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PAYING FOR URBAN GROWTH

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Financing urban growth is a threadbare topic among the political-economic issues being debated in all of the larger States. But up to now the spreading and intensifying urbanization of recent decades has evoked unexceptional methods of finance and political organization to cope with it. Indeed, urbanization's public and quasi-public costs almost seem to be beyond the decision-making process and subject only to a blind, groping, evolutionary sort of change. The institutional constraints inherent in real estate property rights and an inherited political organization may not arrest urban growth but they kink it, divert it, or contort it in ways that are distressingly costly. To see these costs in a significant perspective one must look beyond the present and behind the superficial facts that are ordinarily available on the finances of urban government.

Growth

At the outset it ought to be made clear whether the problem we face is primarily one of financing growth or financing urbanization. Financing growth excites more interest. "Growth" is a good word; its use evokes an affirmative response. Because of its protean nature qualifying adjectives are often used to give it that last ounce of conditioning affirmation -- thus we have "sustainable growth" or "balanced growth." Hardly anyone could oppose public policies that will achieve these goals. Hardly anyone, I presume, could successfully advocate policies for the United States, and particularly California, that would restrict growth.

But I am not persuaded that growth, especially the kind California enjoys, is really the problem. After all, balanced population growth is self-sustaining; more people use more city services but they also pay more taxes. City planners who see nothing but costs in every growth trend should take a page out of the merchandiser-advertiser's manual -- more people -bigger markets-more sales-greater profits. The fact is, that population growth, especially the immigration of workers, does not necessarily aggravate financing difficulties; it may be creating a more than proportionate rise in taxable capacity.

The devotees of economic growth, a large and influential group these days, are not awed by the prospect of a rising population--in fact, lack of such growth would be the cause for alarm. To be sure the natural increase in population and labor supply should, in a refined view, be combined with rising productivity, but the emphasis on rising per capita output is partially induced by the shortcomings of a GNP concept which has no leisure component. Perhaps in countries like Brazil and cities like Rio, where population outstrips food supplies and employment opportunities, economic and social problems become acute as the population increases. But no concern need be felt about growth in California where both jobs and food are plentiful and the existing scale of living stands high among the rich States in the richest country in the world.

Too rapid growth can create problems. For example, if local financial resources are inadequate to provide housing, highways, and community facilities, there may well be a balance-of-payments problem. California is indeed fortunate that its long-continued, and doubtless long-continuing, balance-of-payments deficit is being financed with very modest interest rate differentials by the Midwest and Eastern saving-surplus areas of the country. And investors in these areas appear to have no apprehension that the California economy will fail to generate the capacity to service and repay their borrowings.

Rapid growth, then, is possible to the extent it can be accommodated by projects and enterprises on which investors will risk the savings at their disposal. This rate of growth may not at times measure up to the effective demand and it may not be well conceived from an over-all point of view of the city planner. But if

California were a separate nation it is almost inconceivable that it could marshall the resources for growth that it has as a State in the Union.

Growth, if it is very rapid, or, worse yet, uncertain as to sustainability, causes various bottlenecks, gluts, and uncertainties in the scope and nature of plans and programs to accommodate it. I would not minimize these types of operational problems; they are irritating but they are peripheral to the basic issue involved in my topic.

Urbanization

We should look, I believe, toward the characteristics of urbanization rather than growth to get a better measure of what has to be done or undone to facilitate urban growth.

Local taxation. To start with the undoing. The fiscal-political institutions which we have inherited from a rural economy are not well suited to accommodating urbanization. For example, heavy dependence on the property tax, particularly that part of the tax based on structures and site development, is a deterrent to capital investment--precisely the economic activity needed for urban growth. The tax base does not automatically and promptly respond to changes in economic activity or growth. The use of the tax is encumbered by statutory and constitutional constraints which impair its suitability to an environment in which economic growth and urban obsolescence are of significant proportions.

Over all, the administration of the tax has been frustratingly inadequate--partly because the standard of measuring tax liability is extremely difficult to apply, but also because its administrators are not too well trained and are constantly buffeted by importunings to use their judgment on real estate values in an arbitrary manner so as to hold down local spending, attract industry, or to effect another less public-oriented objective. As can be shown, the system currently produces a very large revenue yield, and one that has been rising more rapidly than GNP in recent years. The fact that this hand-me-down system works, however, is not as significant as the fact that it works badly: encouraging an excessive reliance on debt financing and crisis-to-crisis fiscal arrangements, discouraging public and private investment and implementing the theory that local government expenditures are fixed by the revenues these governments have inherited, or can obtain, and not by the public needs of the community.

Cities, counties, and other local governments, have attempted in one way or another to obtain relief from dependence on the property tax. They have sought authority from the State legislatures to impose other types of taxes, mainly general sales taxes or levies on specific services or commodities. They have also sought grants-in-aid for specific purposes or general purposes paid for from the taxes levied by States or Federal Government. The role of an indigent supplicant, that most of our largest cities have had to assume, before State legislatures and the Congress has placed all parties in a bad light--the cities for seeking handouts, the States and Federal Government for refusing to share revenue sources with governments having greater fiscal needs.

Without any doubt, most of the taxable capacity of the Nation or a State, whether measured by income, wealth, or transactions, is within city boundaries since a very large and growing proportion of our population lives in urban areas. And only people pay taxes, contrary to the fiction about corporations. So it does follow that cities have a rich tax base that they have not been able to exploit. There is also ample evidence that obsolete constitutions and the vested interests in revenue sources enjoyed by the States and Federal Government have hampered cities in their efforts to strengthen their revenue system. But there is more to it than that.

The fundamental difficulty is that cities are competitive in services and costs and this is a greater constraint on the range of their services and taxes than the institutional environment they have inherited. True, the competition is proximate and the measuring rod--the preferences of its existing and potential residents--has never been very finely calibrated but the competitive discipline is nonetheless of considerable importance.

The economic base. It can be said a city is a place to work and to live. Which comes first, the working or the living, depends on the person or the city. For example, I live in the Washington metropolitan area, in a Virginia suburb to be exact, because I work in Washington. Others live there because they were born there; still others are attracted by the city's ethnic cultural or climatic advantages. Do we know why people move to one city instead of another or can we measure the relative pull of the job or the living amenities in a given area? Like all the other key questions, this is one on which we do not have statistics.

Several years ago I theorized that it was possible to construct a rough, but objective, index of relative importance of jobs and amenities. It presumed that the cities that had more to offer than jobs would tend to have larger proportions of employment in local service enterprises where rates of remuneration are lower and smaller proportions in manufacturing where wage rates are higher. In the cities where living amenities were limited industrial jobs would be more plentiful but service business would be more limited and there would be fewer service employees. This rough proxy index showed that West Coast cities, Boston, New York, Washington, Denver, and New Orleans, had 10 to 20 per cent greater employment in services than Chicago, which was about average. At the other end of the scale, Detroit, Milwaukee, Pittsburgh, Baltimore, Philadelphia, and Buffalo, showed service employment as being 5-15 per cent less important than in Chicago.

I think these data at least establish a presumption that living preferences are significantly affected by what a particular urban area has to offer its citizens.

But there is more to keeping a city alive and growing than amenities for living. A city must generate goods and services it can sell competitively to the rest of the country (world). This is necessary in order to buy goods and services that are not produced locally. Moreover, local production costs for such exporters have to be competitive. And included in the local costs are taxes less the off-setting benefits in public service. This uncompromisable fact has brought about legal and extra-legal adaptation of local tax systems to mitigate burdens on exporters and accentuate them on enterprises such as public utilities and downtown office buildings that are confined to the area. This practice is not as hostile to the public interest as it sounds, for the local utility or other interest so treated is no more than an intermediary passing its taxes on--usually to the local consumer, and possibly to its stockholders. The manufacturer who seems to be favored may well be forced by competitive considerations to pass his tax savings on to nonresidents. It is, of course, the best of all possible worlds if a city has an industry that can pass on large tax costs to nonresidents--but this does not happen often or for long.

The point about this digression into the characteristics of the economic base for taxation is to try to show that cities are not as free as they believe they are to adopt the sources of revenue used by State and the Federal Government. State governments have the same problem in a less aggravated form. People even leave the United States because of more favorable tax climates abroad but they are hardly missed and certainly their leaving, or threats to leave, has little or no influence on national tax policy.

Political circumscriptions. Another of the institutional characteristics of urban government that might be undone or modified is the geographical fragmentation of taxing authority inherent in clusters of satellite communities around the central city. Each competes with others in the amenities they have to offer and the tax costs they exact. In addition, these jurisdictions may be quite dissimilar in their taxable capacity. In any metropolitan area there will be suburbs that are predominantly low income, middle income, and high income. There are usually industrial suburbs with small residential areas. Often the industrial areas will be gerrymandered into areas with sparce population and low service requirements, resulting in a low tax rate. A wealthy suburb, with higher-than-average value of residences, may have competitive tax rates but far better and broader range of services. The poorest units will not have the income even with high rates to support the State-fixed minima standard of services and will be dependent on State aids of one type or another.

What can be done about the fragmentation of political and taxing authority within large urban areas? Introducing income or sales taxation at the discretion of, and at the rate selected by, any one of the local governments will not do much to improve local capacity to meet urbanization costs.

Nonetheless, there have been developments in this direction. The intra-State tax situs rules fixed by State general assemblies have been modified in some States to permit sellers of merchandise in one jurisdiction to pass on sales taxes to buyers who live in other towns or cities in the State. In other instances, cities have been given the power to tax the wage and salary income of nonresidents earned locally even though the recipient may live in another city. His home city might be able to tax the same income. Most of the recent moves on the intra-State situs front have come about as a result of efforts of the central city to replace its relatively declining property tax base with levies on nonresidents' income and transactions.

Urbanization, everyone will agree, has political-institutional inheritances that enormously complicate the task of matching the revenue sources of a multitude of urban fragments--including the central city--to the service needs or opportunities that each must meet in order for urban living to match our rising standard of private consumption. It is less well recognized that the tax bases for these local units are quite variable, often fragile, and not as "available" as often supposed.

The reorganization of urban government by annexation and combination so that political boundaries are more nearly coterminous with the urbanized area, and so that tax resources are pooled and a common level of municipal services established, has made limited headway as a political movement. Parochialism, hostility to size, deep set inertia, and a wide range of special circumstances have been deterrents but the major consideration is that the central city has not been able to offer economies of scale in the provision of urban services that makes affiliation of its satellites too advantageous for taxpayers to resist.

Another approach to reorganization--the special purpose unit--has been somewhat more successful. Used mainly for water, transport, and sewerage disposal functions, such units have been able to supply these specialized services for the citizens of scores of urban fragments that would never consider surrendering the general governmental powers of their village or town. These ad hoc units have some vital advantages. Their service areas invite the greatest economies of scale that are consistent with the extensiveness of the urbanized area. As functional specialists they have had an opportunity to make a major technological contribution to solving urbanization problems. However, in practice, few of them have exploited their opportunities and many have, in fact, done less than a pedestrian job, except in providing a more secure haven for political patronage and mismanagement that could exist in a general-purpose unit.

Something can be accomplished in meeting the problems of urbanization by undoing the inheritances of an unresponsive fiscal system and the fragmentation of civic authority and responsibility. But such steps will not be enough, or nearly enough, to solve the problem of financing the type of urbanization this Conference visualizes.

Adverse selection. The largest single financing problem an urbanized area faces is avoiding the costs of "adverse selection." By "adverse selection" I refer to an urban environment which pyramids welfare, health and educational service loads. These are functions which are completely, or to a large extent, financed through the redistribution of income; i.e., the taxes must be paid by those who do not immediately or directly receive any commensurate benefit. The modern American city is not able to levy and collect taxes adequate for these purposes if it has more than a typical incidence of welfare and educational needs without inducing defensive maneuvers on the part of its taxpayers.

To avoid the cumulative effect of mounting service costs and a shrinking tax base the problem of "adverse selection" should be attacked on two fronts. The city must adopt policies with respect to the use of private property that will minimize health and welfare problems. There is no method of finance that will meet the health, welfare and educational costs in one huge bootstrapless slum. In many cities slums have been bought up and razed but the conditions which create them have not been cleared away; until they are, cities will continue to have slums and to attract more than their proportion of health and welfare costs. Basic progress on the slum problem has been made in zoning and code restrictions but public costs inherent in the unrestricted private use of urban land are not charted, or even understood. In an economy where technological change is so pervasive, obsolescence in urban layout, facilities and structures, is creating not only slums but also a great deal of misplaced public and private investment.

The other attack on the problem of "adverse selection" is to shift all or the major part of the cost of health, welfare, and education services to the State and National Government. The taxes levied for income redistributing functions should have as broad a geographical base as possible. There are political objections to be overcome in broadening the base for local school operation, but by using both flat and equalization grants it is practicable, in my judgment, to retain meaningful local control and some differential enrichment of minimal programs while eradicating the inadequate programs imposed by deficiencies in local tax resources.

Working along these two lines, urbanization would not entail differential tax costs because of health, welfare, and educational costs and local tax bases would be available for other purposes, including property tax abatement. But more can be done.

Pricing. A sustained effort should be made to "price" more municipal services. Prices are better than taxes because they measure demand more precisely and are a safeguard against over- or under-fixed investment. Since they relate cost to use they make it possible to avoid the wastage inherent in a proxy measure of service need. A certain amount of haphazard, slipshod pricing is now used for water, garbage collection, transport, and sewerage disposal. The cost basis, however, is poor or nonexistent. Local tax subsidies or profits on the sale of municipal services should be more accurately determined and made a part of deliberate policy rather than chance. And the services for which prices can be substituted for taxes, on a cost basis only, should be extended as broadly as possible. At a minimum, water supply, waste and sewerage disposal, local street construction and fire protection--to refer only to the major functions--should be sold or assessed on the basis of cost of the quantity used.

Being the most populous State in the Union has a price--urbanization--and urbanization costs money. And there are no ready-made or simple answers to all the problems involved in financing the city. On the other hand, I don't suggest here in California, for example, that you need resort to Colin Clark's proposal to blast surplus population off to planets in outer space. Nor need you follow the example of Puerto Rico, necessarily. This delightful island harbors its population on a basis which, given a few climatological changes, would support a population in California of about 110,000,000 people. If Californians really want the prize for size I am sure they can muster the ingenuity and determination to adopt policies which will make this not only a painless distinction but possibly a pleasurable one.

I've tried to indicate that to some of the problems there are partial solutions which should be pursued further. In other cases there are at least new and promising directions in which we can and should be moving. As for myself, I'm optimistic. Particularly when a great university such as yours sponsors a conference such as this. It indicates to me that though the problems are substantial, so are the resources--both in terms of men with a dedicated curiosity and in terms of the scientific knowledge and facilities at their command.