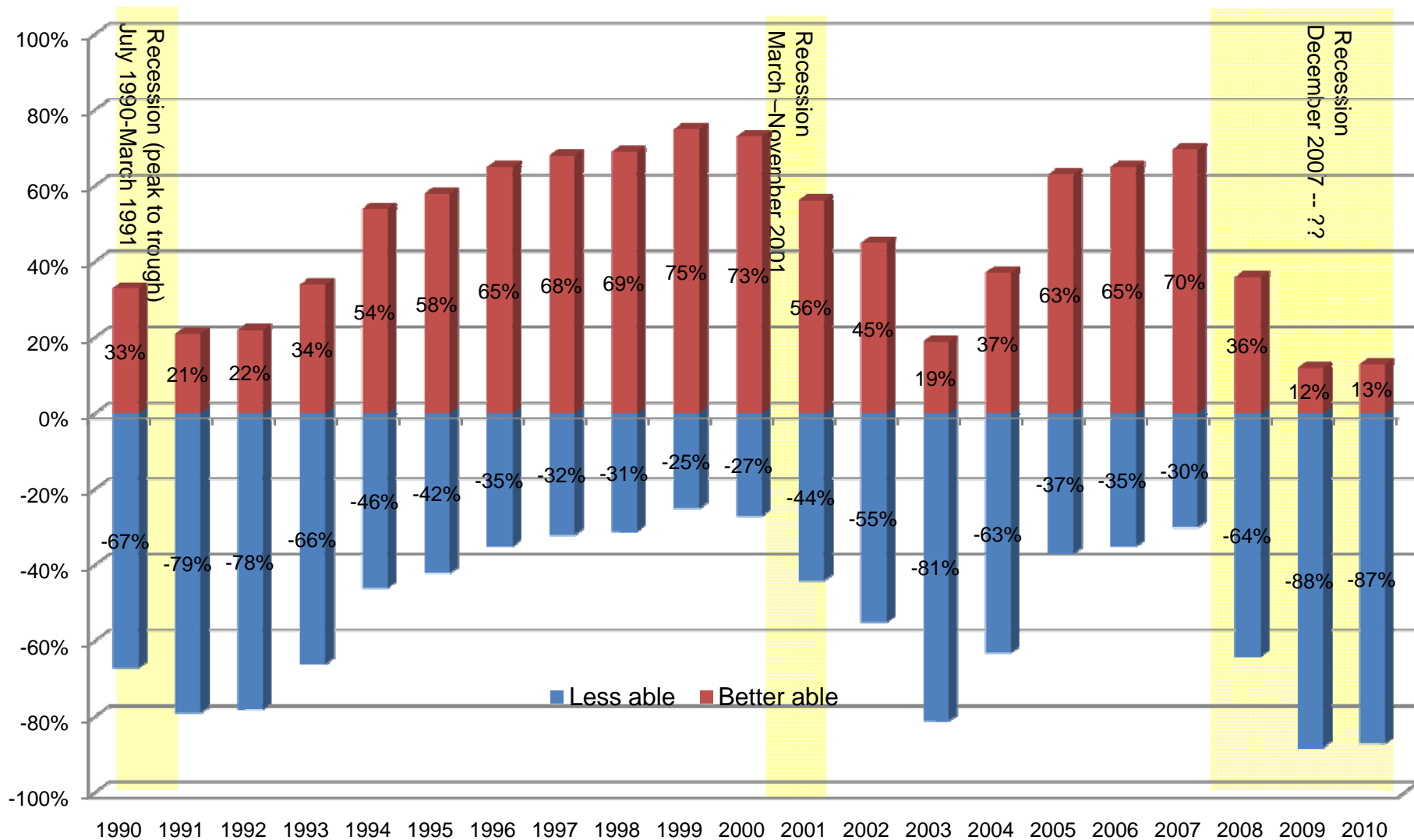
Year	<i>Own-source revenues (excl Enterprise) as Percent of Total Revenues</i>	<i>Property tax as Percent of Own-Source</i>	<i>Sales Tax as Percent of Own-Source Revenue</i>	<i>Charges as Percent of Own-Source Revenue</i>
1942	65.20%	78.40%	4.10%	11.30%
1952	62.10%	61.20%	11.60%	18.60%
1962	62.20%	55.60%	12.50%	24.10%
1972	55.70%	46.80%	13.60%	27.40%
1982	51.60%	32.70%	17.10%	37.80%
1992	55.80%	32.20%	16.10%	39.20%
2002	59.40%	29.10%	17.70%	40.20%

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# Changing Shape of Cities' Fiscal Conditions

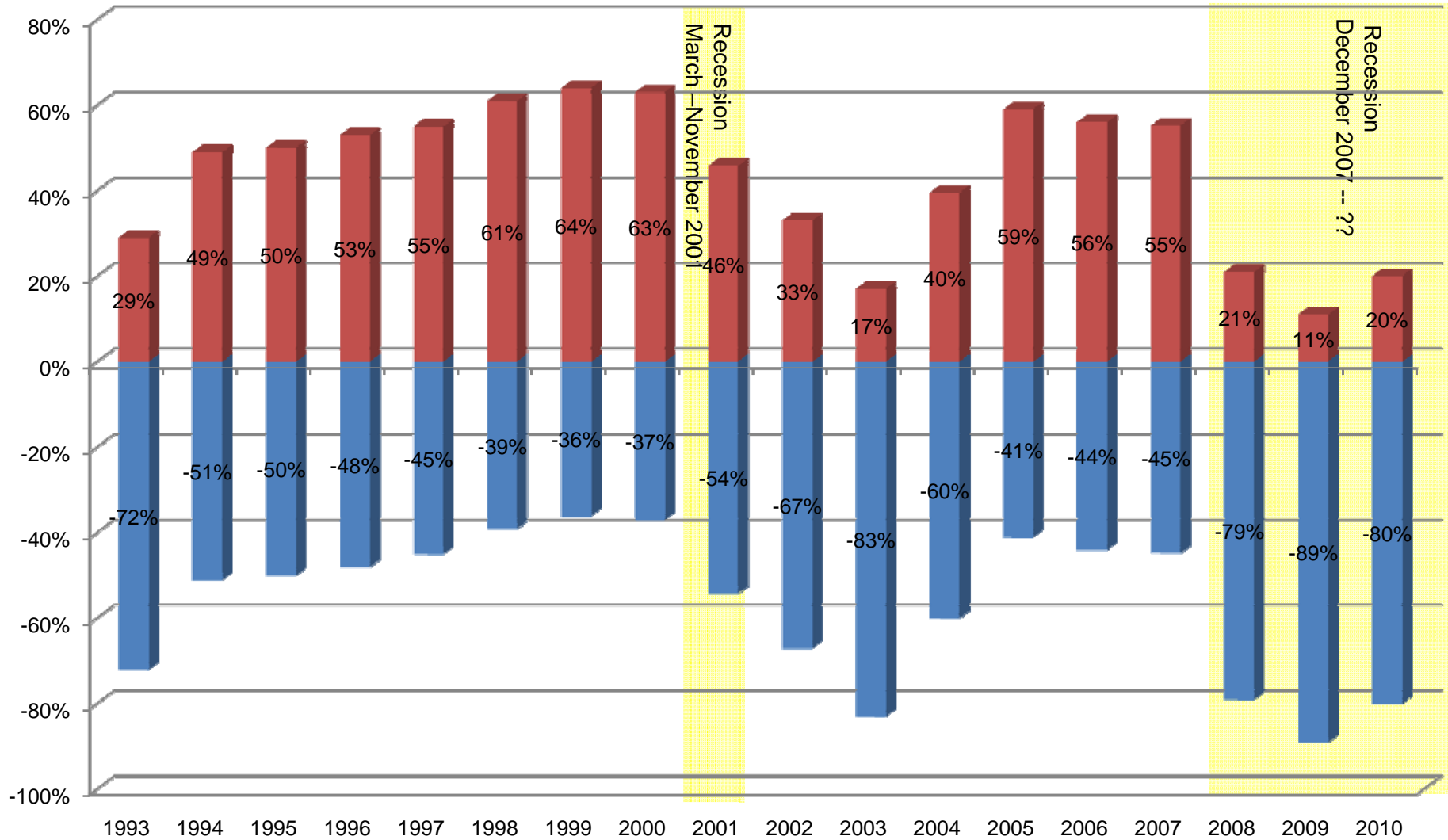
- **Variations on a Revenue Theme**
  - Actions and Reactions
  - Fiscal Mismatch and Contemporary Challenges
  - Crystal Ball Gazing
-

# Percentage of Cities "Better Able/Less Able" to Meet Financial Needs in Current Year



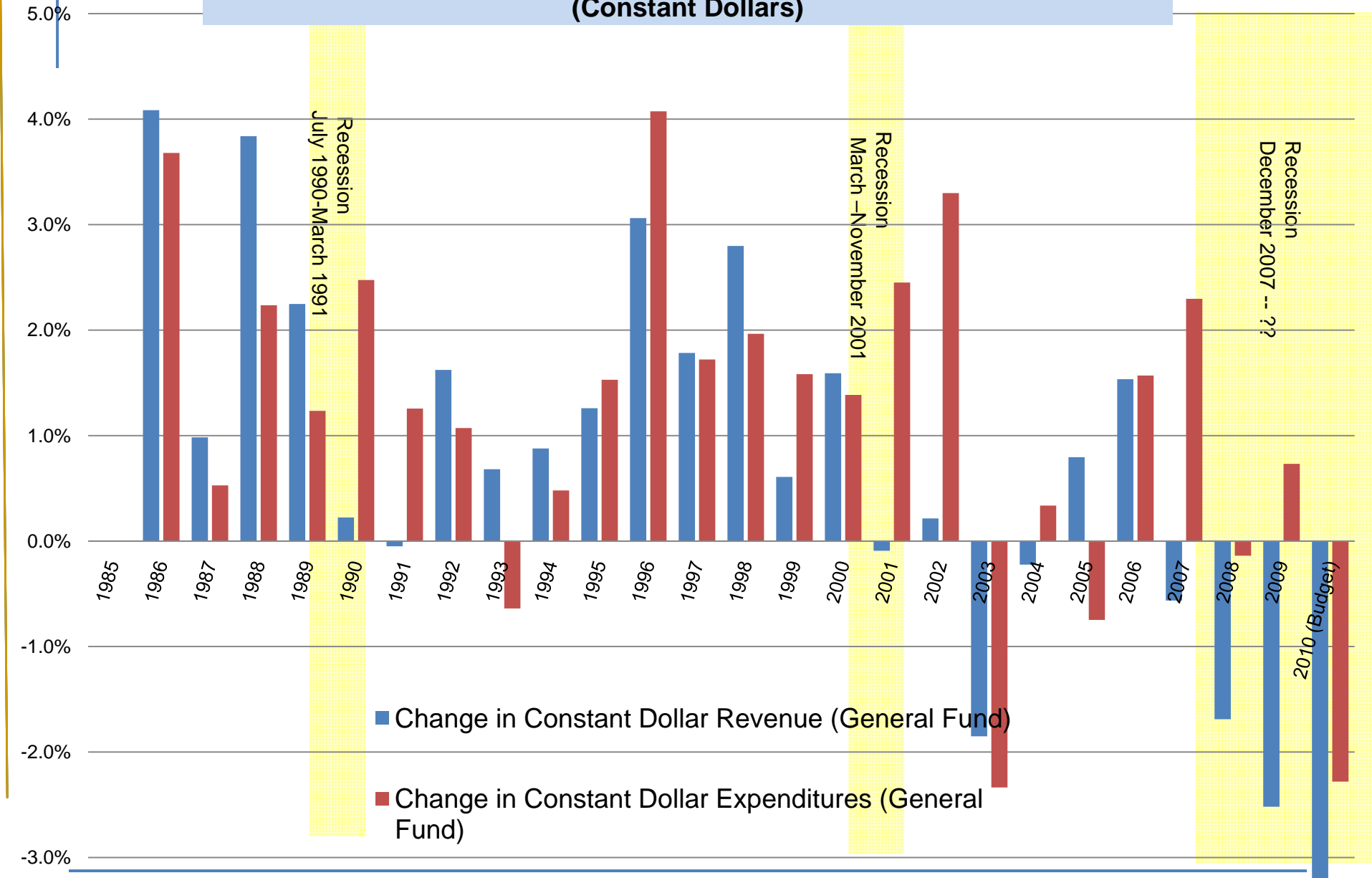


## Percentage of Cities "Better Able/Less Able to Meet Financial Needs Next Year"





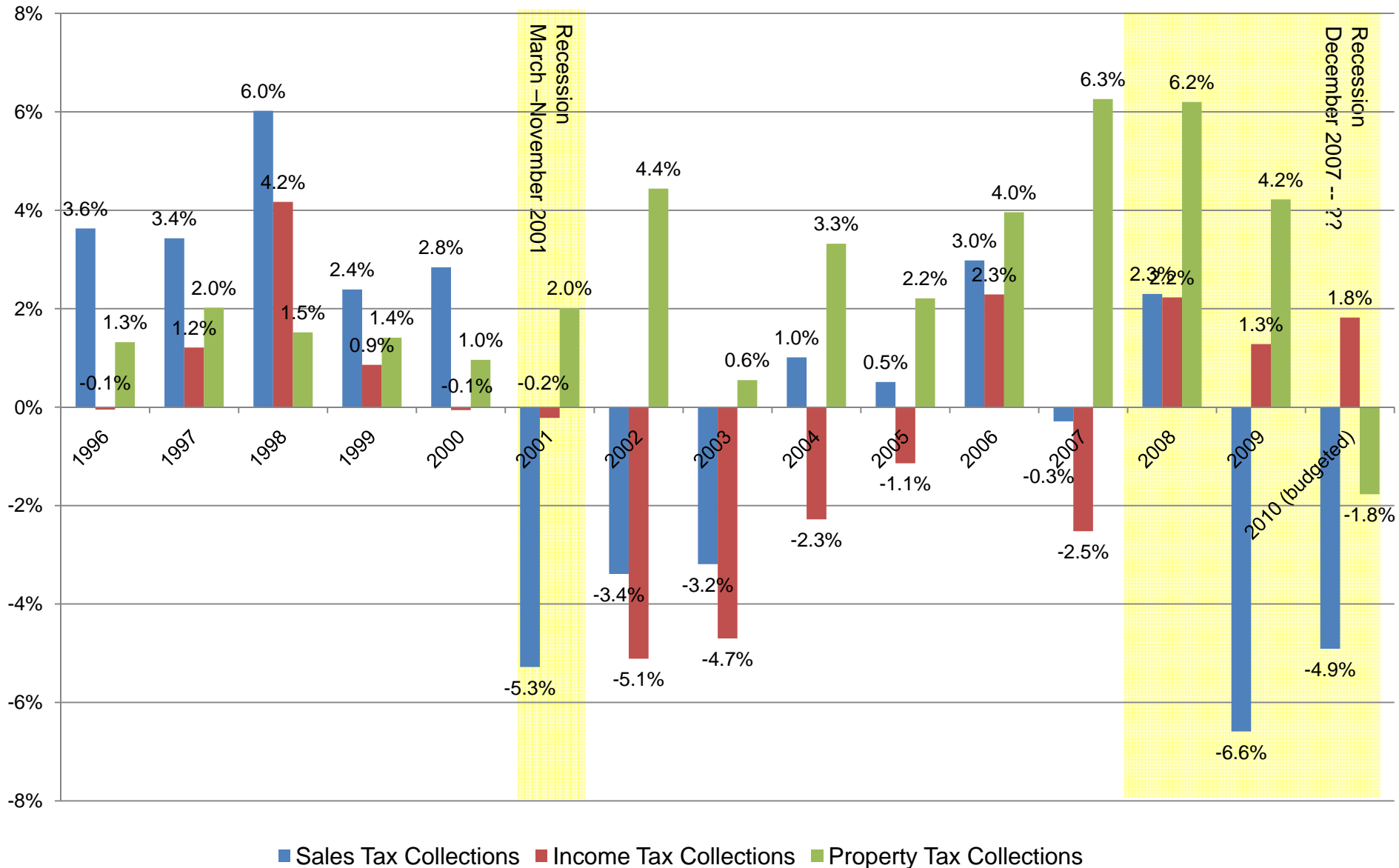
# Year-to-Year Change in General Fund Revenues and Expenditures (Constant Dollars)







# Year-to-Year Change in General Fund Tax Receipts (Constant Dollars)



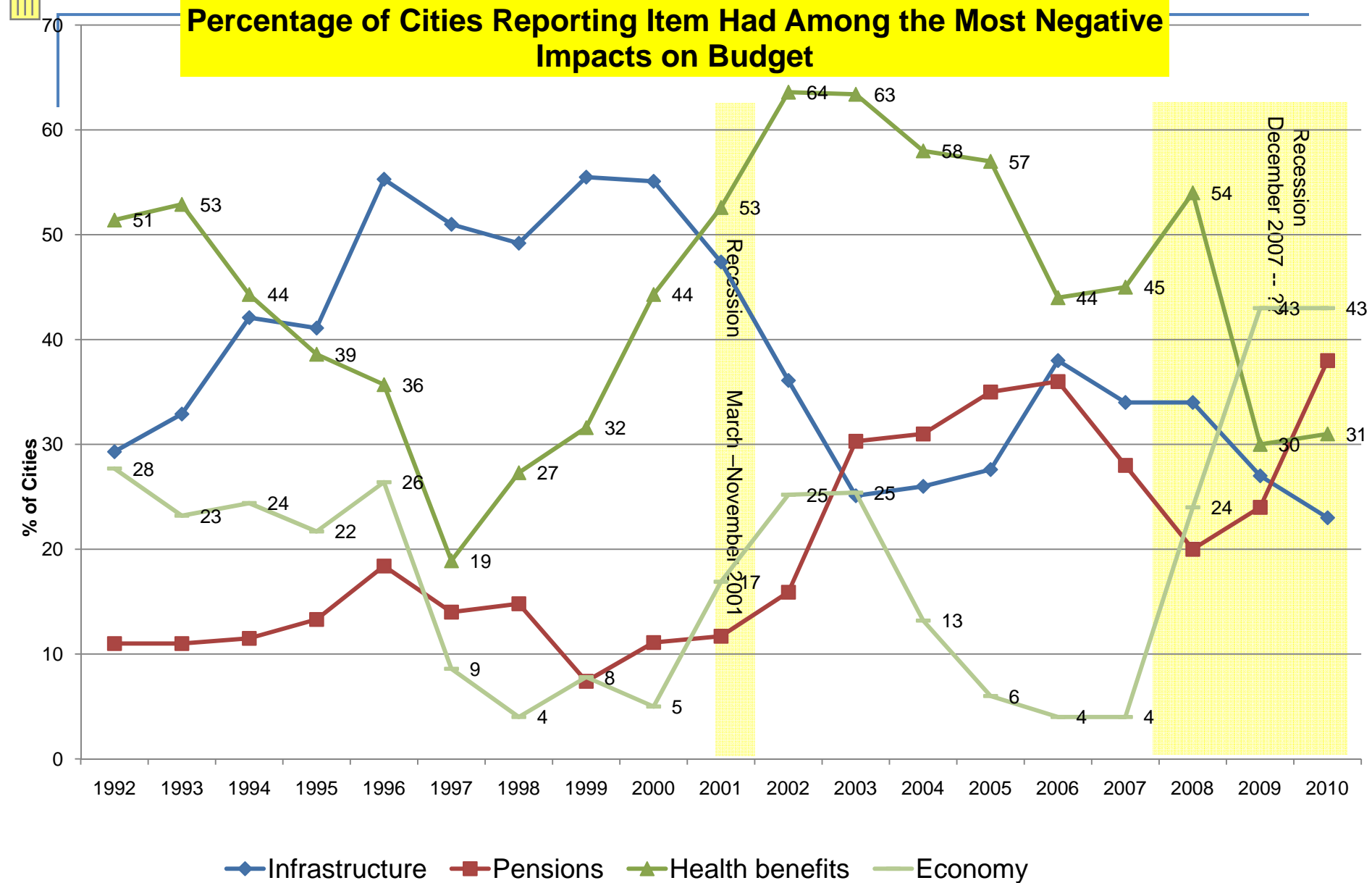
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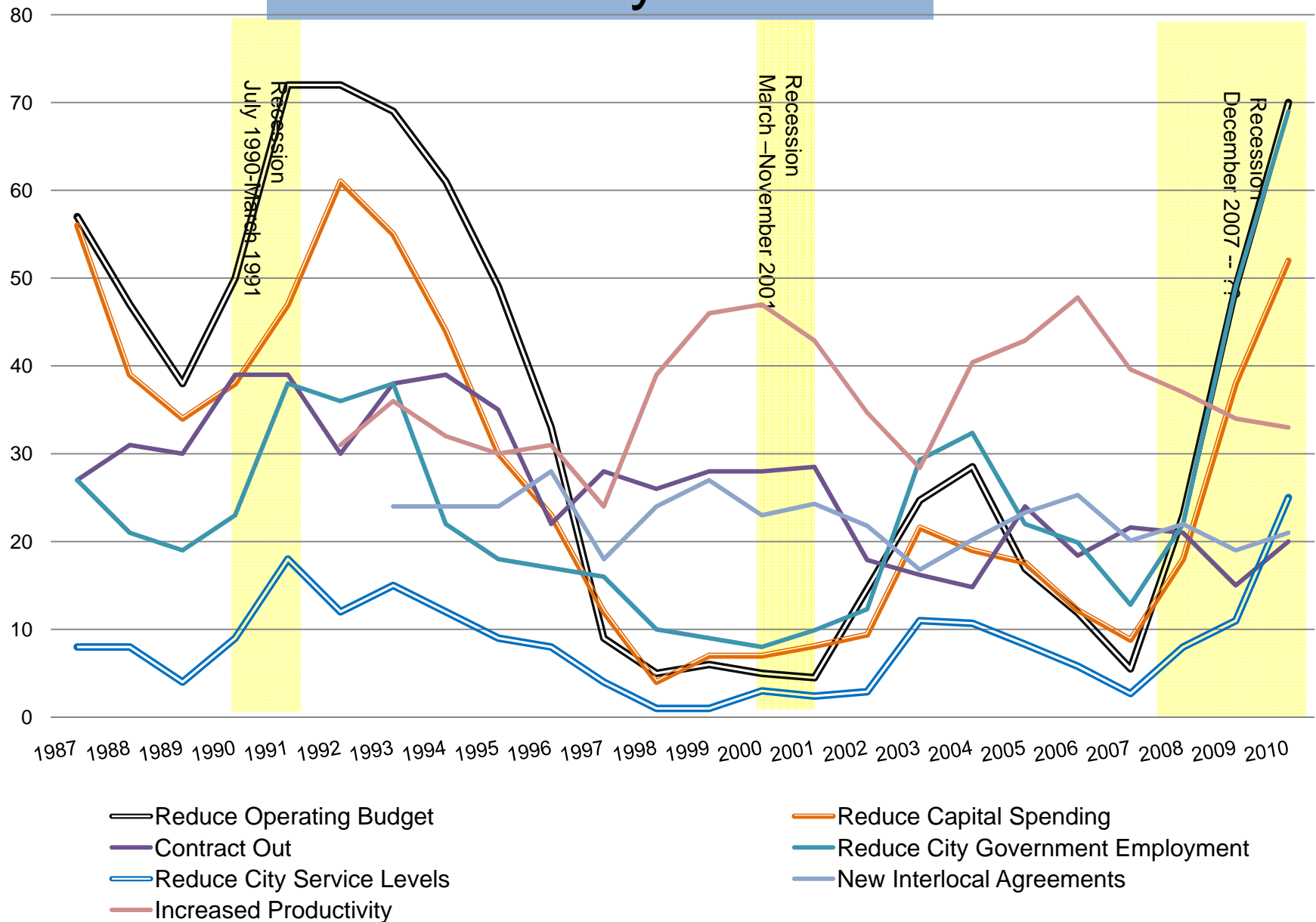
# Percentage of Cities Reporting Item Had Among the Most Negative Impacts on Budget



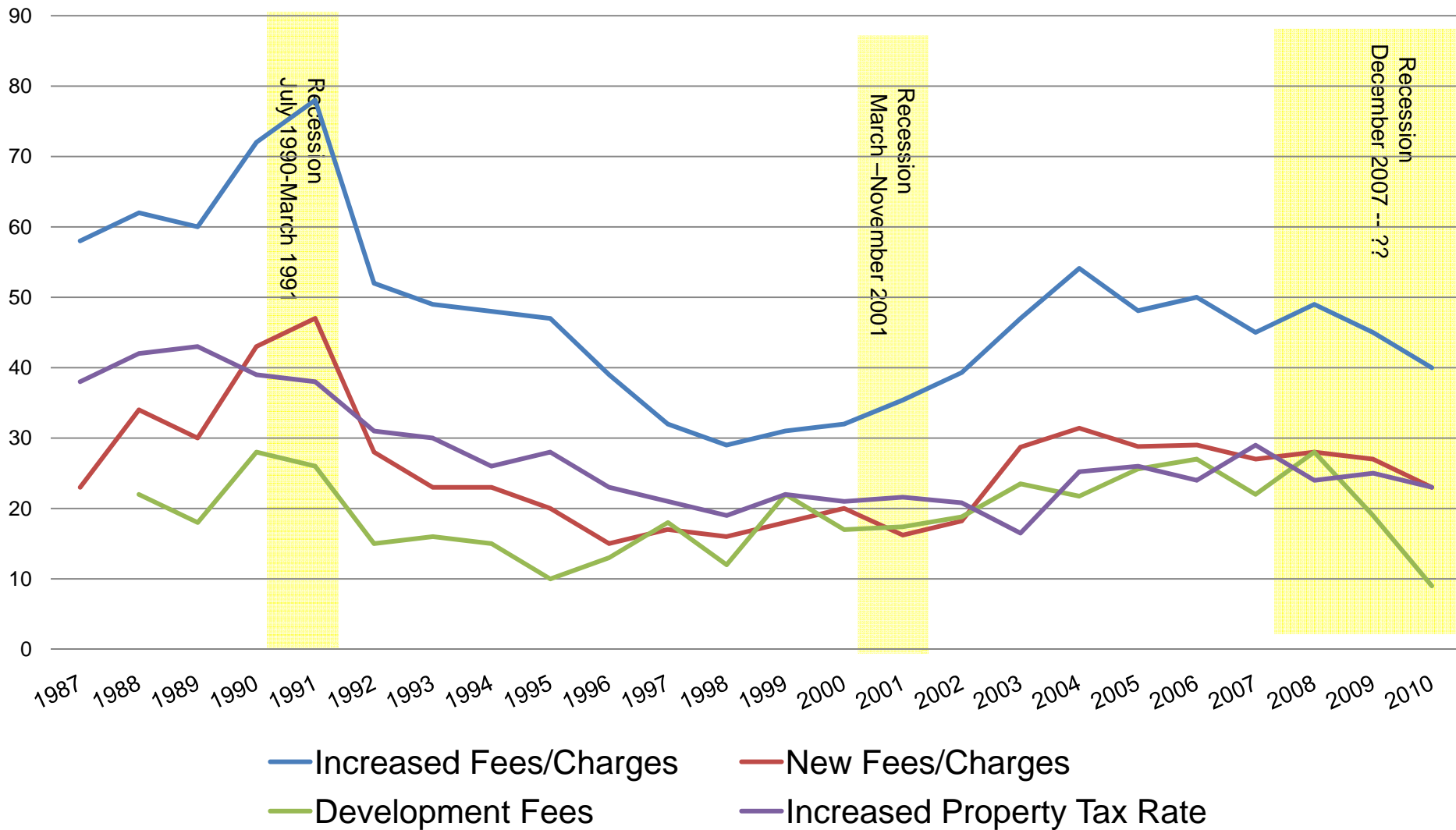


# Selected City Actions

Percentage of Cities



# Percentage of Cities Adopting a Revenue Action

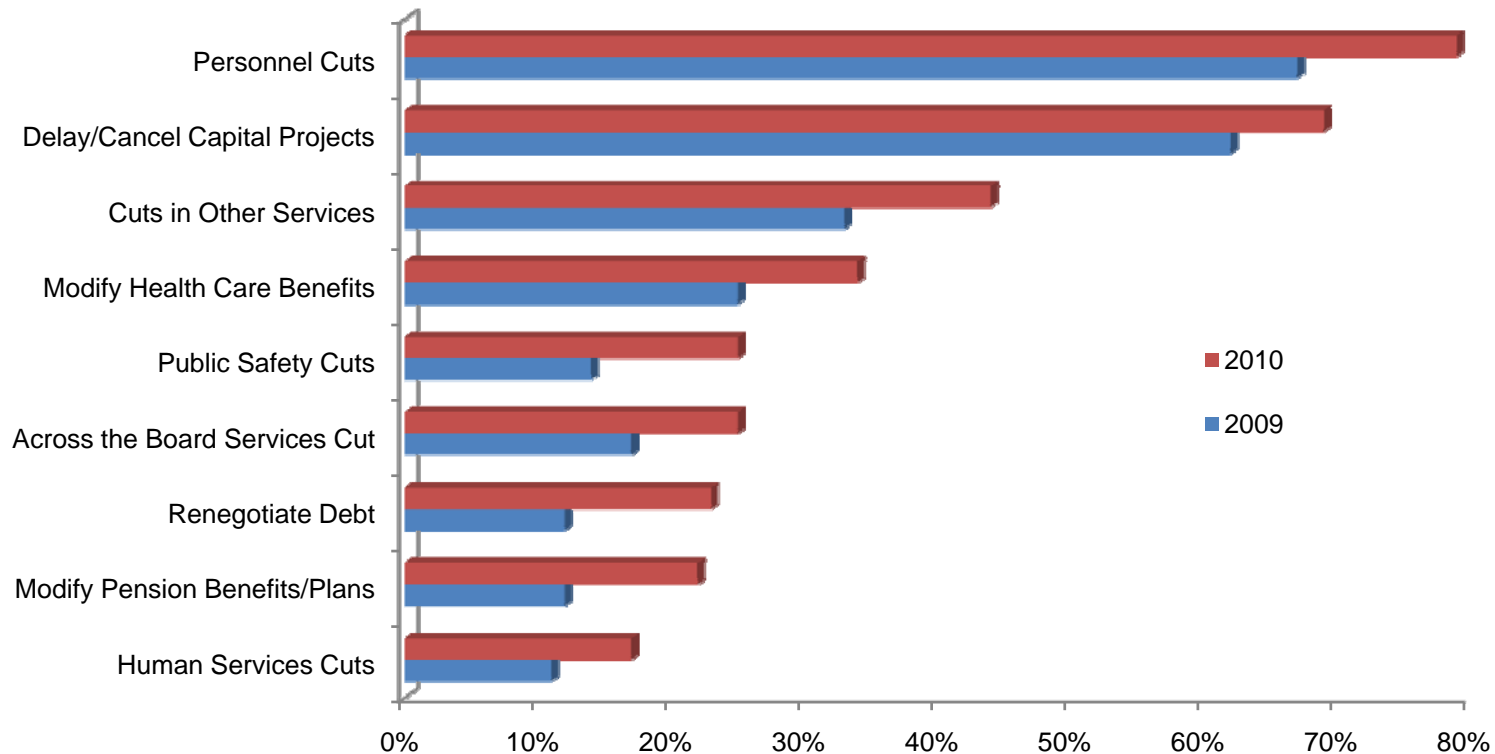


Source: Michael A. Pagano, "Creative Designs of the Patchwork Quilt of Municipal Finance," in Gregory K. Ingram and Yu-Hung Hong, *The Changing Landscape of Local Public Revenues* (Cambridge, MA: Lincoln Institute of Land Policy, 2010), pp. 116-140.

# Expenditure Actions

(% of city finance officers listing factor)

## City Spending Cuts in 2009 and 2010

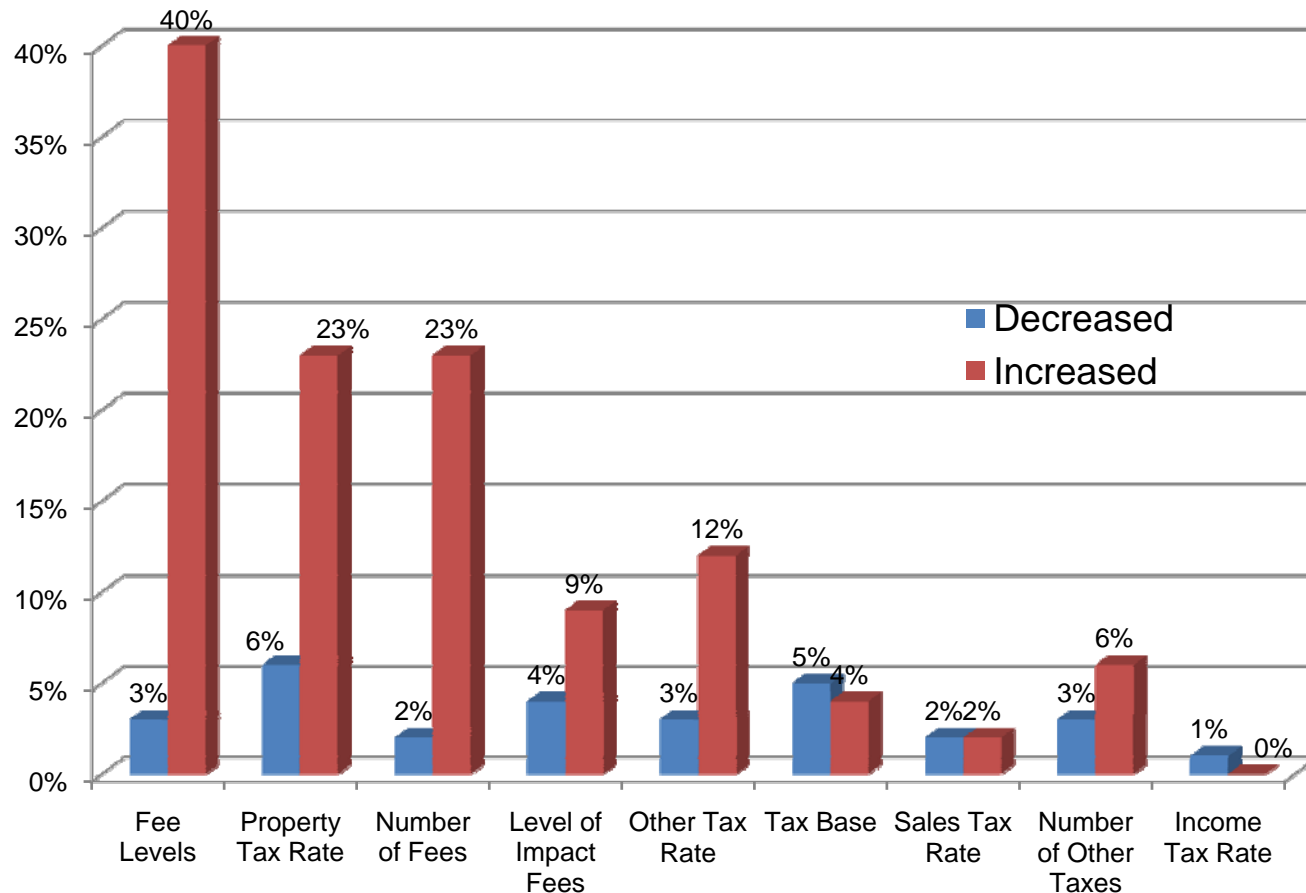


Source: Christopher Hoene and Michael Pagano, *City Fiscal Conditions in 2010* (Washington, DC: National League of Cities, 2010)

# Revenue Actions

(% of city finance officers listing factor)

## Revenue Actions in 2010

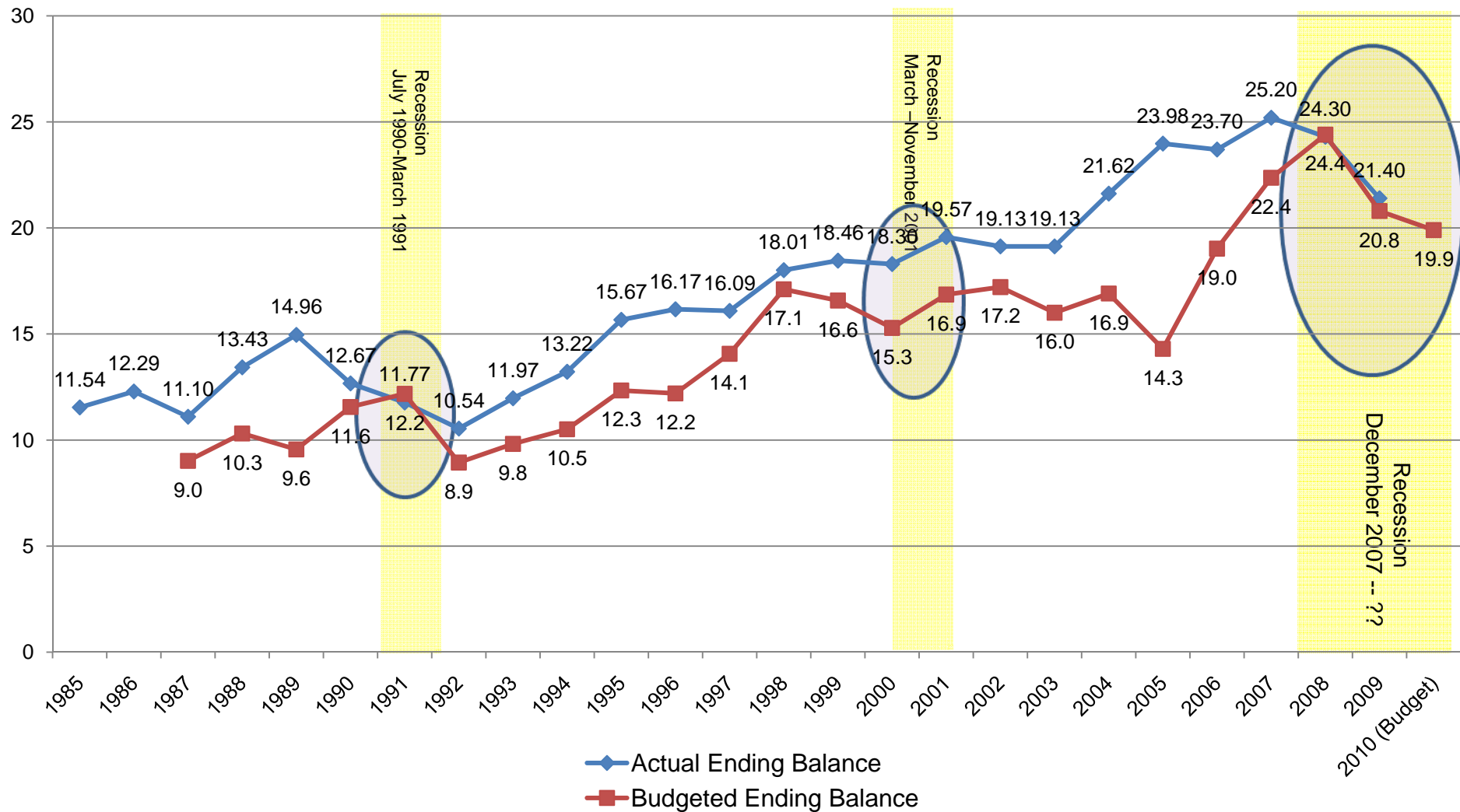


Source: Christopher Hoene and Michael Pagano, *City Fiscal Conditions in 2010* (Washington, DC: National League of Cities, 2010)





## Ending Balances as a Percentage of Expenditures (General Fund)



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



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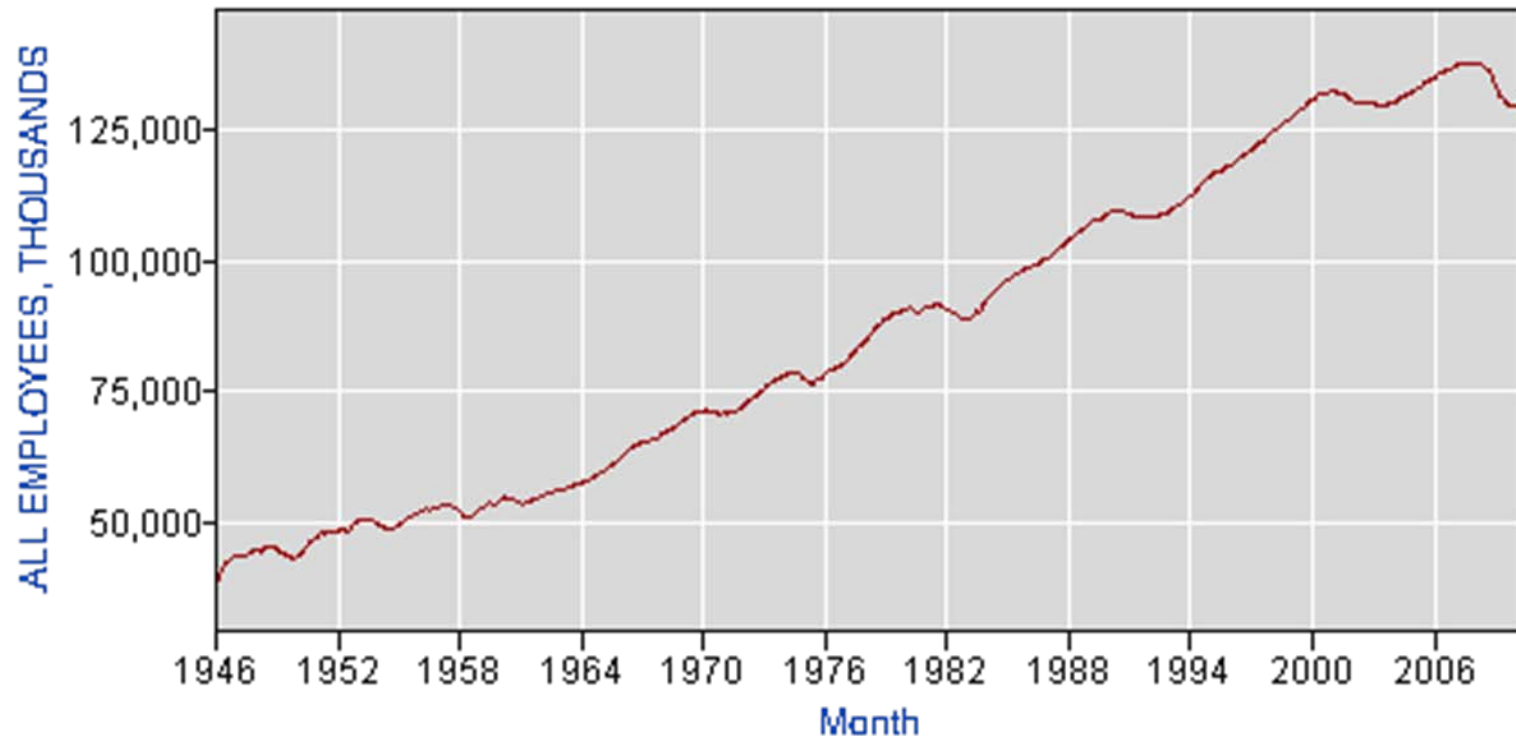
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# Bureau of Labor Statistics

Industry: Total Nonfarm

Data Type: ALL EMPLOYEES, THOUSANDS

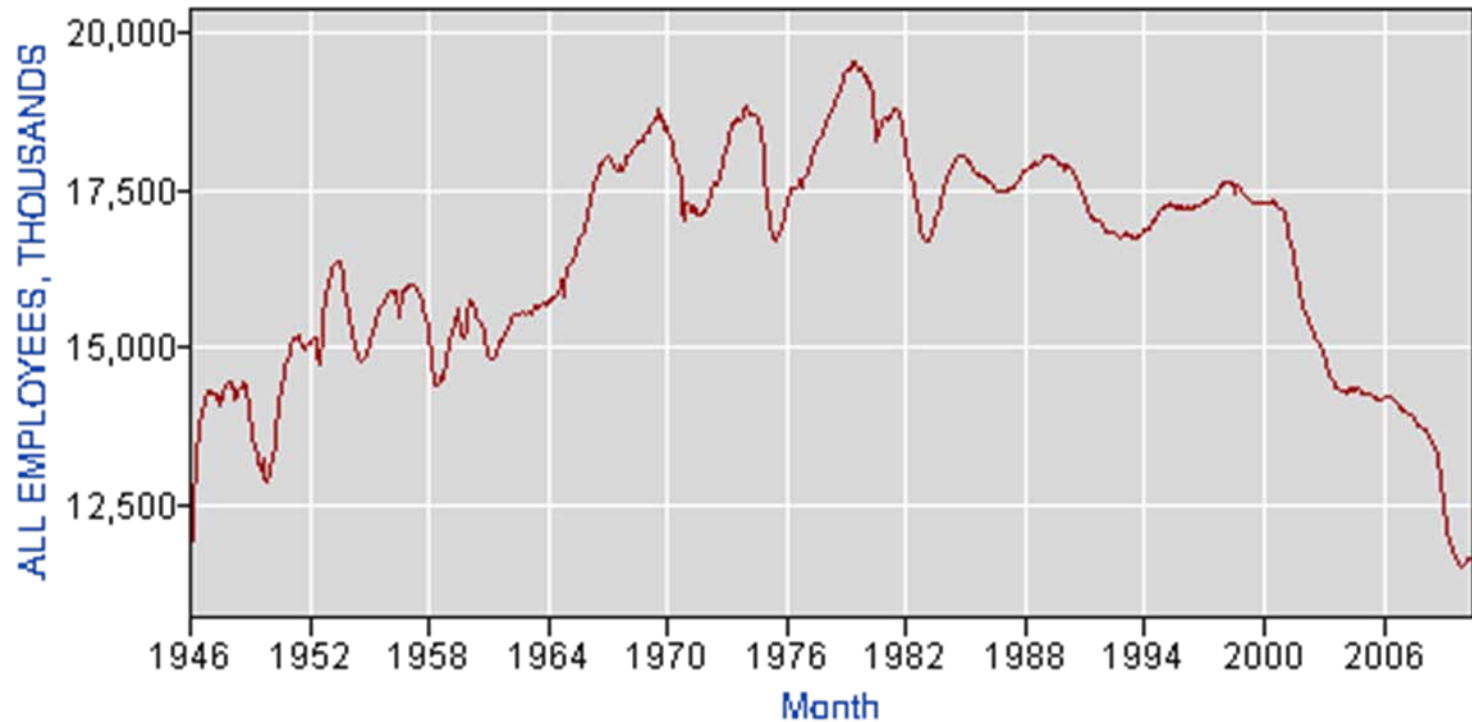




# Bureau of Labor Statistics

Industry: Manufacturing

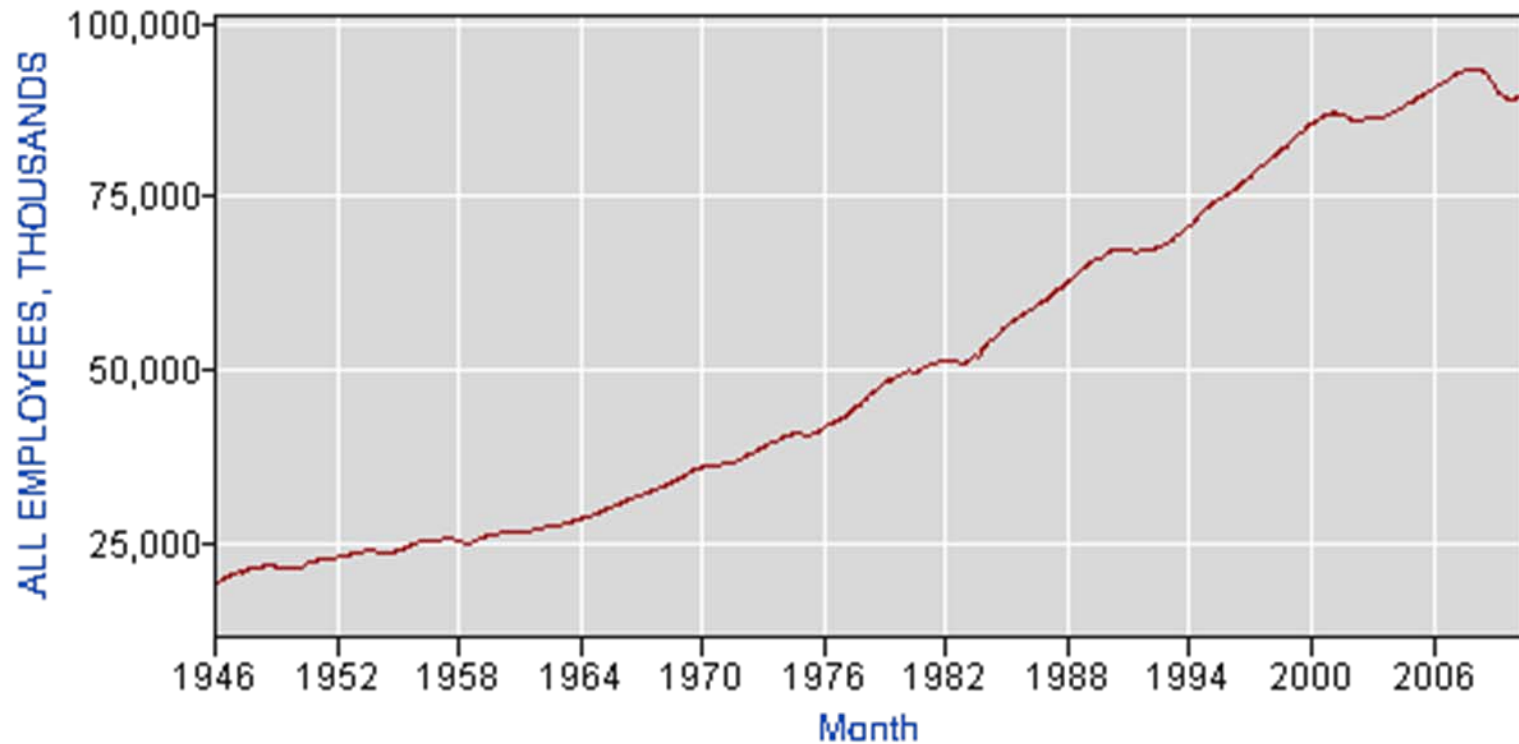
Data Type: ALL EMPLOYEES, THOUSANDS



# Bureau of Labor Statistics

Industry: Service-providing

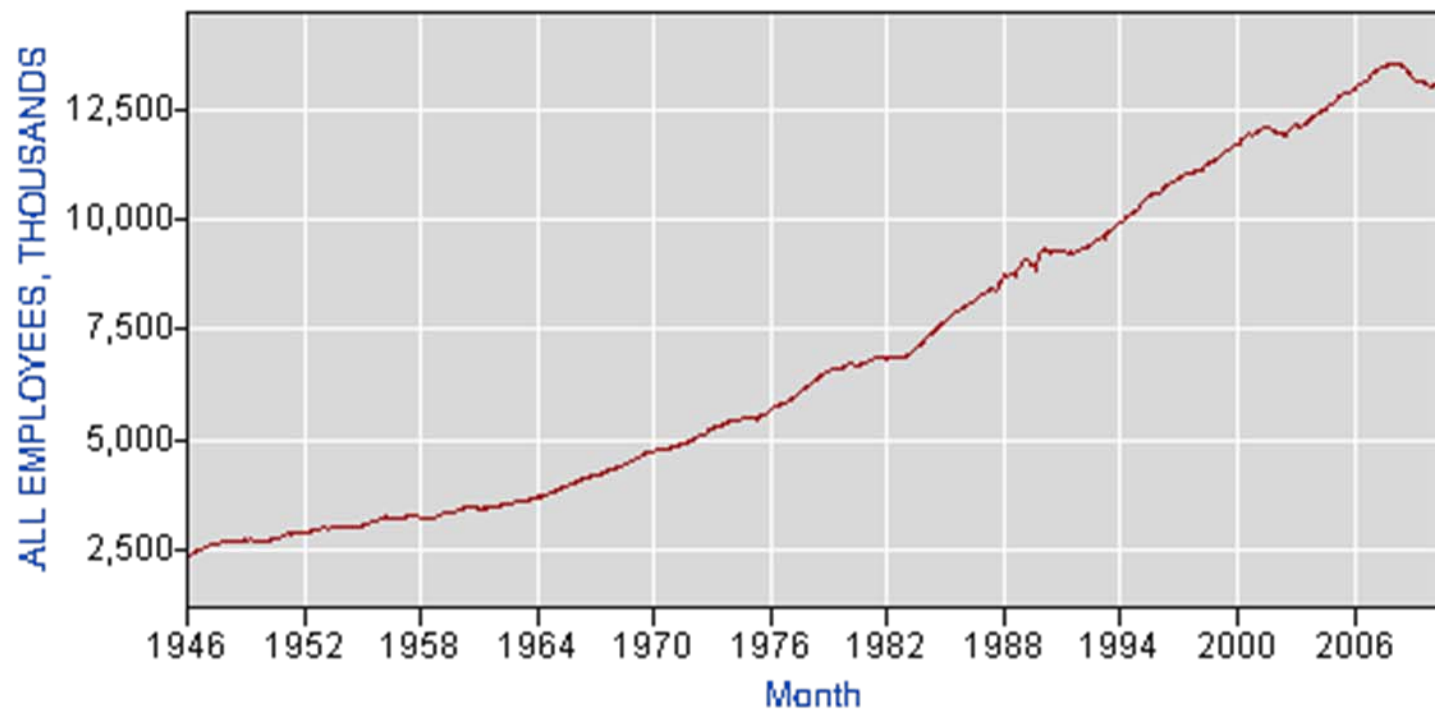
Data Type: ALL EMPLOYEES, THOUSANDS



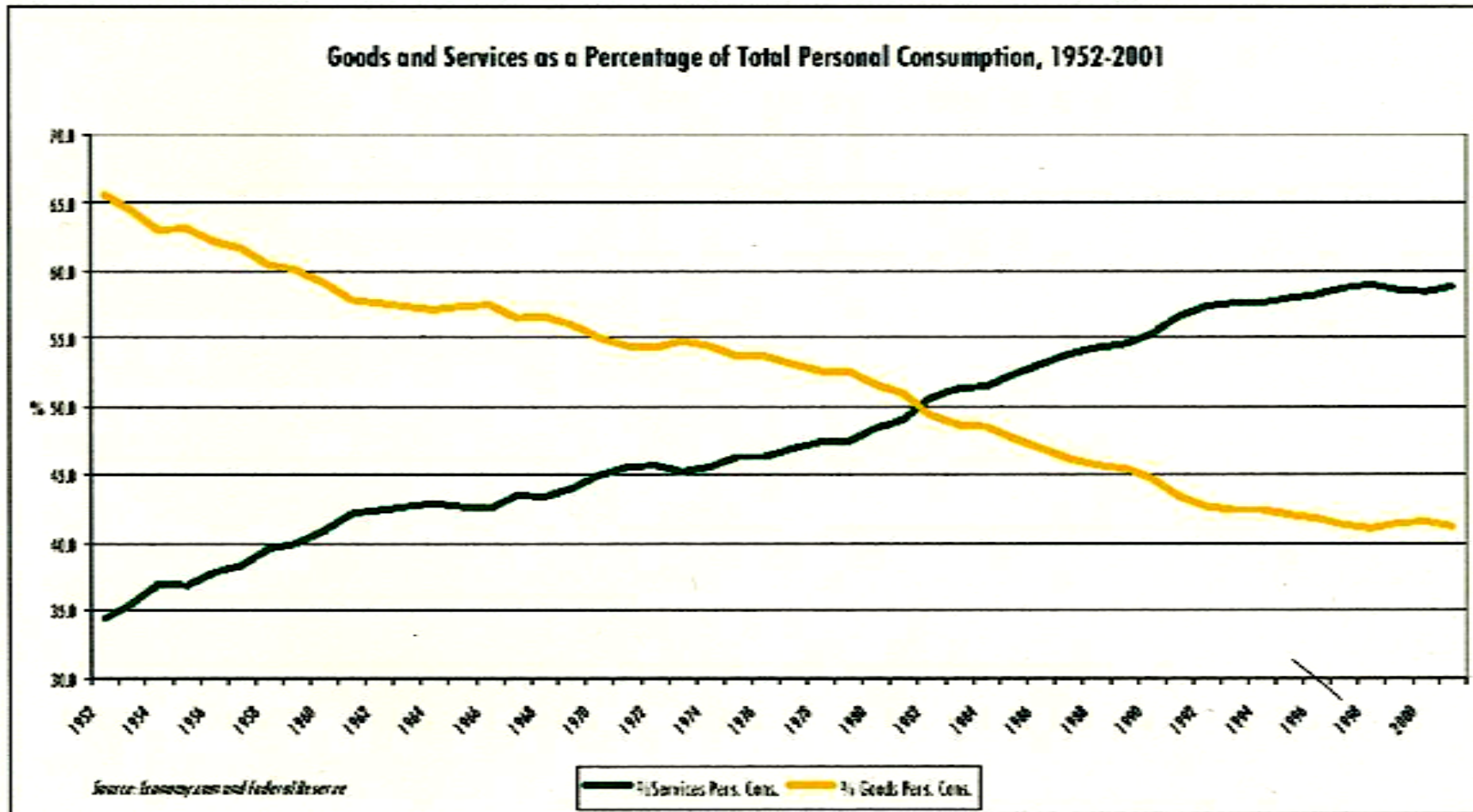
## Bureau of Labor Statistics

Industry: Leisure and hospitality

Data Type: ALL EMPLOYEES, THOUSANDS

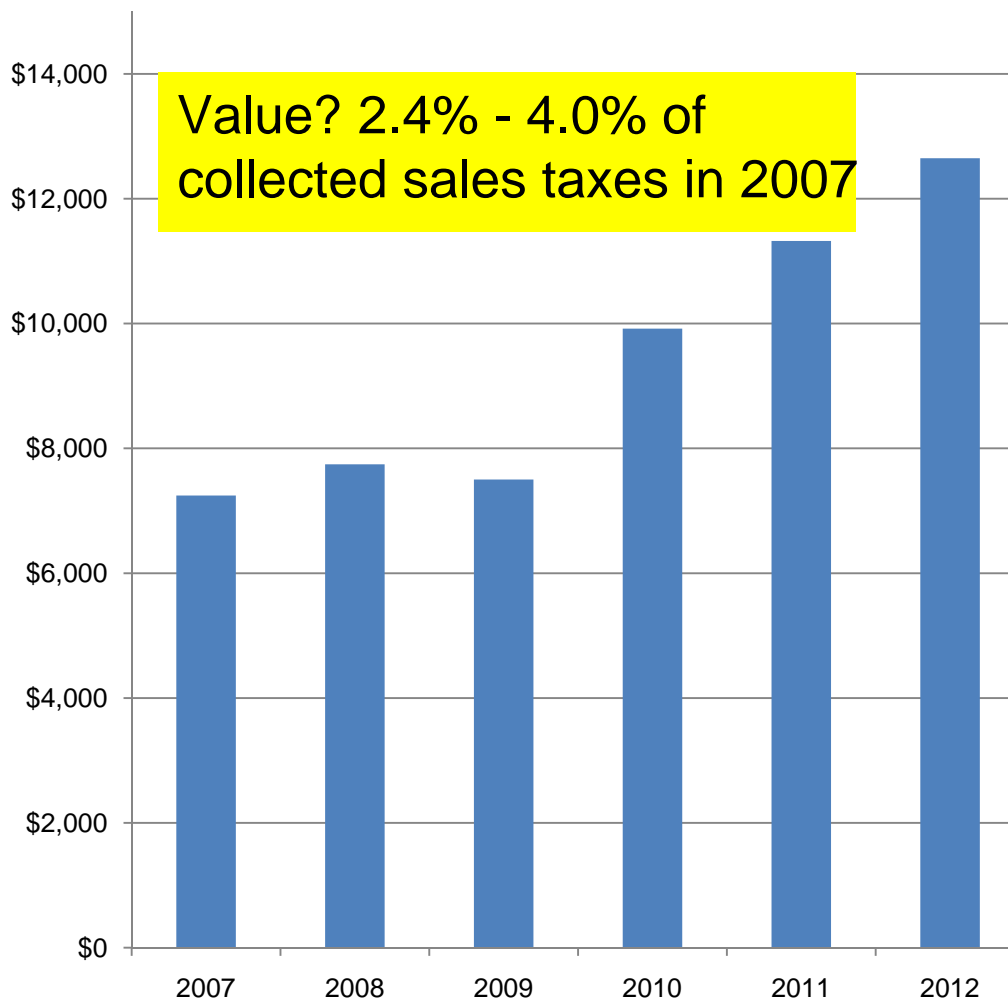


# Shift from Goods to Services



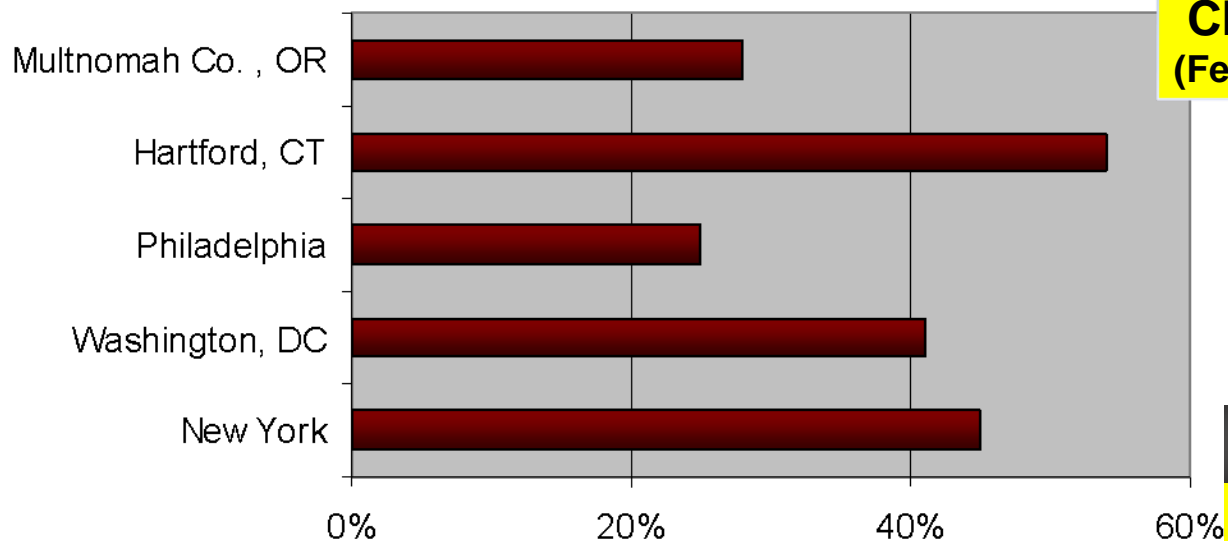


## Estimated Total State and Local User and Sales Tax Revenue Loss



Source: State and Local Government Sales Tax Revenue Losses  
from Electronic Commerce  
By Donald Bruce, William F. Fox, LeAnn Luna. April 13, 2009  
<http://cber.utk.edu/ecommerce/ecom0409.pdf>

## Exempt Property as Percentage of Total Assessed Value



*The New York Times*

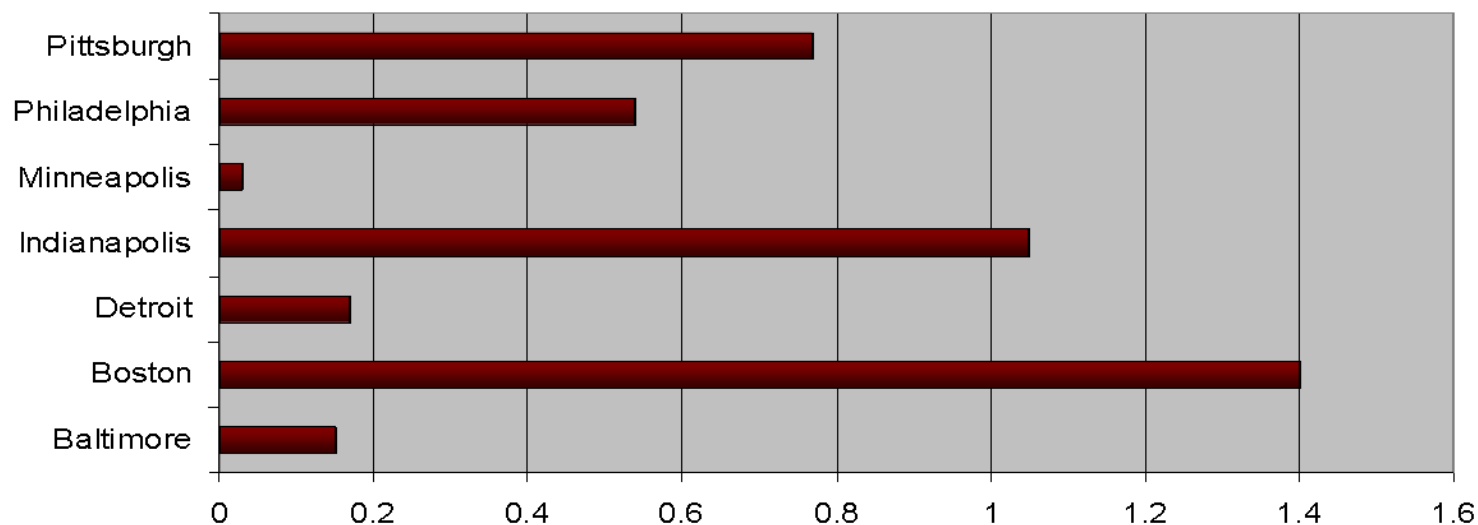
**States Move to Revoke  
Charities' Tax Exemptions**  
(February 27, 2010)

*Provena-Covenant  
Medical Center v.  
(Illinois)Dept. of  
Revenue (2010)*

**THE WALL STREET JOURNAL.**

**Pittsburgh Pushes Tax on  
College Students**

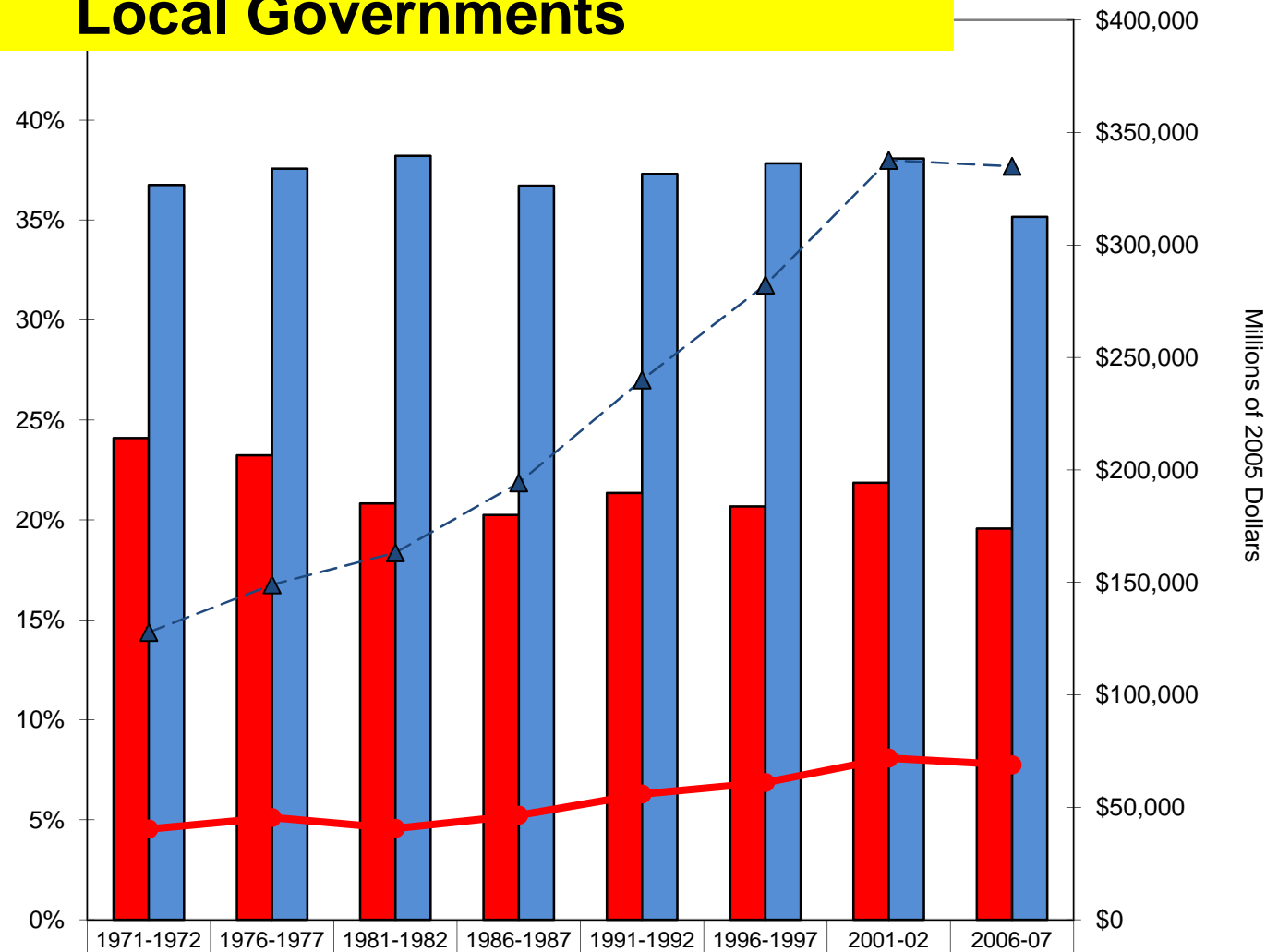
## PILOT Revenue as Percentage of Budget







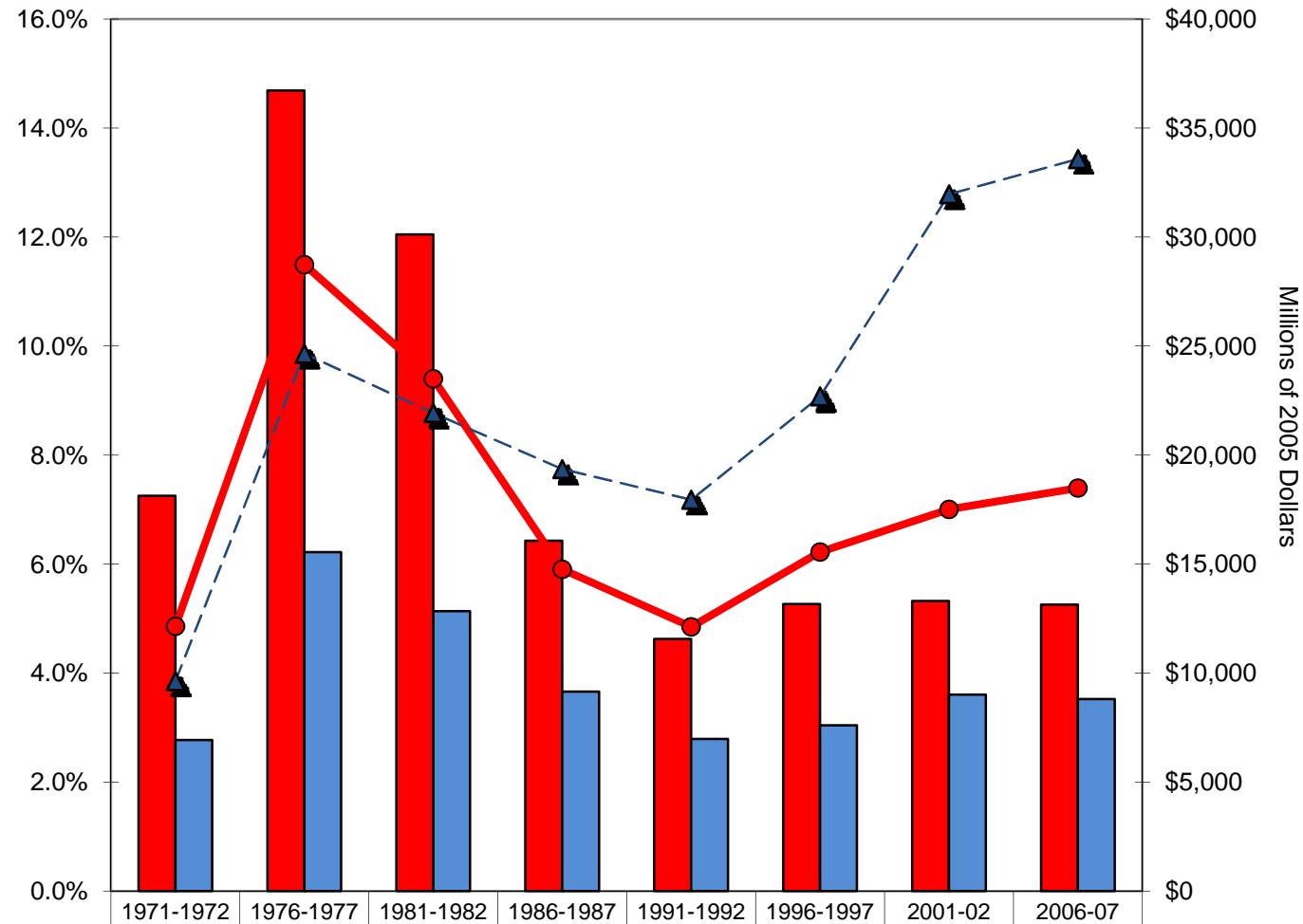
# State Aid to Municipalities and to All Other Local Governments



<div></div> State aid as Percentage of General Municipal Revenue	24.1%	23.2%	20.8%	20.2%	21.3%	20.7%	21.9%	19.6%
<div></div> State aid as Percentage of Total Local Government Revenue, Excluding Municipalities	36.8%	37.6%	38.2%	36.7%	37.3%	37.8%	38.1%	35.2%
<div></div> State Aid to Municipalities (\$Millions)	\$40,358	\$45,450	\$40,613	\$46,470	\$55,906	\$61,064	\$71,887	\$68,838
<div></div> State Aid to Local Governments, Excluding Municipalities (\$Millions)	\$127,806	\$148,942	\$163,194	\$194,268	\$240,062	\$282,247	\$337,677	\$335,011

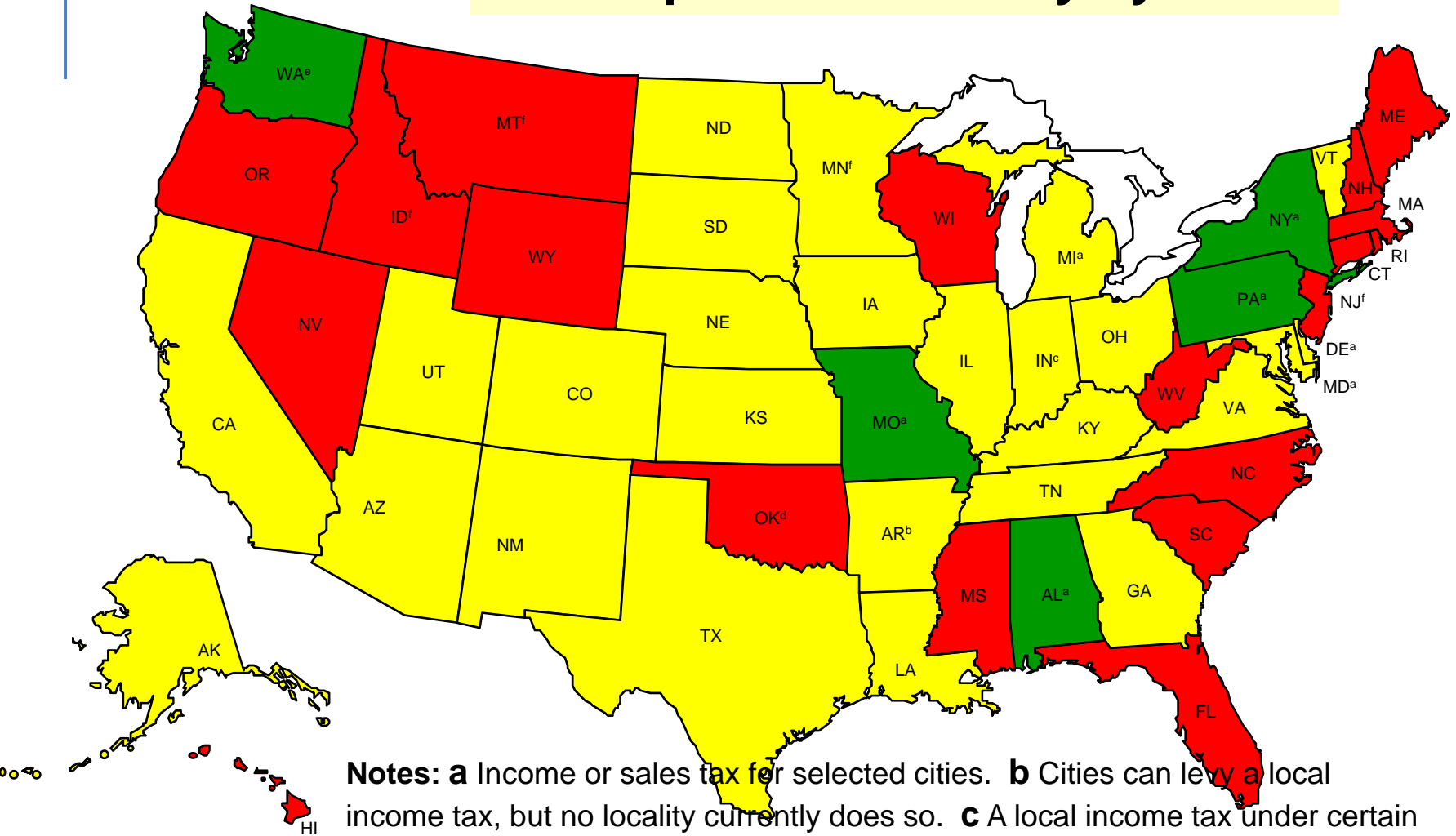


# Federal Aid to Municipalities and to All Other Local Governments



<div></div> Fed aid as Percentage of General Municipal Revenue	7.3%	14.7%	12.0%	6.4%	4.6%	5.3%	5.3%	5.3%
<div></div> Fed aid as Percentage of Total Local Government Revenue, Excluding Municipalities	2.8%	6.2%	5.1%	3.7%	2.8%	3.0%	3.6%	3.5%
<div></div> Federal Aid to Municipalities (\$Millions)	\$12,145	\$28,735	\$23,500	\$14,757	\$12,119	\$15,553	\$17,511	\$18,487
<div></div> Federal Aid to Local Governments, Excluding Municipalities (\$Millions)	\$9,633	\$24,652	\$21,927	\$19,357	\$17,953	\$22,692	\$31,966	\$33,580

# Municipal Tax Authority by State



**Notes:** **a** Income or sales tax for selected cities. **b** Cities can levy a local income tax, but no locality currently does so. **c** A local income tax under certain circumstances. **d** Sales tax only; cities can levy a property tax for debt-retirement purposes only. **e** Cities can impose the equivalent of a business income tax. **f** Sales taxes for selected cities and/or restricted use only.

Property + sales + income

Property + sales OR Income

Property or sales only

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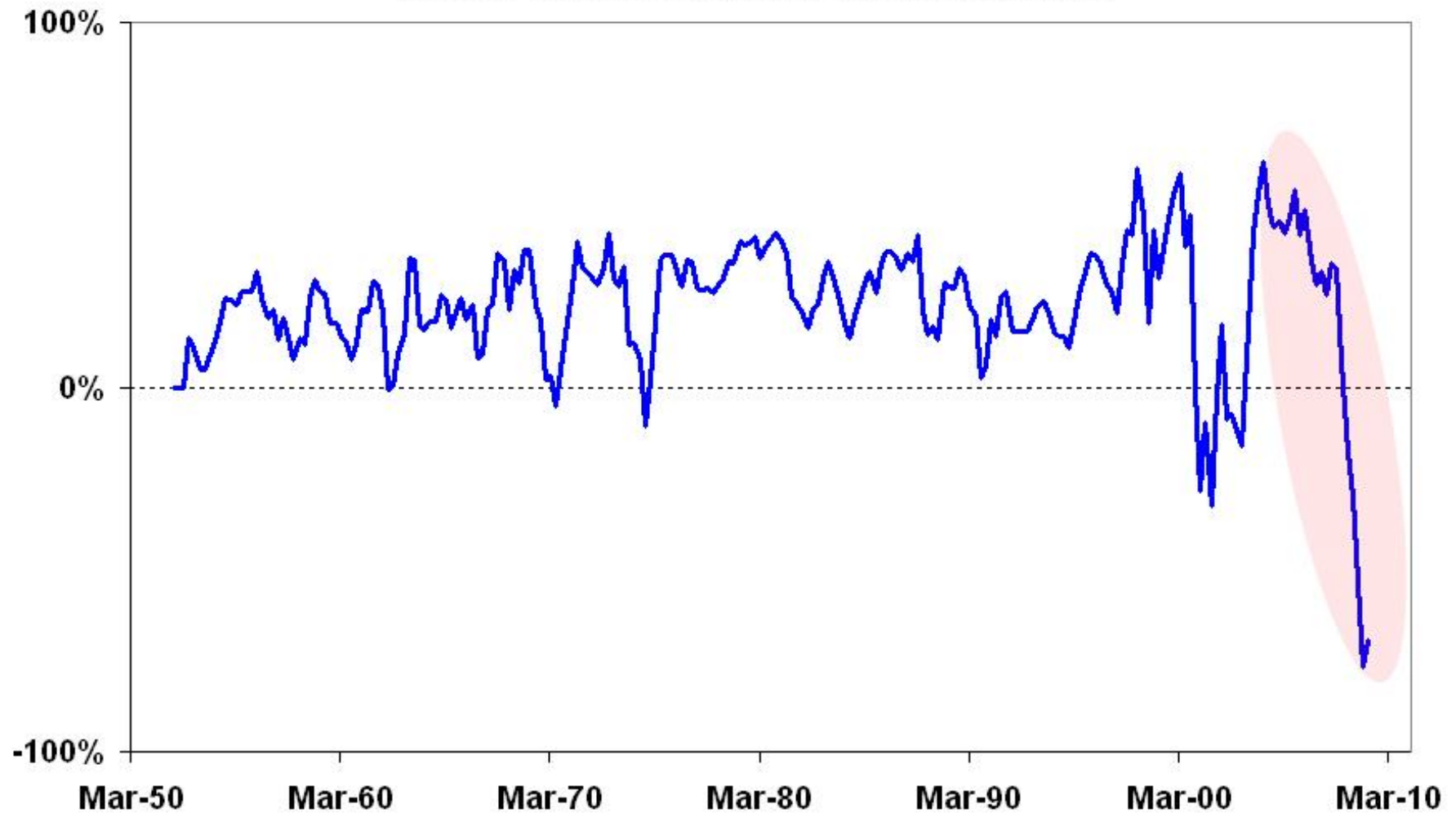
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*“It's tough to make predictions, especially about the future.”* Yogi Berra



## 12-Month Change in Household Net Worth as a % of Nominal Gross Domestic Product

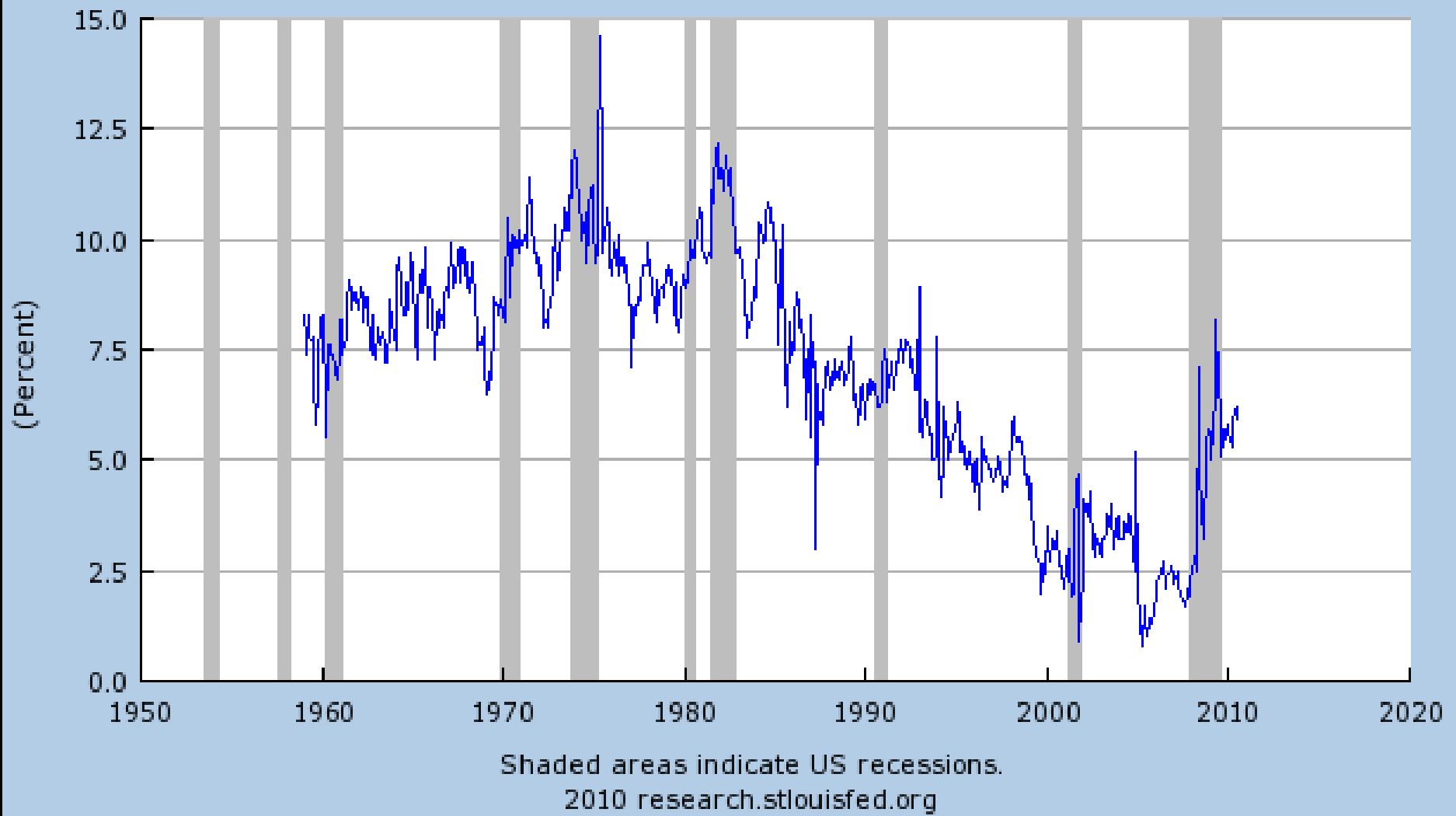
(Source: Federal Reserve, Bureau of Economic Analysis)





## Personal Saving Rate (PSAVERT)

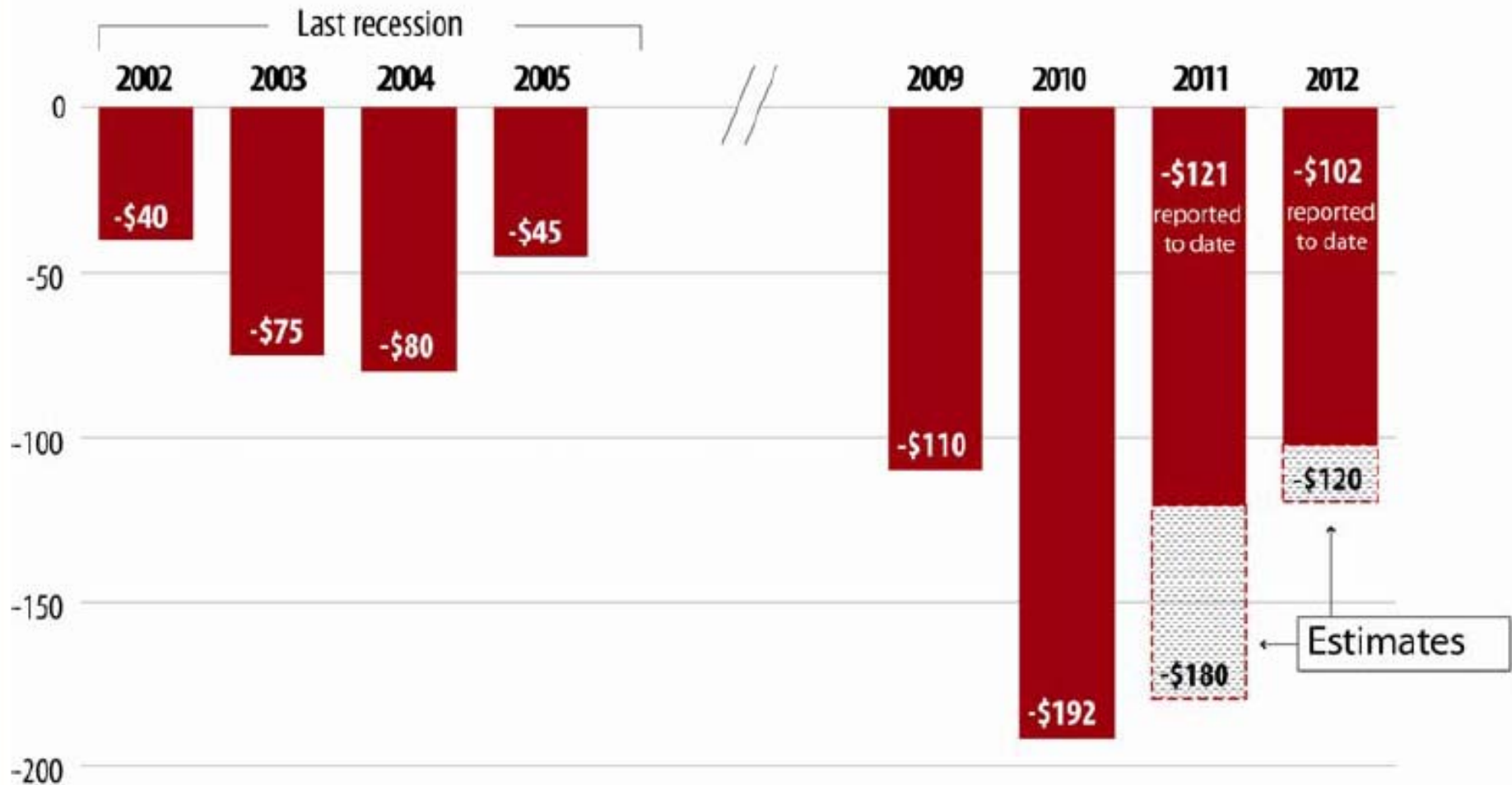
Source: U.S. Department of Commerce: Bureau of Economic Analysis



# FIGURE 3

## Largest State Budget Shortfalls On Record

Total state budget shortfall in each fiscal year, in billions



Source: Elizabeth McNichol and Nicholas Johnson, "Recession Continues to Batter State Budgets: State Responses Could Slow Recovery" Center for Budget and Policy Priorities, February 2010 <http://www.cbpp.org/files/9-8-08sfp.pdf> (updated July 15, 2010)

# What to do?

## ■ It's not 1935, but ...

- Real estate market will be slow to recover: 2011-12?
  - Consumer spending and wages also down
  - Cities will tap into ending balances/reserves
    - Public concern will limit options

■ ***Don't Waste a Crisis:*** The economic shock of 2007 to the present ought to encourage a political discourse about reforming the fiscal architecture of municipalities:

1. **If States Want Cities to be Responsible for Their Actions, States Should Give Them Adequate Tools.** Diversify. Authorize access to taxes. Eliminate TELs.

2. **The Fiscal Mismatch Is Weakening Cities. Reform the tax structure:** Tax structures might be designed that link closer to cities' underlying engines of growth or to income and wealth.

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





# Don't Waste a Crisis

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

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

3. **Jointly Provide Services and Share Service Delivery Costs.** Create regional taxing powers. Municipalities will be looking for regional partners and allies in designing a system that is less destructive to the region's long-term interests and fairer in distributing the costs to the users.
4. **Pricing Drives Consumer Behavior and Often Disadvantages Cities.** Approximating the market value of city-delivered services would possibly reduce subsidies to free-riders. Mileage fee? Fee for service?

THANK YOU

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