

**BUSINESS MORTALITY:  
A NECESSARY EVIL?**

**PAVING THE SCHOOL  
DISTRICT'S BUMPY  
FISCAL ROAD**

**BLUEPRINT FOR  
METROPOLITAN REFORM**



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**Business Mortality: A Necessary Evil?**

. . . Can we find a way to reap the social benefits of business failure and yet avoid personal costs?

**Paving the School District's Bumpy Fiscal Road**

. . . Commonwealth contributions to public education in Philadelphia have soared, but new local revenues may be required to head off fiscal chaos.

**Blueprint for Metropolitan Reform**

. . . Attention to certain key considerations might go a long way towards resolving the continuing debate on metropolitan government reform.

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## Business Mortality: A Necessary Evil?

by Duane G. Harris

Russell, Majors, and Waddell were giants in their industry. They rode the crest of economic growth to fame and fortune. Their company spanned half the country and brought service to thousands. Yet still more frontiers beckoned. A Government contract provided the impetus for a revolutionary idea in communications. Quickly the company established nearly 200 outlets and expanded employment by nearly 400 workers. But if development was swift, so was demise. Eighteen months after the new venture got off the ground, it folded — and with it the company.

Unfortunately for Russell, Majors, and Waddell, the Pony Express preceded cost-plus pricing and Government guarantees. They miscalculated costs and paid the entrepreneurial price — failure. Although possibly in less glorious fashion than their 1860 counterpart, over 10,000 companies in 1970 went the way of the Pony Express. At one time, such a purge of the marketplace was considered desirable, indeed even neces-

sary, to guarantee the best products at the lowest prices. But because of the heavy personal burden caused by the failure process, many people are having second thoughts about the market outcome. With the recent troubles of some major U.S. corporations, many are questioning how deeply the knife-edge of failure should cut.

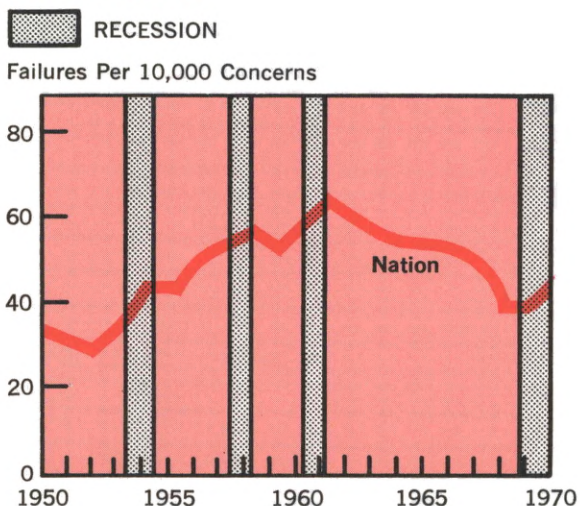
### WHY ALL THE FUSS?

In terms of sheer numbers, there is little to indicate that we are experiencing an onslaught of business casualties. An indicator of the prevalence of failure in our economy is the number of failures<sup>1</sup> per 10,000 con-

<sup>1</sup> Dun and Bradstreet define business failures to include “those businesses that ceased operations following assignment or bankruptcy; ceased with loss to creditors after such action as execution, foreclosure, or attachment; voluntarily withdrew leaving unpaid obligations; were involved in court actions such as receivership, reorganization, or arrangement; or voluntarily compromised with creditors.” See *The Failure Record Through 1970* (New York: Dun & Bradstreet, Inc., 1971).

cerns.<sup>2</sup> Chart 1 shows this failure rate for the nation since 1950. Although the rate rose from 1969 to 1970 (37 to 44), it still fell short of the average for the twenty-year period (47) and far short of the post-World War II peak (64) in 1961. In fact, in the last three years, the rates were the lowest recorded since 1955.

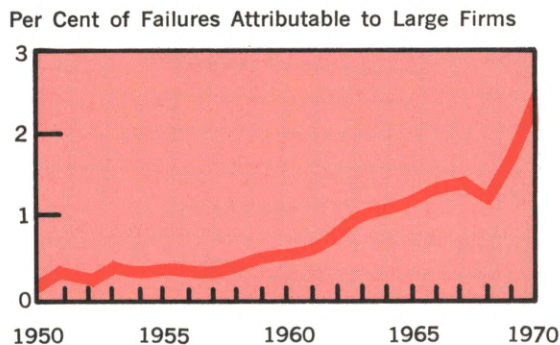
**CHART 1  
FAILURE RATES EXHIBIT  
VOLATILITY.**



Of course, the impact of failures on the economy depends on the size of failing firms in addition to the rate of failure. Chart 2 shows the percentage of total failures in

<sup>2</sup> The number of concerns "represents the total number of business enterprises listed in the Dun & Bradstreet Reference Book. This Book includes manufacturers, wholesalers, retailers, building contractors, and certain types of commercial service including public utilities, water carriers, motor carriers, and airlines. . . . Specific types of business not listed are: financial enterprises including banks and mortgage, loan and investment companies; insurance and real estate companies; railroads; terminals; amusements; and many small one-man services. Neither the professions nor farmers are included."

**CHART 2  
LARGE-FIRM FAILURES JUMP IN  
'69 AND '70.**



each year accounted for by large firms.<sup>3</sup> It jumped sharply in 1969 and again in 1970. So, although recent failure rates are not abnormal, the impact still may be greater because of a sharp surge in the failure of large firms.

**FAILURE IMPACT**

No matter what the rate of business casualties, it is obvious that they play havoc with the lives of thousands of people each year. The shop proprietor who has his lifetime savings tied up in his business is left destitute. The employee trying to give his family some of the better things in life suddenly finds no income to cover his car payments and dental bills. The rush-hour commuter wakes up to discover no public transportation to his center-city job. Certainly, these calamities may only be short run in nature, but the short-run costs to individuals are substantial. The shopkeeper can start a different business—but with what? The employee can find other work

<sup>3</sup> We denote as large firms those failures classified by Dun & Bradstreet as having current liabilities in excess of \$1 million. See *The Failure Record Through 1970*.

— but only by spending long hours beating the sidewalk, moving his family to another locale, and perhaps taking a cut in pay. The commuter can find other ways to his job — but that means more lost time, a second car, or a move closer to work. It is understandable, then, that for any of these individuals, business failure invokes a substantial sacrifice and offers no obvious benefit.

So, in some quarters, sentiment runs high that because of the welfare of the thousands of owners, employees, and customers affected by business failure, we simply cannot let the failure process run its course. But life is complicated by the fact that in addition to generating a certain aura of disaster, business failures also perform an economic service to society.

For one thing, failures help guarantee that society's goals are met. They force resources to be channeled into those uses most highly valued by our people. Even though an individual may feel quite inconsequential in relation to giant enterprise, all individuals together wield a powerful vote in the marketplace. For example, consumers signal their priorities to business by buying. As they prefer new or different products and services, businessmen must keep up with those changed preferences or they ultimately may fail.

Individuals also establish priorities through government. If public pressure to spend less on highways and more on mass transit changes the character of government expenditures, firms in those industries receive a signal through the marketplace that demand has shifted. If they don't get the message and act accordingly, they may be threatened with failure.

Also, business failures operate to guarantee that the products and services desired by society are produced at the lowest possible cost. High-cost, inefficient firms — those that waste resources which could be utilized elsewhere — will be driven out of the market via the failure process.

Thus, it becomes less clear when we con-

sider the long-run benefits of social choice that we can run headlong into programs which prevent the failure mechanism from working. Consider what might have happened in 1860 if today's pressures had dominated then. The Russell, Majors, and Waddell freight company, parent company of the Pony Express, was the largest in its industry, employing over 6,000 teamsters. So, certainly, it met two of the criteria usually advanced for special treatment today — size of the firm and number of people employed. Possibly, if the Government had agreed to underwrite the costs of the Pony Express, both it and the freight company could have been preserved, jobs could have been saved, and service would not have been interrupted. Who knows, even today, maybe we could send a letter first class, air mail — or by Pony Express.

But are we to be left with an unresolvable dilemma? Must we suffer the short-run personal costs of failure to preserve our longer run social priorities — or alternatively, must we give up some of our freedom of choice to diminish the impact of unemployment and inconvenience? Or can we find policies and programs which will cut down the number of failures, diminish the impact of those failures that do occur, and yet preserve society's ordering process? To answer these questions, we need to examine more closely the nature of failures and their pattern over time.

## THE UPS AND DOWNS OF FAILURE

If we look back over the past two decades, we see that the failure rate seems to follow the business cycle (Chart 1). For example, the rate peaked during the recessions of '54, '58, and '61. But note also that even during the very best of the last 20 years, the failure rate seldom fell below 30 failures per 10,000 concerns. So, it seems that we can expect failures each year regardless of business conditions. In fact, it is helpful to consider the overall rate of business failures to be comprised of two factors

— the “natural” rate and a cyclical component.

The natural rate represents the number of firms per 10,000 that could be expected to fail each year in a world devoid of unexpected fluctuations in general business activity. Suppose businessmen knew exactly what the overall economic climate for the next year was going to be. Even then, some would miscalculate demand for their product or service. Others would not keep close control over their costs. Still others might be hit by fire or flood. So the natural rate encompasses those failures caused by inexperience, mismanagement, natural disaster, and so forth. Thus, we can look upon the natural rate as that which is necessary to guarantee that we efficiently utilize our resources and produce those products and services most desired by society.

But, in addition, unexpected fluctuations in business activity may cause the actual failure rate to swing up and down from the natural rate. Suppose businessmen expect an especially good year ahead. They translate a strong upswing at the national level to be particularly good news for their own products. Sales will be high, so they gear up production and start building inventories. But then something goes wrong. Customers just do not show up at the door. For some reason they are not in a buying mood. Sales are slow to develop and inventories continue to build. In the meantime employees must be paid, the rent check must be sent, and the bank loan comes due. In that scenario, some of the firms that otherwise could have stayed afloat sink because of developments in the general business climate. Unexpected business slowdowns magnify the natural rate of failure. In a similar manner, an unexpected pick-up in business activity can lower the rate of failures below the natural rate. Firms that otherwise would, and should, fail are temporarily saved by an exceptionally healthy economy.

Hence, unexpected fluctuations in business give us the worst of two worlds. Too

many failures during slowdowns mean unnecessary unemployment and inconvenience; too few on the boom side mean wasted resources and “undesired” products.

So, conceptually we can separate the cyclical component of business failure from the natural rate. But how material have these unexpected fluctuations been in generating the ups and downs in the failure rate? Evidence suggests that, indeed, businessmen’s errors in estimating the rate of growth of economic activity are an important factor. Furthermore, based on the U. S. experience since 1920, indications are that the natural failure rate is approximately 50. If businessmen were able to forecast correctly the rate of growth of GNP, we could still expect some 50 failures for each 10,000 firms.<sup>4</sup>

If, then, we are to enjoy the social benefits of failure and yet avoid the individual costs, we should strive to stabilize the failure rate at its natural level and then provide programs which blunt the personal impact of those failures.

## BLUNTING THE BLOW

Unfortunately, the near-term prognosis for stabilizing the rate of failure does not look bright. Certainly, advances in forecasting techniques may help businessmen to

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<sup>4</sup> In an attempt to determine the effect of unexpected changes in business activity on the rate of business failures, we utilized a simple regression model. The rate of failure in any time period was considered to be equal to some constant (natural rate) plus an increment caused by the difference between the expected rate of growth in GNP and the actual rate. We assumed that businessmen formulate their expectations about business activity according to a standard “error-learning” process. That means the expected growth rate of GNP during a certain time period is equal to the estimate made for the previous period, plus an adjustment based on the degree to which the previous forecast was in error. Using annual data for the period 1920 to 1970, we found that 81 per cent of the variation in the failure rate was accounted for by the variation in the gap between expected and actual rate of growth of GNP.

make the unexpected expected and thus lessen the impact of fluctuations in business. And Government policymakers may become better able to control economic activity so that a goal of constant rate of growth in GNP comes closer to reality.<sup>5</sup> But such advances may be a long while in coming. In the meantime, we can search for ways to dampen the personal costs of the failure process.

Of course, a solution much in the news today is Government intervention to save failing firms. But that solution jeopardizes our longer run priorities. What we need are policies and programs that attack the short-term costs of failure head on. For example,

<sup>5</sup> However, the intricacies of our economy make stabilization policy a difficult task indeed. In fact, given our state of expertise, discretionary monetary and fiscal policy may even at times be destabilizing. See Mark H. Willes, "Lags, Fine Tuning, and Monetary Policy," *Business Review*, Federal Reserve Bank of Philadelphia, September, 1970.

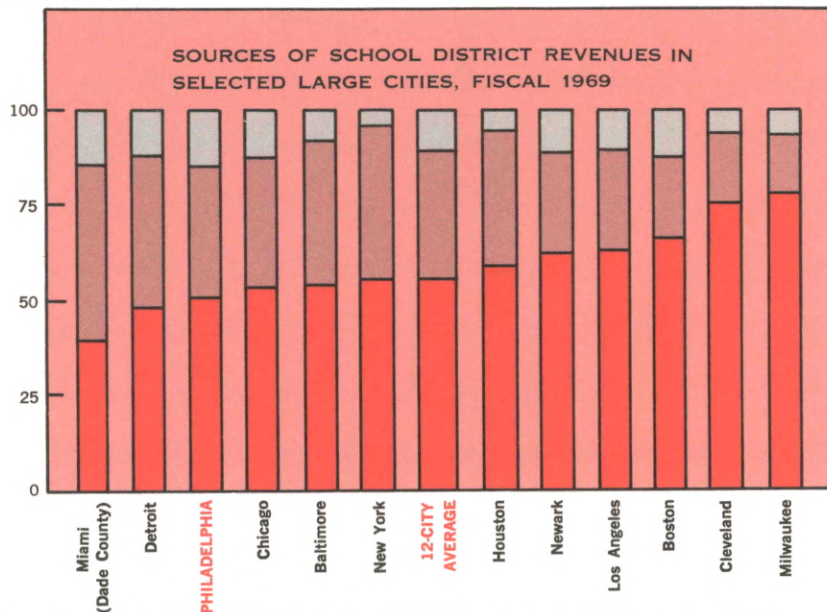
since unemployment is one of the key by-products of failure, perhaps we could bolster our efforts to make that unemployment as transitional and painless as possible. Unemployment compensation programs may have to be made more comprehensive, retraining programs made more accessible, relocation costs more extensively absorbed by society. By helping the individual rather than saving the firm, perhaps we could diminish the personal costs and yet preserve the social benefits of business failure.

Certainly, in very special cases where the welfare of a substantial portion of our people is threatened, we may have to consider direct government assistance to failing firms. But we must be especially mindful of the consequences of such action. In the soul-searching of the next decade, as society realigns its priorities to make a better world for everyone, we cannot afford to retain too many twentieth-century versions of the Pony Express. ■

# Paving the School District's Bumpy Fiscal Road

THE SCHOOL DISTRICT OF PHILADELPHIA RECEIVES A SMALLER PORTION OF TOTAL REVENUES FROM LOCAL TAXES THAN DO SCHOOL DISTRICTS IN MANY OTHER LARGE CITIES.

FEDERAL AID  
 STATE SUBSIDIES  
 LOCAL REVENUES  
 Per Cent of Total Revenues



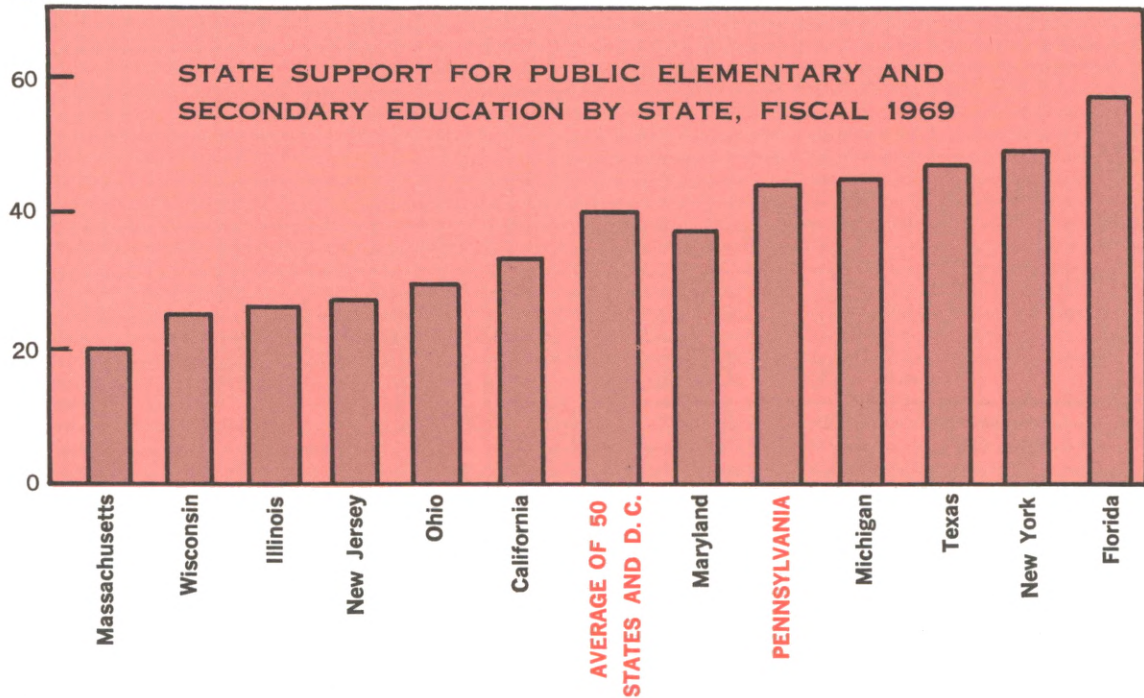
Source: Advanced data from *Statistics of Local Public School Systems 1968-69, Finances*, soon to be published by the National Center for Educational Statistics, U.S. Office of Education.

Philadelphia public schools receive 50 per cent of their total revenues from local taxes. The Miami (Dade County) school district shouldered the smallest burden locally — 39 per cent — while Cleveland and Milwaukee, two districts at the other extreme, tap their taxpayers for over 75 per cent of the public education bill.



THE PRINCIPAL REASON IS THAT THE COMMONWEALTH OF PENNSYLVANIA IS SHOULDERING A GREATER SHARE OF THE RESPONSIBILITY FOR FINANCING PUBLIC ELEMENTARY AND SECONDARY EDUCATION THAN ARE MANY OTHER STATES.

Per Cent of Total Revenues

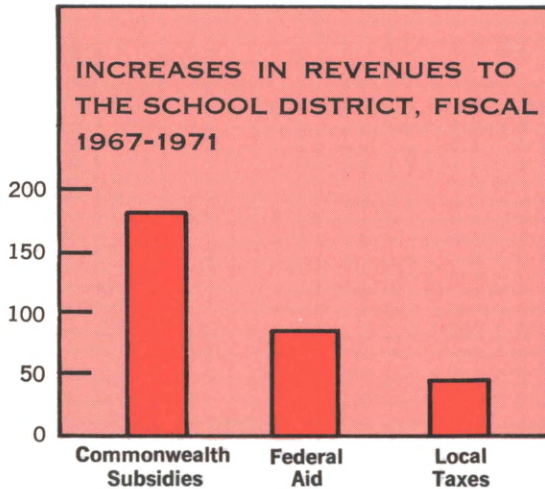


Source: Estimates of School Statistics, 1969-70, Research Division, National Education Association.

The percentage of public education revenues drawn from state funds varies widely across the nation. Pennsylvania contributes 46 per cent to the bill for primary and secondary public education, while Massachusetts pays 20 per cent, and Florida lays out a thumping 60 per cent of the total cost of public schooling.

**COMMONWEALTH CONTRIBUTIONS TO THE SCHOOL DISTRICT OF PHILADELPHIA HAVE SURGED ALMOST 200 PER CENT IN THE LAST FOUR YEARS, WHILE LOCAL SUPPORT INCREASED LESS THAN 50 PER CENT.**

Per Cent

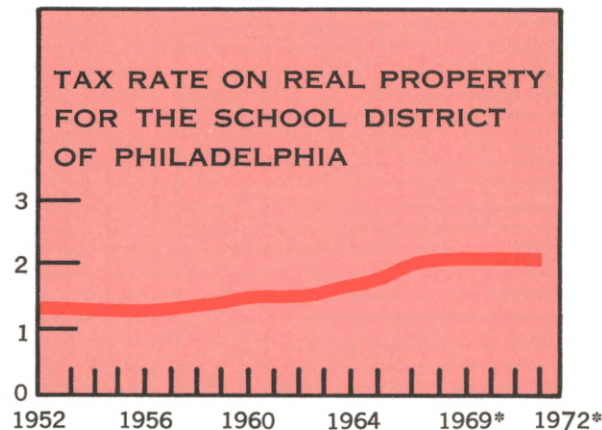


Source: School District of Philadelphia.

New State taxes and legislative recognition of the special problems facing public education in Philadelphia combined to push Commonwealth aid from \$50 million in fiscal 1967 to over \$145 million in fiscal 1971. Over the same period, Federal support was increased from \$30 to \$55 million, while some additional "nuisance" taxes helped local tax collections grow from \$110 to \$160 million.

**LOCAL FUNDING HAS REGISTERED A COMPARATIVELY MODEST INCREASE PRIMARILY BECAUSE THE TAX ON REAL PROPERTY, MAINSTAY OF LOCAL REVENUE FOR THE SCHOOL DISTRICT, HAS NOT CHANGED IN FIVE YEARS.**

Tax Rate (Mills)



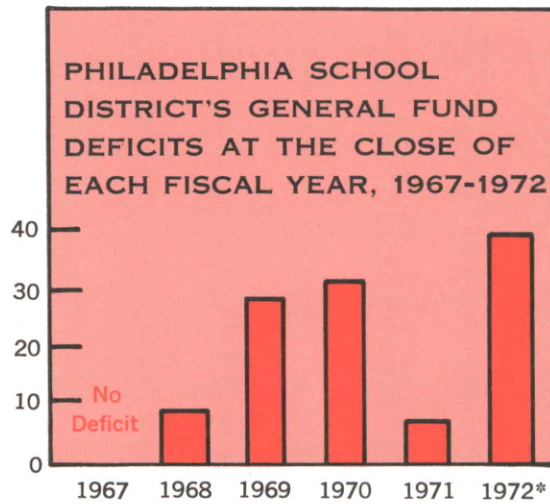
\*The use of fiscal years (July 1st to June 30th) began in 1966.

Source: City of Philadelphia, Department of Collections.

The strengthened role of Commonwealth support for public education in Philadelphia has allowed a soft peddling of efforts to increase local school taxes. And taxes that have been passed since 1966 generated only small amounts of new revenue. A new Corporate Income tax upped receipts by \$16 million, while an increase in the General Business tax added only \$2 million to the revenue coffers. The Commercial Realty Use and Occupancy tax, adopted in 1970, is expected to pull in \$8 million.

**BUT, AS DEFICITS CONTINUE TO MOUNT AND IF ADDITIONAL STATE FINANCING IS NOT READILY FORTHCOMING, NEW LOCAL FUNDS MAY BECOME MORE ESSENTIAL TO SMOOTH THE SCHOOL DISTRICT'S BUMPY FISCAL ROAD.**

Millions of Dollars



\*Estimate.

Source: Office of Finance, School District of Philadelphia.

In fiscal '70, the School District was \$30 million in the red. Sale of revenue bonds and budget cutting trimmed this deficit to \$7 million the following year. However, continued wage escalation will push expenditures \$40 million over currently committed revenues in fiscal '72. ■

## Blueprint for Metropolitan Reform

by L. Christine Grad



Probably nothing raises the blood pressure of suburban residents more rapidly than proposals for metropolitan reform advanced by their poorer city cousins. Ever since city dwellers discovered that taxes were lower and resources greater across the city line, they have pressed to extend the city's territorial limits beyond existing boundaries to tap the lucrative tax base of suburban areas. And ever since the first city dwellers beat an exit to suburbia's "wide, open spaces," they have vigorously opposed such a plan.

Nevertheless, there is still some life left in reorganization proposals. Although suburbanites cling to a conception of small, limited, neighborhood governments, many have found that they cannot escape the new, regional nature of metropolitan affairs (see box).

Post-war urbanization has rendered the structure of metropolitan government in-

## THE METROPOLITAN AREA, WHAT?

Post-war urbanization precipitated considerable decentralization of social and economic activity out of the core city. Accordingly, attention has shifted from "the city" to the broader "metropolitan area." The Bureau of the Census defines a standard metropolitan statistical area (SMSA) as "an integrated economic and social unit with a recognized large population nucleus." To be considered a SMSA, an area must contain at least one city of 50,000 inhabitants or more, or "twin cities" with a combined population of at least 50,000. It is a *region*, with a large nonagricultural, residential, and industrial population, and its integrated nature depends, not on local government boundaries, but on people's housing, employment preferences, and commuting patterns.

adequate and outdated. In every major urban area, a number of independent local governments face the formidable task of each trying to tackle problems that extend beyond their individual bounds and that are, therefore, actually regional concerns. Many local governments plod along, simply too small to be efficient and effective providers of public services. And, as if this were not enough of a headache, uneven growth has led to big social and economic differences among areas—differences which have stymied attempts to generate a smooth flow of revenues necessary to service area-wide problems. For these reasons, some urban and suburban leaders advocate metropolitan reform as the route to the best of several alternative futures.

### FLEDGLING ATTEMPTS . . .

Cities and their neighboring suburbs recently have tried a wide variety of cooperative arrangements. The most common ventures include intergovernmental agreements, planning authorities, and special service districts.

Intergovernmental agreement, one type of reform on the rise, is essentially a contract between governments. Either one government agrees to sell its services to another,

or several governments consent to provide jointly a specific function, such as water or sewer services. A metropolitan council or planning commission, another possible remedial innovation, is, in effect, a special type of intergovernmental agreement. Councils provide for cooperation in research, planning, and deliberation of areawide issues.

A second major way of effecting reorganization of metropolitan government has been the creation of single- and multi-purpose special districts. Special districts, also known as authorities, are independent units of government, established under state law, for the purpose of performing one (or a few) areawide services or supervising joint regional programs. These special governments—such as the Delaware River Port Authority and the Southeastern Pennsylvania Transportation Authority (SEPTA)—probably are the most popular reform measure used to date.

Even though intergovernmental agreements, metropolitan councils, and special districts help promote intergovernmental cooperation, many experts feel they are too conservative—both with respect to scale and scope—and have been instituted too late to be totally effective. In each case,

cooperation between autonomous local governments is restricted to *ad hoc* coordination of one, or, at best, a few functions. Today, many government experts argue that it's time to wipe the slate clean — to trade in the old, time-worn model — and begin anew with one designed to meet head-on changed circumstances. Hence, they generally argue for more comprehensive measures, such as the two-tier metropolitan federation and the national cities proposals.

### AND SWEEPING PROPOSALS

The two-tier metropolitan federation is a broad-based approach to the governmental problem for use in large, multi-county metropolitan areas. It involves two levels of government. An upper level — or “metropolitan government” — would be a new jurisdiction, embracing the whole metropolitan area. This new unit would be concerned primarily with areawide problems. The lower level of “community district governments” would be made up of existing local governments with alterations in their powers and functions. It would concentrate on local public functions and be close enough to the people for easy communication and participation. An important feature of this proposal is its emphasis on *shared* power and joint responsibility between the two levels of government.

The concept of national cities, quite different from other schemes for metropolitan reorganization, represents a move towards isolationism by big cities. Its fundamental thrust is for the Federal Government to charter big cities (cities with more than 50,000 people). Under these charters select cities would be granted independent status and special powers. Some see this remedy as a means of untying the city's hands from restrictive state control and of loosening the Federal purse strings.

### A LOOK AT THE GROUND RULES

While argument about specific proposals

has raged, progress has been made in a number of areas of reorganization which offer some savings to all parties. Indeed, part of the reason why intergovernmental agreements, metropolitan councils, and special districts have been so popular is that these proposals clearly reduce costs. When opportunities to reap substantial savings are apparent, both city and suburb are willing to overcome antagonisms which previously thwarted their attempts at working together.

Any reform has a number of other effects in addition to its impact upon costs of operation. For example, each type of reform influences how much control voters exercise over the spending of public funds or the ability of government to provide a variety of services. Even though these effects may not be immediately obvious, they may prove to be of substantial importance in the long run.

Government planners have advanced a number of guidelines for metropolitan reorganization which take the multiple consequences of public action into account. While several of these ground rules are political and administrative, two key ones are based on consideration of economic efficiency.<sup>1</sup>

**Economic Guidelines.** A first important economic consideration relates to matching benefits to costs. As a general rule, if a government is to provide desired amounts of services, then it must be able to tax all those who receive benefits. One practical way of assuring this is to draw the boundaries of a government in such a way as to include within its taxing jurisdiction all

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<sup>1</sup> For a more complete analysis of standards, see Advisory Commission on Intergovernmental Relations, *Metropolitan America: Challenge to Federalism* (Washington, D.C., 1966), pp. 30-33; and George F. Break, *Intergovernmental Fiscal Relations in the United States* (Washington, D.C.: The Brookings Institution, 1967), pp. 116-223.

those benefiting from its services.<sup>2</sup>

If this standard were to be used as the sole guide for distributing public responsibility, far-reaching changes would probably take place. For example, the Federal Government would most likely finance all education and welfare programs,<sup>3</sup> since the benefits of these services may spill out across the entire nation. And local governments would be accountable for basic library, police, streets, fire, recreation, and sanitation services, all of which have limited spillovers. Furthermore, should this standard be adopted, a new regional level of government probably would be created. This government would shoulder responsibility for providing air and water pollution control, water supply, area-oriented recreation, specialized library and police services, mass inter-regional transit, regional planning, and health and sanitation services—services which have areawide spillovers.

A second economic consideration concerns the size of government and the costs of its operations. If efficiency is to be realized, then a local government should be large enough to provide services at minimum unit cost. Few are. For example, one community with a population of 10,000 may be able to provide water at a cost of 15 cents per gallon, while another municipality with a population of 5,000 may furnish this same service at 20 cents per gallon. While the first is clearly more efficient, both would

find it beneficial to supply the service jointly in a larger operation if, in fact, they can do so for 12 cents per gallon. This consideration, which economists tab “economies of scale,” may point towards different government boundaries for each function, since different services do involve very different scale economies. Hence, this guideline may prove neither very clear-cut nor very simple to implement. Nevertheless, if it is a government’s aim to provide services at the lowest possible cost, then this rule will have some importance in determining boundaries.

#### **Political-Administrative Considerations.**

Progress has come up against a stone wall when attempts have been made to base innovations upon anything other than these economic considerations. Students of government structure have drawn several other guidelines which government might follow. These rules, which previously have been neglected in public discussions of government reform, focus primarily on the administrative structure—its capacity for making decisions and its relationship to the public.

If local governments are to be effective providers of desired services, then they ought to have the legal, financial, and administrative clout to perform accordingly. Of these components of responsibility, financial is currently the most troublesome. Many of our big cities—including New York and Philadelphia— are currently plagued by inability to finance ever-expanding demands for public services. In large part, this failure may reflect the disparity in income levels between people in the cities and their neighbors in the suburbs. Thus, some experts argue that any reform proposal must be judged in terms of its ability to redistribute resources.

A second administrative hallmark is that government be responsible for providing a number of services so that it is involved in the resolution of conflicting interests and a balancing of total public wants against total public resources. If a government is to

<sup>2</sup> Theoretically, it is possible for one government providing services from which other governments or individuals benefit to be compensated by user charges. But, as a practical matter, this arrangement does not work very well, hence the need for expanding the area of government.

<sup>3</sup> While the Federal Government would become responsible for “funding” these services, the local and metropolitan governments might share responsibility for “management” of them. Furthermore, this proposal advances the thesis of *shared* government responsibility for service provision since many functions have both local and regional aspects.

spend revenues most effectively,<sup>4</sup> then it needs to be confronted with many service demands, some of which are interrelated. Multiple demands require decisionmakers to trade one off against the other in order to formulate social policy. A classic illustration of this principle is the Federal Government's resolution of a "guns and butter" conflict. With limited funds, the Federal Government has to decide whether to spend each dollar on peacetime, domestic activities or wartime, military programs.

Not only is this process, termed "inter-program evaluation," likely to be socially desirable because it leads to the "best possible" use of scarce resources, but also it promotes overall coordination, both geographic and functional, of interrelated activities. And coordination prevents duplication and waste. One of the major weaknesses of several of the most widely accepted and used approaches to reform of metropolitan government is that these new government units are not responsible for an overview of the entire public service picture, which interprogram evaluation implies.

Two final considerations revolve around the relationship between the government and the public. Hardly any American would dispute the notion that a government's performance should be subject to public control. Accordingly, direct voter control over government's use of resources — for example, referendum on bond issues — merits consideration in any discussion of proposals for government reorganization. Tied in with this idea of voter control over government performance is a companion consideration. Governmental organization should encour-

age a maximum of citizen participation while maintaining effective political performance. This is not to suggest, however, that political punch should be sacrificed to having everyone put in his two cents. Rather, one should be balanced off against the other. Furthermore, this standard of "people-to-government proximity" is not equally important for all types of public services.

### STACKING UP REORGANIZATION PROPOSALS

Most experts would agree that all these considerations have merit, but each may emphasize only one or a few. Therefore, different people may advocate different reform proposals.

Five proposals for government reform which have gained currency in recent years are detailed in Chart 1. Just how do they stack up against all the guidelines?

While metropolitan councils (and planning commissions) are the least satisfactory form of governmental reform, the two-tier metropolitan federation is the most substantial and comprehensive in terms of meeting the guidelines. Councils fall short on all counts; their most serious limitation is their lack of legal powers. The two-tier proposal satisfies all criteria and seems to tap the root of the metropolitan problem — the interdependence of events and the isolation and fragmentation of government. Hence, this alternative appears to offer a viable solution to the problems of our largest urban centers.

Special districts, while meeting many of the same standards as intergovernmental agreements, have the added plus of being nonvoluntary. But special districts deprive local government of far more authority and responsibility than do intergovernmental agreements. Even the quite new and revolutionary proposal for the creation of national cities fails to cope with the most pressing urban difficulty in that it does not take into account the regional nature of metropolitan problems.

<sup>4</sup> "Spending revenues in the most effective manner" implies that the last (or marginal) dollar spent on one activity should provide the same additional (or marginal) public benefits as the last dollar spent on every other activity. This calculation enables policymakers to determine not only what services, but also how much of each, to provide.



**NEEDED: A REDEFINITION**

Since an anachronistic governmental structure is by no means the only source of current metropolitan blight, it should not be expected that governmental reorganization — whatever form it might take — will be the panacea for all metropolitan ills. In fact, government reform is just one step, even though a very important one, towards a comprehensive solution.

But clearly, some restructuring of government along functional lines is called for. If government in metropolitan areas is to be as effective as possible, redefinition of urban government in terms of the impacts of the activities it performs, not in terms of current boundaries and current centers of power, is desirable. Flexible standards of performance, such as those discussed, would

be useful guidelines for reform.

If political obstacles can be eliminated<sup>5</sup> — and this may be no easy task — it would seem that the two-tier metropolitan federation proposal may offer the best long-run solution. Combining an expandable area-wide government with numerous small local units, this innovation would satisfy both the current trend towards centralization and local pressures for diversity and decentralization.

<sup>5</sup> The states and the Federal Government will probably have to initiate changes. The inertia of local governments, their bias towards home rule, and state constitutional restrictions will probably make local governments in metropolitan areas reluctant to undertake reorganization voluntarily. ■

**SUMMARY OF GROUND RULES AND KEY TO TABLE**

- Internalize Spillovers .....IS
- Achieve Economies of Scale .....EOS
- Legal, Financial, and Administrative Ability to Perform Effectively .....APE
- Authority over the Resolution of Conflicting Public Service Demands ..TRADE-OFF
- Subject to Voter Control .....SVC
- Proximity-To-The-People .....PEOPLE POWER

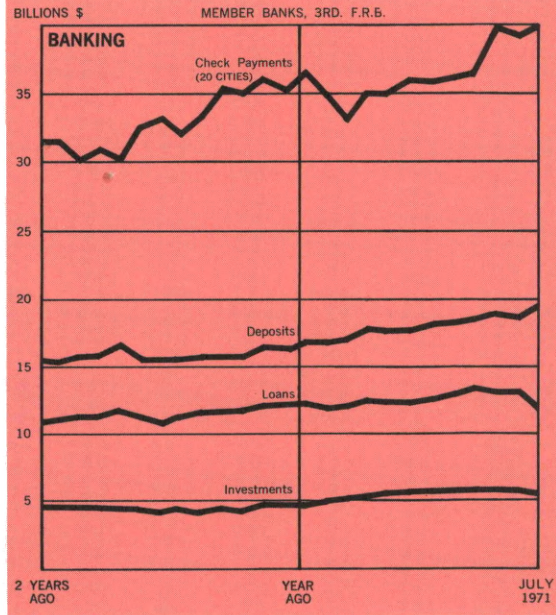
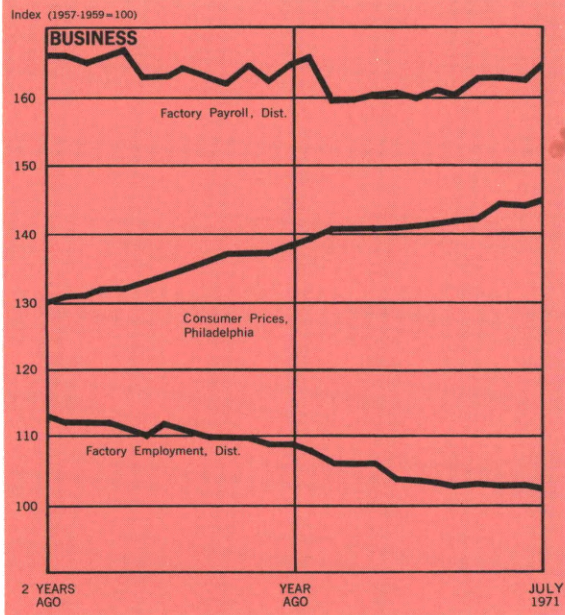
## SIZING UP REORGANIZATION PROPOSALS: THE BALANCE SHEET

Proposal	Description	Advantages and Purposes	Disadvantages
Intergovernmental agreements.	Cooperative contractual arrangements under which one government sells services to another government, or several governments join to provide a specific function.	They make possible the provision of specialized services, may promote orderly metropolitan growth, and forward the achievement of IS and EOS.	Because they are voluntary and, therefore, easily disrupted, they do not satisfy APE. Furthermore, intergovernmental agreements do not offer an effective solution to the TRADE-OFF, SVC, or PEOPLE POWER standards. Their extensive use is likely to weaken local government as it becomes a passive purchaser of services, and they may encourage the exercise of monopoly pricing.
Metropolitan councils and planning commissions.	In effect, they are intergovernmental agreements for the joint conduct of research, planning, and deliberation of areawide issues.	By promoting discussion among local governments in metropolitan areas, they may lay the groundwork for a broadened base of geographic and functional cooperation. Furthermore, since they do not disturb the status-quo, they are politically feasible.	Metropolitan councils do not meet any of the six criteria. The most glaring disadvantage is that councils have no operating functions and lack all legal powers (APE). As forums for discussion, research, and recommendation, their powers are solely persuasive. In addition, they may retard real progress by <i>appearing</i> to accomplish more than they do.
National Cities	Cities with population in excess of 500,000 granted independent status and special powers by Constitutional amendment and Federal Government charter.	While satisfying standards APE, SVC, and PEOPLE POWER, the major advantage of this reform would be the independence and stability accorded by it to our urban centers. Not only would cities get out from under the control of a rural and suburban-dominated state House, but also they would unite in solving common concerns. This structure would enable cities to deal directly with Washington on all major matters and to better finance urban services. Moreover, it would help solidify Federal responsibility for urban development.	National Cities will neither deter nor advance the achievement of IS, EOS, and TRADE-OFF. Furthermore, the idea is not likely to be accepted readily by the state governments, and therefore, may not be politically feasible.

## SIZING UP REORGANIZATION PROPOSALS: THE BALANCE SHEET (continued)

Proposal	Description	Advantages and Purposes	Disadvantages
<p>*Single- or multi-purpose special districts.</p> <p>*The former are also known as authorities; the latter, as metropolitan service corporations.</p>	<p>Independent units of government set up in accordance with state law to perform one (or a few) area-wide public services and to supervise joint regional programs. Boundaries are usually drawn to coincide with the dimensions of the problem(s) to be solved.</p>	<p>Within the limited scope of the function(s) provided, special districts of both types may meet standards IS, EOS, and APE. Both circumvent tax and debt limitations on local governments, avoid lengthy delays associated with more fundamental reform, and establish self-supporting public enterprises financed by user charges. In addition, the multi-purpose district partially satisfies the TRADE-OFF criteria and promotes flexibility — geographically and functionally — while avoiding the establishment of numerous, independent, and uncoordinated single-purpose districts. The multi-purpose district has as an additional attraction, its relative ease of financing.</p>	<p>Single-purpose districts do not satisfy TRADE-OFF and neither form meets SVC or PEOPLE POWER with any success. While both reduce geographic fragmentation, only the multi-purpose district is likely to promote functional coordination of closely aligned functions. There is a tendency for special districts to multiply rapidly and take the place of more fundamental reform. Both weaken independent local government by taking authority for various functions out of its hands. Furthermore, they add layer upon layer to government and increase the distance between community leaders and citizens. Because the multi-purpose district threatens the political status-quo, it is less politically feasible than the single purpose.</p>
<p>Two-tier Metropolitan Federation.</p>	<p>Two levels of government that <i>encompass several counties or towns</i>. An upper level — or “metropolitan government” — would be a new jurisdiction, embracing the totality of the metropolitan area and created to handle all area-wide concerns. The lower level — of “community district governments” — would be adjusted existing units of local government, concerned primarily with local public functions. An important feature of this system is the emphasis on <i>shared</i> power between both levels of government.</p>	<p>This form of governmental reorganization satisfies all our rules, and it provides an adaptable and flexible system for any future adjustments.</p>	<p>This proposal may be too radical to overcome the inertia and vested interests of established units of government and existing city-suburban tensions. Second, it has had little state or Federal support, which would be vital for its successful implementation. And even if these political obstacles could be overcome, two practical problems may prove sticky. First, it will be very difficult to define the boundaries of all jurisdictions — to decide what territory to include and what to exclude, and on what grounds. Second, the proper scale for internalizing spillovers may not be met.</p>

# FOR THE RECORD...



SUMMARY	Third Federal Reserve District			United States		
	Per cent change			Per cent change		
	August 1971 from		8 mos. 1971 from	August 1971 from		8 mos. 1971 from
	mo. ago	year ago	year ago	mo. ago	year ago	year ago
<b>MANUFACTURING</b>						
Production .....				+ 3	- 2	N/A
Electric power consumed .....	- 3	- 3	0			
Man-hours, total* .....	+ 1	- 6	- 8			
Employment, total .....	+ 1	- 6	- 7			
Wage income* .....	+ 1	+ 1	- 1			
CONSTRUCTION** .....	+25	+31	+17	+ 1	+26	+16
COAL PRODUCTION .....	+18	- 5	+ 5	+35	- 3	N/A
<b>BANKING</b> (All member banks)						
Deposits .....	+ 1	+15	+15	0	+14	+16
Loans .....	+ 2	+ 9	+10	+ 2	+ 8	+ 7
Investments .....	+ 2	+29	+27	- 1	+18	+22
U.S. Govt. securities .....	0	+ 9	+12	- 1	+ 5	+15
Other .....	+ 3	+43	+37	0	+27	+27
Check payments*** .....	+ 2†	+12†	+ 6†	+ 5	+17	+15
<b>PRICES</b>						
Wholesale .....				0	+ 4	+ 3
Consumer .....	0‡	+ 5‡	+ 6‡	0	+ 5	+ 5
				†15 SMSA's ‡Philadelphia		

LOCAL CHANGES Standard Metropolitan Statistical Areas*	Manufacturing				Banking			
	Employment		Payrolls		Check Payments**		Total Deposits***	
	Per cent change August 1971 from		Per cent change August 1971 from		Per cent change August 1971 from		Per cent change August 1971 from	
	month ago	year ago	month ago	year ago	month ago	year ago	month ago	year ago
Wilmington ...	- 1	- 1	- 4	+ 3	- 6	+ 2	- 6	+22
Atlantic City ..					+10	+18	+ 3	+22
Trenton .....	0	- 6	+ 4	- 1	+ 5	+11	- 2	+13
Altoona .....	- 3	- 4	0	0	+ 2	+10	- 1	+11
Harrisburg ....	0	- 3	- 1	0	+ 1	+13	+ 3	+13
Johnstown ....	-17	-22	-24	-26	- 4	+32	0	+16
Lancaster .....	+ 2	- 6	+ 4	+ 1	- 5	- 6	+ 1	+85
Lehigh Valley ..	+ 2	- 7	- 2	- 2	+ 4	+11	+ 2	+20
Philadelphia ..	0	- 6	0	0	+ 4	+15	+ 2	+13
Reading .....	+ 4	- 3	+ 4	+ 5	0	+17	+ 1	+ 9
Scranton .....	+ 4	- 2	+ 1	+ 6	-15	+ 1	+ 1	+18
Wilkes-Barre ..	+ 3	+ 2	+ 5	+14	+ 6	+22	+ 1	+14
York .....	+ 2	- 4	+ 1	+ 3	- 5	+ 9	+ 2	-39

\*Production workers only  
\*\*Value of contracts  
\*\*\*Adjusted for seasonal variation

\*Not restricted to corporate limits of cities but covers areas of one or more counties.  
\*\*All commercial banks. Adjusted for seasonal variation.  
\*\*\*Member banks only. Last Wednesday of the month.