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Philadelphia's Budgets:
Past, Present, Future

Sales Levy Crucial to
New Jersey's Tax Revenues

Fighting Poverty with Jobs:
Public and Private Payroll Weapons

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## IN THIS ISSUE . . .

### Philadelphia's Budgets:

### Past, Present, Future

. . . Big assists from Washington and Harrisburg have enabled City and School District budgets to grow substantially; however, inflation ate up a huge proportion of this increase and, as a result, the growth of services has been slowed.

### Sales Levy Crucial to

### New Jersey's Tax Revenues

. . . The Garden State satisfies most of its financing needs through taxes, with the sales tax now the most productive of the revenue-generating sources.

### Fighting Poverty with Jobs:

### Public and Private Payroll Weapons

. . . Making Uncle Sam an "employer of last resort" is one way of guaranteeing an adequate income for every family, but the cost of implementing this policy suggests that combining the strong points of direct Government action and the market economy might be a more effective way to provide family security.

**On our cover:** Wheatland, located on Marietta Avenue in Lancaster, Pa., is the historic home of James Buchanan, 15th President of the United States (1857-61). The mansion was built in 1828 by a Lancaster banker, who named it "The Wheatlands" because of the fields of waving grain that surrounded his new home. Through usage the name was eventually simplified to "Wheatland." Overlooking a gentle slope of lawn and flanked by tree-lined driveways, the house has been restored to its original state, with authentic pre-Civil War furnishings. (Photograph courtesy of The James Buchanan Foundation for the Preservation of Wheatland, Lancaster, Pa.)

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# Philadelphia's Budgets: Past, Present, Future

*By William A. Cozzens*

Spring is budget time in Philadelphia. The City and the School District present their proposed operating budgets for the fiscal year. Both documents are long and complex. So, often, are the debates over them. Despite considerable newspaper and TV coverage, the average citizen has trouble finding out what is going on, much less what is at stake for City tax dollars.

Three years ago the Federal Reserve Bank of Philadelphia published a study that sought to clarify some of the issues involved in the operating budgets of the City and the School District.[1] Reviewing past trends and expenditures, the Fed study concluded that large deficits were inevitable for both City and School District budgets, unless new revenue sources were developed or services were curtailed.

Three years later there are no large deficits. What has happened? In a nutshell, new revenue, largely in the form of Federal Revenue Sharing, closed the gap between income and expenditures. At the same time, though, inflation gnawed away at the purchasing power of the City's dollars, reducing the real growth in City expenditures. For the School District, new aid from the Commonwealth generated some revenue growth, but inflation absorbed most of the increases. As a result, School District outlays on the whole have shown virtually no *real* growth with cuts occurring in some areas, notably Senior High, Special Education, and School District Administration. Unraveling the "Mystery of the Missing Budget Deficit" in more detail requires an understanding of what the fiscal situa-

[1] David W. Lyon, "The Financial Future of City and School Government in Philadelphia," *Business Review* of the Federal Reserve Bank of Philadelphia, March 1971, pp. 3–71.

tion in the City and the School District has been, and what it is now.

## IN 1970, WHAT WAS THE FISCAL PICTURE AHEAD?

On the expenditure side, the Philadelphia Fed study showed that municipal and school outlays increased dramatically during the 1960s. Two factors were at work. Real expenditures—expenditures after the effects of inflation have been removed—rose substantially during the 1960s. Inflation pushed costs ever higher: Teacher and municipal employee salaries climbed rapidly, as did the prices of other items bought by the City and School District.

On the revenue side, the study identified two important trends. First, City and School District taxes were consuming an increasing proportion of personal income. This growing tax burden generated strong resistance to further increases in local taxes. Second, the City and School District were becoming more dependent on intergovernmental revenues—transfers from Washington and Harrisburg—to finance the provision of services. This increase in nonlocal support for expenditures meant that the City would be increasingly reliant on decisions by others to insure adequate provision of services.

Building on these past trends, the Philadelphia Fed in 1970 projected what the budget picture would look like in fiscal 1975 without major policy changes by the City or the School District. The picture was gloomy. Nearly all indicators of the need for municipal services were projected to continue rising during the 1970–75 period. Inflation, in the form of both increasing salaries and other rising costs, was expected to continue. But revenues, relatively unresponsive to inflation, were not expected to rise as rapidly. Thus, according to the study, without policy changes such as larger intergovernmental grants, there would have been a growing gap between revenue and the expenditures necessary to meet those increasing service and educational needs. When combined, the City and School District budget deficits were projected to be a staggering $235 million in 1973 if no remedial action was taken.[2]

Yet, as the Fed study noted, legal and economic constraints prevent the City and School District from posting operating deficits of this magnitude. Clearly something had to give. The policy conclusion of the study was straightforward: To maintain the '60s trend of supplying increasing levels of service and real expenditures in response to expanding demands, the City and the School District would have to find significant new revenue sources. The alternatives to this were some combination of (1) a slowdown in the rates of increase in provision of services, including possible cutbacks, and (2) increases in productive efficiency so the City and School District could squeeze more output from each dollar.

## HOW DID THE FISCAL PICTURE DEVELOP THROUGH '73?

Both the City and the School District registered balanced budgets in fiscal 1973, so some major changes did take place.[3] What were they? Did revenues rise to keep pace with both inflation and the increasing demand for services? Or did City and School District officials harness expenditures and limit their response to the growing demand for services? Both events occurred. The City and the School District received a strong helping hand with revenues through intergovernmental transfers. And, both City and School District expenditures did not grow as rapidly as projected by the Fed.

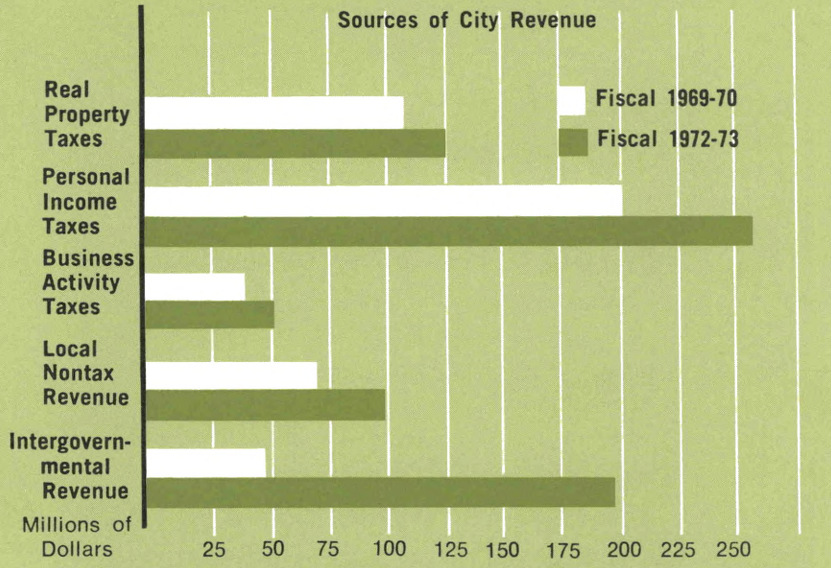
**Revenues: A Helping Hand from Washington and Harrisburg.** The City boosted its revenue take more than 55 percent from fiscal 1970 to fiscal 1973. Almost 60 percent of this growth came from an expansion of intergovernmental

[2] Ibid., p. 19.

[3] This article examines revenues and expenditures in the City's General Fund, Anticipated Grants Revenue Fund, the Special Gasoline Tax Fund, and the County Liquid Fuel Tax Fund. Model Cities and the Economic Opportunity Program are not analyzed. Fiscal 1973 covers the budget period from July 1, 1972 to June 30, 1973. This is the last full fiscal year for which exact expenditure data are available. The analysis of the School District focuses on its General Fund.

CHART 1

INTERGOVERNMENTAL REVENUES WERE THE FASTEST-GROWING SOURCE OF FUNDS FOR THE CITY . . .




Source: Data presented in Appendix 1.

aid—transfers from Washington and Harrisburg. In effect, this means that Federal and State contributions to the City's budget grew from about 10 percent in 1970 to almost 30 percent in 1973. (Chart 1 and Appendix 1 show this revenue growth.) Locally, the largest City revenue increases came from the wage and salary tax. The wage tax is a good revenue source in periods of inflation. Because it is a percentage levy on all wages, collections increase as wages go up in periods of rising prices. The City gets a constant percentage of this growing income base. Thus, from 1970 to 1973 collections from the wage tax (up 27 percent) have more than kept pace with the City's increasing costs (up 23½ percent).

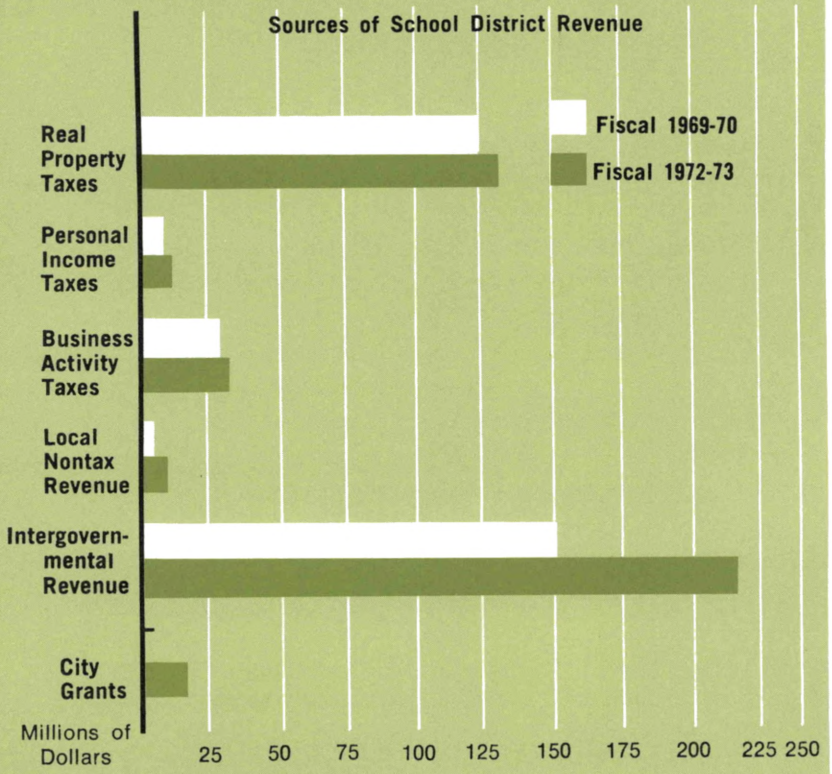
Like the City, the School District received a revenue boost from intergovernmental transfers (see Chart 2 and Appendix 2). In fact, these transfers provided the lion's share of School District revenue growth. In contrast to the City, however, the School District felt more of a revenue pinch from inflation because the District draws heavily on the real estate tax for local revenue. Among other drawbacks this tax does not respond to inflation as does the wage tax. The problem is twofold. First, property values in large central cities like Philadelphia often do not go up as fast as do prices in the economy as a whole. Slack demand for central city locations dampens what might otherwise be rapid price increases. Second, even when property values are climbing, these escalating values will not translate into higher tax revenues without reassessment.

For both reasons the School District would face a revenue shortfall as the soaring costs of services outpaced revenue growth. From 1970 to 1973 this indeed happened. Property tax revenues climbed only 11 percent.[4] Periodic reas-

[4]The City Finance Director's Office reports that between 1968 and 1972 the ratio of property tax assessments to sales prices fell from 53.6 to 42.9 percent. This would tend to confirm the second reason for the inelasticity in property taxes—assessments are not keeping up with increases in property value.

CHART 2

AND FOR THE SCHOOL DISTRICT




Source: Data presented in Appendix 2.

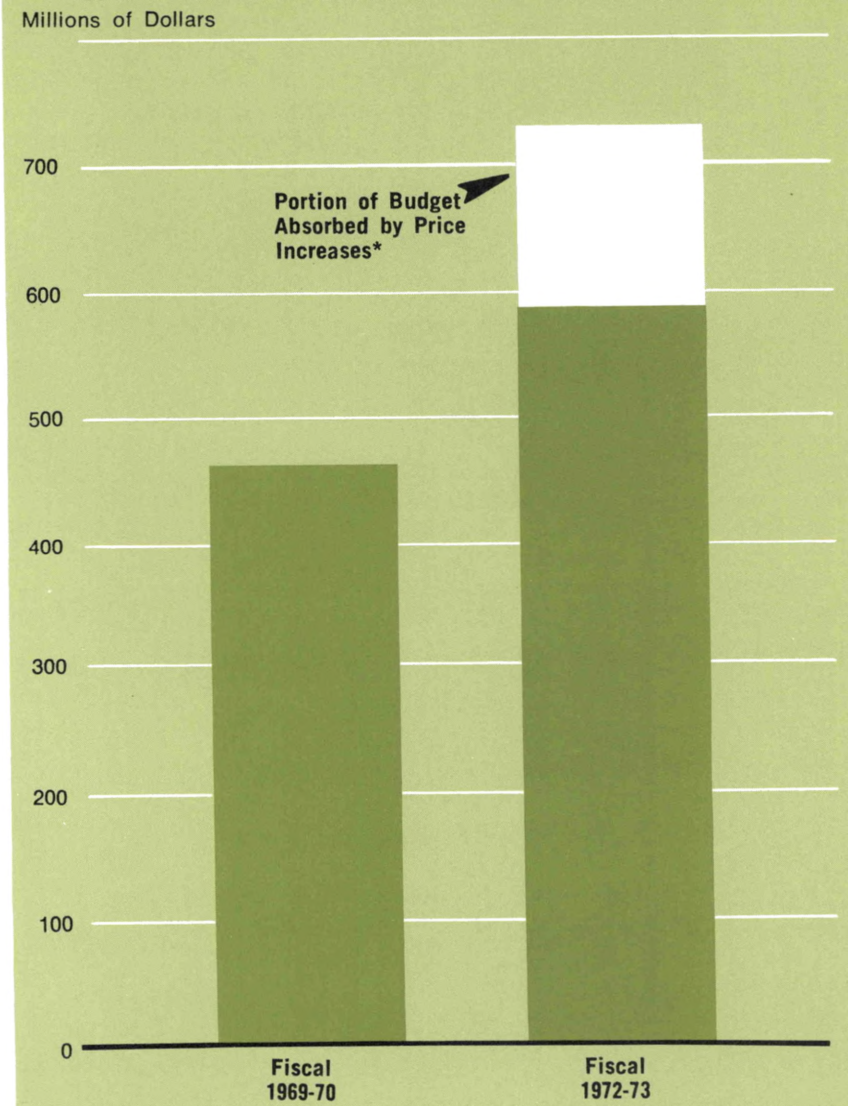
sessment of real property would have partially remedied this problem, but reassessment is an administrative process that is costly, time-consuming, and frequently meets strong political opposition. Moreover, the property tax is thought by most to be regressive—that is, its burdens fall more heavily on poorer people—so increases are undesirable on equity grounds. In short, the School District finds its local revenues tied to a tax with limited elasticity in a period of rapidly rising income and demand for government services. Consequently, it has had to rely increasingly on outside aid.

**Expenditures: Less Bang for the Buck.** To avoid any deficit or surplus, growth in expenditures must equal growth in revenues. From fiscal 1970 to fiscal 1973 *current* dollar expenditures for the City swelled by 55 percent to $729 million. The School District's expenditures climbed 21 percent to $340 million.

The growth in current dollar expenditures, however, tells only part of the story. Inflation hit both the City and the School District hard. Also, all departments and expenditure categories in the City and the School District did not enjoy the same growth after adjusting for the effects of inflation. Thus, two questions stand out: How much of the budget increases have gone to pay for inflation? And, after adjusting for inflation, which services chalked up gains and which, if any, suffered losses?

CHART 3

HIGHER PRICES ACCOUNTED FOR MORE THAN HALF OF THE 55 PERCENT INCREASE IN CITY EXPENDITURES




* Price increases calculated on 1969-70 dollar base.

Source: Data presented in Appendix 4.

For the City, inflation consumed 55 percent of the budget growth between 1970 and 1973 (see Chart 3). All prices were up sharply, but wages climbed fastest—almost 34 percent. A hefty portion of these wage increases came from binding arbitration decisions granting City policemen and firemen substantial pay hikes in 1971. The net effect of the wage and price increases is that the City's purchasing dollar in '73 buys about 20 percent less than it did in '70. (See Box 1 and Appendix 3 for a more detailed discussion of price changes.)

Because of inflation, real expenditures on City services have grown by slightly less than 26 percent, in contrast to the 55 percent jump in current dollar expenditures. Of the 26 percent real growth, 25 percent was funded by State and Federal sources.

Now the second question is, which departments or activities have benefited from this real budgetary growth? As might have been expected, all programs did not grow proportionately. Several grew rapidly during the period, with Pensions and Employee Benefits the

BOX 1

## SPURRED BY BIG WAGE SETTLEMENTS PRICES OF CITY AND SCHOOL DISTRICT SERVICES ROSE RAPIDLY

Higher budgets do not necessarily mean higher levels of service. In periods of rapid inflation, a significant portion of any revenue increases must offset the rising costs of government services, rather than pay for more services. In Philadelphia the cost of providing services climbed sharply from 1970 to 1973. For both the City and the School District wage increases led the inflationary spiral—up 34 percent for municipal employees, up 27 percent for School District employees. Prices for other expenditure categories climbed, but not as fast.

The accompanying tables summarize City and School District price changes. Different expenditure categories show different rates of inflation. The tables also show the percent each expenditure category occupies in the total budget. Appendix 3 explains how these price changes were estimated.

**CITY PRICE CHANGES**

| | Percent Price Change 1969–70 to 1972–73 | Percentage of City Budget (Weights) |
|---|---|---|
| WAGES | | |
| Policemen and Firemen | 38.4% | |
| Nonuniformed Employees | 30.9 | |
| WEIGHTED AVERAGE | 33.6 | 53% |
| PURCHASE OF OTHER GOODS AND SERVICES | 10.7 | 23 |
| DEBT SERVICE AND PENSIONS AND EMPLOYEE BENEFITS | 13.3 | 24 |
| | | 100% |
| WEIGHTED AVERAGE OF PRICE CHANGES FOR CITY SERVICES | 23.5% | |

### SCHOOL DISTRICT PRICE CHANGES

| | Percent Price Change 1969–70 to 1972–73 | Percentage of Total Budget (Weights) |
|---|---|---|
| Personal Services and Employee Benefits | 26.6% | 76.3% |
| Nonpersonal Services | 10.7 | 8.5 |
| Debt Service | 13.3 | 14.9 |
| | | 100.0% |
| WEIGHTED AVERAGE SCHOOL DISTRICT PRICE CHANGES | 21.6% | |

most—almost 75 percent! Court activities and Health expenditures—including Philadelphia General Hospital—also grew substantially. Except for the Fire Department, all other departments grew but at more moderate rates. These include Debt Service, Welfare, the Streets Department, Police, Recreation, and other general administrative activities. The Fire Department's expenditures remained virtually constant. (Box 2 and Appendix 4 tell the story in detail.)

Inflation, then, meant that the growth in real services in the City was considerably less than the more visible dollar growth. Two of the categories which, in real terms, grew rapidly —Debt Service and Pensions and Employee Benefits—were ones over which the City administration had little control. The growth of two others—Courts and Police—reflects the law enforcement platform of the present administration and presumably the preferences of the voting majority of Philadelphians.

For the School District, it is more difficult to draw precise conclusions about budgetary developments through 1973. The teacher strike disrupted many of the long-term trends in spending. Whether looking at expenditure estimates made prior to the strike or actual outlays for the year, several important facts do, nevertheless, stand out. As Chart 4 indicates, inflation ate up a huge proportion of budget growth. In fact, actual School District outlays, when adjusted for the effects of inflation, show a slight decline from 1970 levels. If the strike had not occurred and the School District had experienced a more "normal" year, there would have been some real budget growth (although as the discussion of revenues has indicated, it is unclear where the District could have gotten the money to pay for a "normal" year).

How has the School District responded to the problem of limited revenue gains coupled with rapidly rising prices? Except for mandatory increases in Debt Service, little expenditure growth has been permitted in any budget category. Because elementary school enrollments have been declining, the District has been able to reduce the number of teachers and cut expenditures in the elementary grades. Some of these resources have been reallocated to junior high and middle schools where enrollments have increased slightly. Proportionately, the largest budget cutbacks have occurred in School District administration and other support functions. At the same time, there have been some expenditure and staff increases for plant operations and building maintenance. (Chart 5 and Appendix 5 show the changes in the particular expenditure items in greater detail, with a comparison of the budget estimates without a strike and the actual expenditures incorporating the effects of the strike.)

Summing up, then, the School District, hit hard by rising prices and tightly limited resources, pared a number of expenditure items—Senior High, Special Education, and Administrative Support. Still, however, the

BOX 2

## REAL CITY EXPENDITURES CHANGED UNEVENLY BETWEEN 1970 and 1973

| City Department | Percent Change |
|---|---|
| Pensions and Employee Benefits | +74.0% |
| Courts | +45.2 |
| Health Dept., P.G.H. | +45.0 |
| Other | +23.6 |
| Debt Service | +19.5 |
| Welfare | +18.3 |
| Streets Department | +10.3 |
| Police Department | + 8.8 |
| Recreation | + 6.5 |
| Fire Department | − 2.8 |
| TOTAL REAL EXPENDITURE GROWTH | +25.6% |

| | |
|---|---|
| Real Expenditure Growth from Intergovernmental Revenue | +24.6% |
| Real Expenditure Growth from Local Revenue | + 1.0% |

The largest rate of increase—even after eliminating price changes—has been registered by Pensions and Employee Benefits. The City has tried to catch up in the reduction of its actuarial liability, so contributions to the Pension fund have expanded rapidly. Also labor settlements have included some increases in Employee Benefits.

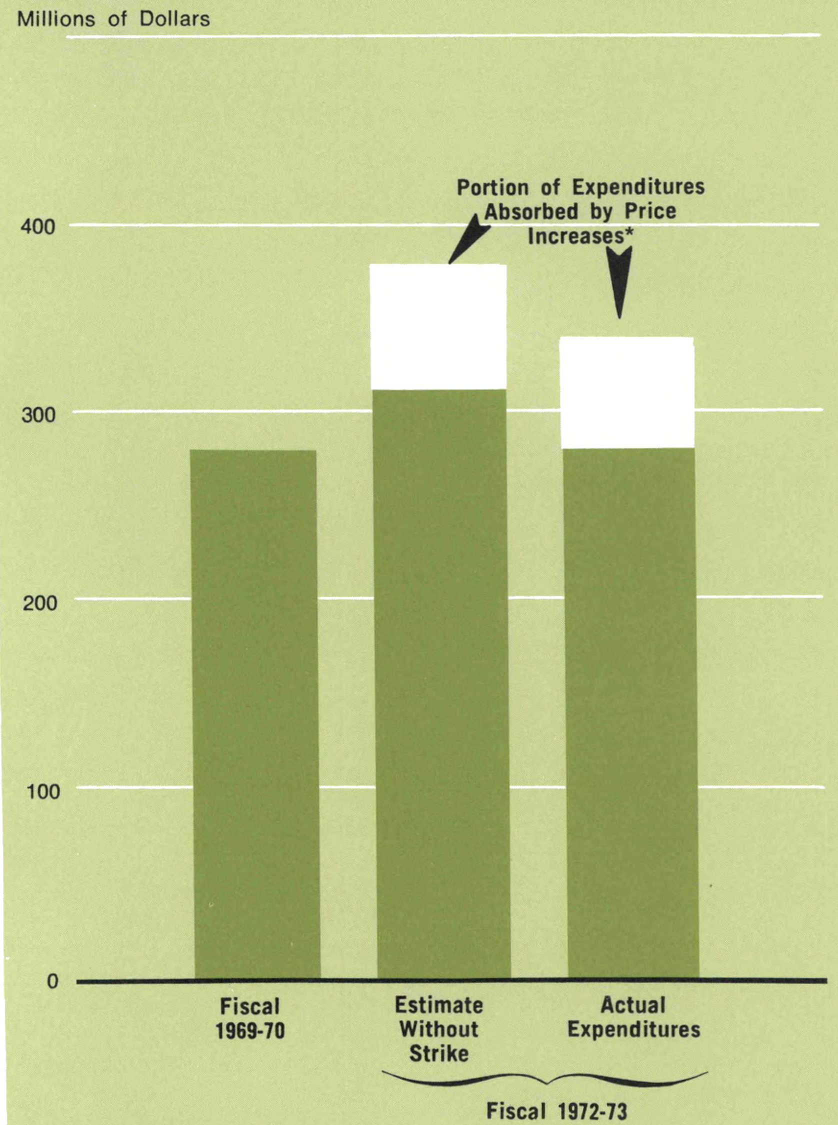
The strong growth in Court expenditures and the more moderate increase in Police are consistent with the emphasis of this administration on crime prevention and law enforcement.

The Health Department and Philadelphia General Hospital also substantially increased real expenditures during this period. In addition to Police, all other activity areas except the Fire Department increased their real expenditures moderately. Real expenditures for the Fire Department declined very slightly.

Intergovernmental revenues supported the bulk of all expenditure increases. When City revenues (see Appendix 1) are corrected for the effects of inflation, 96 percent of the remaining real growth comes from intergovernmental sources. Of the 25.6 percent growth in *real* expenditures, only 1 percent was funded from City sources, whereas 24.6 percent was funded by Washington or Harrisburg.

CHART 4

SCHOOL DISTRICT EXPENDITURE GROWTH, WITH AND WITHOUT STRIKE IMPACT

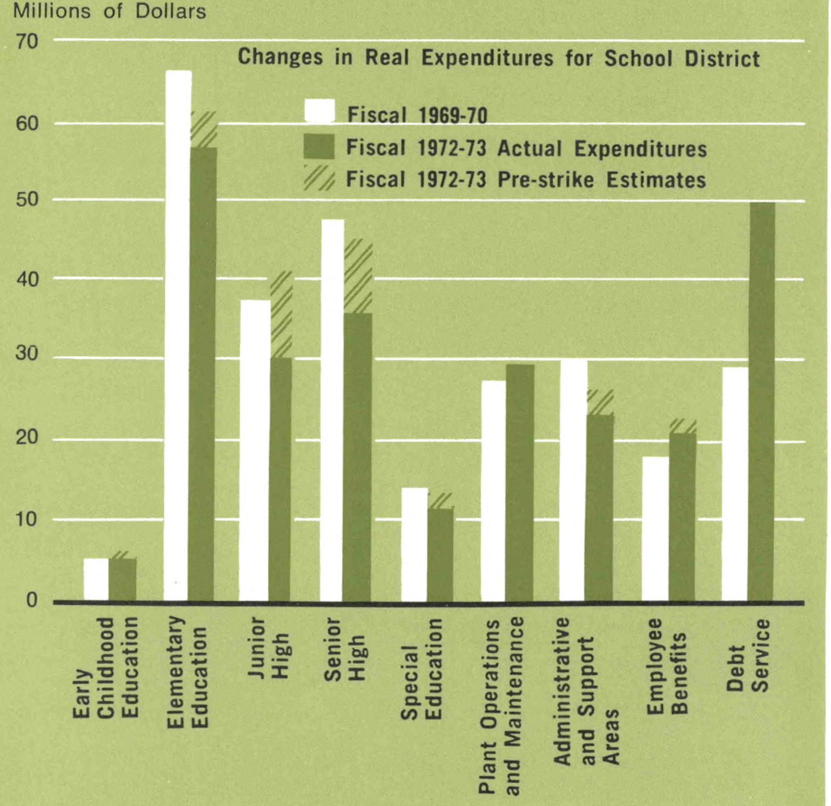



* Price increases calculated on 1969-70 dollar base.

Source: Data presented in Appendix 5.

CHART 5

DEBT SERVICE, EMPLOYEE BENEFITS, AND BUILDING MAINTENANCE WERE THE ONLY SCHOOL DISTRICT EXPENDITURE ITEMS SHOWING REAL GROWTH




Source: Data presented in Appendix 5.

teacher strike was the main factor preventing a large deficit in '73.

## PROSPECTS FOR THE FUTURE

What is the budget picture, then, as Philadelphia approaches fiscal 1975? It is hard not to be somewhat pessimistic. On the surface, expenditures from fiscal 1970 through fiscal 1973 appear to have climbed substantially. However, when the effects of inflation are removed, the growth in real expenditures has been much slower. Revenues have, for the City at least, kept just ahead of inflation. The City has been in better fiscal shape because of the wage tax, but above and beyond that, Revenue Sharing and other intergovernmental aid bailed the City out of its immediate fiscal predicament. The School District is in a less secure position. The strike settlement mandated staff increases as well as salary and benefit hikes which, of course, will cost money. The District appears to have attempted some economies through staff reductions in the administrative and support areas. But it is unclear where additional cuts can be made under the teacher contract provisions.

What are the City's prospects for the future? If the City can maintain or improve its employment base, the wage tax should provide continued revenue growth. On the bearish side, Revenue Sharing may prove to have been only a stopgap.

If Revenue Sharing funds fail to keep pace with rising costs, then the City will have to trim services or find additional sources of revenue. Without additional help from outside revenue sources, the Mayor's promise of no new taxes may require the equally unpopular alternative of reduced services—unless rapid increases in efficiency occur.

The future for the School District is even harder to predict. Costs will continue to rise. Also, the widely recognized necessity for improved educational achievement by poor and minority students will persist for some time. In the immediate future there is little prospect of substantially increased aid from Harrisburg, and although Federal Revenue Sharing for education is still under discussion, it may well involve no new money. Some financial reforms may, nevertheless, lie ahead. In several states court decisions are requiring more equitable financing formulas for state educational aid. Revised financing methods and a formula for state aid more fully reflecting the special requirements of educating disadvantaged students could generate additional revenue for school districts of large urban areas such as Philadelphia.

In the meantime, the City and the School District face some hard choices. Without aid from Harrisburg or Washington, Philadelphia must either raise taxes, cut services, or try to improve the efficiency and effectiveness with which services are provided. This third alternative—getting more impact out of each dollar—is not a panacea, but a number of cities have enjoyed significant improvements in productivity of certain municipal services through systematic analysis.[5] Philadelphia would do well to step up its efforts in this direction.

[5]Many cities are discovering that productivity increases in municipal services can be achieved through the use of analytical models. In New York City, where The New York City-Rand Institute is based, $12.6 million per year is being saved by the Fire Department alone—fire protection resources were reallocated and adaptive responses to fire alarms are used. Denver, Tacoma, Jersey City, Columbus (Ohio), Washington (D.C.), Wilmington (Delaware), and Yonkers are now developing and using these efficiency methods. Health services, sanitation, water pollution, police protection, and the criminal justice system have all been examined with many successful results, using these more sophisticated operations research methods. For additional information on increasing productivity in municipal services, see David P. Eastburn, "Productivity in Urban Areas," and Kathryn L. Kindl, "Boosting Productivity in Local Government: Progress and Problems," *Business Review* of the Federal Reserve Bank of Philadelphia, February 1972 pp. 3–9.

# APPENDIX 1

## MORE THAN HALF OF PHILADELPHIA'S REVENUE GROWTH CAME FROM THE U.S. GOVERNMENT AND THE COMMONWEALTH OF PENNSYLVANIA

| Revenue Source | 1969–70 ($ Millions) | Revenue Percent | 1972–73 ($ Millions) | Revenue Percent | Percent Growth in Revenue 1969–70 to 1972–73 | Percent of Total Revenue Growth |
|---|---|---|---|---|---|---|
| LOCAL REVENUES | | | | | | |
| Real Property Taxes | $111.3 | 23.7% | $124.7 | 17.1% | + 12.0% | 5.1% |
| Personal Income Taxes | $201.9 | 43.0 | 257.2 | 35.2% | + 27.4 | 21.2 |
| Business Activity Taxes | 40.8 | 8.7 | 51.0 | 7.0 | + 25.0 | 3.9 |
| Local Nontax Revenue | 71.0 | 15.2 | 99.2 | 13.6 | + 39.7 | 10.8 |
| Total Local | $425.0 | 90.6% | $532.1 | 72.9% | + 25.2% | 41.0% |
| INTERGOVERNMENTAL REVENUE[1] | | | | | | |
| Commonwealth[2] | $ 36.7 | 7.6% | $ 94.0 | 12.9% | + 156.1% | 22.0% |
| Federal | 5.7 | 1.2 | 101.1 | 13.8 | +**1674.0** | 36.6 |
| Other | 2.0 | 0.1 | 2.8 | 0.1 | + 40.0 | 0.0 |
| Total Intergovernmental | $ 44.4 | 9.4% | $197.9 | 27.1% | + 345.7% | 58.6% |
| TOTAL LOCAL AND INTERGOVERNMENTAL REVENUES | $469.4 | 100.0% | $730.0 | 100.0% | + 55.5% | 100.0% |

Source: 1969–70 date from David W. Lyon, "The Financial Future of City and School Government in Philadelphia," *Business Review* of the Federal Reserve Bank of Philadelphia, March 1971, pp. 3–71; 1972–73 from Table 3. City of Philadelphia, *Financial Report Fiscal Year 1973*, Office of Director of Finance, October, 1973, p. 5, p. 105.

[1]In 1973 Intergovernmental revenues entered the City's budget through both the General Fund and the Anticipated Grants Revenue Fund. The revenue for the two Funds breaks down as follows: Aid from the Commonwealth: $82.5 million General Fund and the fuel funds referred to in note 2; $11.4 million Anticipated Grants Revenue Fund. Federal aid: $78.2 million General Fund; $22.9 million Anticipated Grants Revenue Fund. In the 1973 Financial Report, the total Federal contribution to the AGRF was $34.8 million. $11.9 million of that revenue went to Model Cities and the Economic Opportunity Program, neither analyzed in this article.

[2]Commonwealth aid here includes revenues from the Liquid Fuels Tax and the Special Gasoline Tax: $6.8 million in 1970, $11.5 million in 1973.

# APPENDIX 2

## FOR THE SCHOOL DISTRICT, GOVERNMENT AID WAS THE MAIN SOURCE OF SIGNIFICANT REVENUE GROWTH

| Revenue Source | 1969–70 Revenue Millions | 1972–73 Revenue Millions | Percentage Growth in Revenue | Percentage of Total Revenue Growth |
|---|---|---|---|---|
| Real Property Taxes | $ 95.2 | $105.1 | + 10.4% | + 10.2% |
| Personal Income Taxes | 7.5 | 8.3 | + 10.7 | 0.8 |
| Business Activity Taxes[1] | 28.8 | 29.2 | + 1.4 | 0.4 |
| Local Nontax Revenues | 2.9 | 7.4 | +155.2 | 4.7 |
| Intergovernmental Revenues | | | | |
| Commonwealth | 140.0 | 210.7 | + 50.5 | **72.1** |
| Federal | 6.0 | 5.0 | − 16.7 | − 1.0 |
| City Grant[2] | | 12.0 | | 12.3 |
| TOTAL | $280.4 | $377.7 | + 34.7% | 100.0% |

Source: 1969–70 date from David W. Lyon, op. cit., 1972–73 data from The School District of Philadelphia, *Annual Financial Report,* Fiscal Year Ending June 30, 1973, p. 3.

[1]In 1972 the School District faced a Pennsylvania State Legislature-imposed choice—eliminate the corporate net income tax or abolish the general business tax. The Legislature argued that the imposition of both these local business taxes placed too high a tax burden on businesses. The Philadelphia Tax Study Committee recommended the elimination of the corporate income tax rather than the general business tax. As a result, the School District lost approximately $14 million per year in revenue. The small gain in total business activity taxes comes as a result of increasing revenues from the commercial occupancy tax and the general business tax.

[2]This is a one-time grant from the City. A revenue transfer from the City has become permanent through a shift of 4 mills of real estate tax from the City to the School District. The Finance Director's office reports that the average annual yield will be $20 million.

# APPENDIX 3

## CITY AND SCHOOL DISTRICT PRICE INCREASES

To estimate the impact of inflation, economists construct a "price deflator"—that is, a weighted average of all the price increases for the labor, goods, and services bought by a consumer (in this case, the City or School District of Philadelphia).

Ideally a deflator should include all of the individual price changes for the many items and types of services purchased. This detailed information is not available for the City or the School District, so some averages and estimates must be used. To develop an estimate of the total impact of inflation, budgets for the City and School District have been divided into several major categories. Price changes have been estimated for each category. Then the price changes have been averaged, each weighted by its percentage in the total budget.

# APPENDIX 3 (continued)

For both the City and the School District, the budget was divided into three major categories: Wages and personal compensation; purchases of other goods and services; and payments to Debt Service and Employee Benefits. For the School District, employee benefits were included in personal compensation to simplify the estimate.

**Wages and Personal Compensation.** For the City, data on wage changes were taken from published sources updated with information from the Personnel Director's Office.[1] The specific wage settlements for uniformed and nonuniformed employees were converted into annual rates of growth, weighted by their percentage in the total wage bill and averaged to get the overall wage inflation.

The price deflator for personal services in the School District was estimated from data on number of staff positions and personal services expenditures found in the Summary of the Proposed Operating Budget of the School District of Philadelphia for fiscal 1971 and fiscal 1973.

To arrive at an overall wage deflator the average per capita compensation by program and educational unit was calculated for fiscal 1970 and fiscal 1973. The percentage change from fiscal 1970 to fiscal 1973 was calculated. These program specific wage deflators were weighted by their percentage in the total School District wage bill and averaged.[2]

**Purchase of Other Goods and Services.** Items included in this expenditure category range from pencils and paper clips to police cars and payments for child care. Neither the City nor the School District publishes information on these price changes. As a substitute, the nonpersonal services element of the U.S. Price Deflator for State and Local Government Purchase of Goods and Services was used. The assumption here is that Philadelphia has faced the same price changes as other cities across the country.

**Debt Service and Employee Benefits.** The rate of inflation in the Philadelphia Consumer Price Index was used as the deflator for Debt Service in the City and the School District and for City Employee Benefits.

[1] *Philadelphia Municipal Employees. Compensation Chronology, 1953–1971.* Bureau of Labor Statistics, Mideast Region, Regional Report No. 3, November 1971; *Philadelphia Municipal Employees. Compensation Chronology.* (Supplement No. 1) Bureau of Labor Statistics, Mideast Region, Regional Report No 7, September 1972.

[2] Personal Service Price Change $= \sum_{c=1}^{n} W_c \frac{(C_{c73} \div P_{c73})}{(C_{c70} \div P_{c70})}$

When: C = personal compensation expenditure
P = number of staff
c = School District expenditure category
70,73 = the two fiscal years
W: = weight, fraction of total School District personal compensation in expenditure category c.

# APPENDIX 4

## REAL CITY EXPENDITURES CHANGED UNEVENLY

| City Department | (1) Actual Expenditures in Current Dollars — General Fund 1969–70 | (2) General Fund 1972–73 | (3) Other Grants* 1972–73 | (4) TOTAL 1972–73 (2) + (3) | (5) Price Deflator[1] 1969–70 = 100 | (6) Total Real Expenditures 1969–70 Dollars ($M) | (7) Percent Real Expenditure Growth 1969–70 to 1972–73 |
|---|---|---|---|---|---|---|---|
| Courts | $23 | $ 38.9 | $ 3.4 | $ 42.3 | 126.7 | $ 33.4 | +45.2% |
| Debt Service | 59 | 79.9 | — | 79.9 | 113.3 | 70.5 | +19.5 |
| Fire Department | 30 | 39.7 | .2 | 39.9 | 136.9 | 29.1 | − 2.8 |
| Health Dept., P. G. H. | 45 | 74.9 | 4.0 | 78.9 | 120.9[2] | 65.3 | +45.0 |
| Pensions & Employee Benefits | 43 | 84.8 | — | 84.8 | 113.3 | 74.8 | +74.0 |
| Police Department | 85.3[3] | 124.3 | 2.7 | 127.0 | 136.9 | 92.8 | + 8.8 |
| Recreation | 26.7[3] | 30.0 | 6.3 | 36.3 | 127.6 | 28.4 | + 6.5 |
| Streets Department[4] | 46.8 | 58.2 | 6.6 | 64.8 | 125.6 | 51.6 | +10.3 |
| Welfare | 39 | 49.8 | 4.6 | 54.6 | 118.1[2] | 46.1 | +18.3 |
| Other | 72 | 95.9 | 12.2 | 108.0 | 121.4 | 89.0 | +23.6 |
| Payment to School District | | 12.0 | — | 12.0 | 113.3 | 10.6 | |
| TOTAL | $469.8 | $689.3 | $40.0 | $729.3 | 123.5 | $590.0 | +25.6% |

Sources: Column 1 from Lyon, op. cit., Column 2 from Schedule I-A-2d-2, City of Philadelphia, *Financial Report Fiscal Year 1973*, Office of Director of Finance, October, 1973, pp. 28–35, *Column 3, Anticipated Grants Revenue Fund from Schedule I-A-18b-2, ibid, pp. 100–103.

[1]Price deflators were calculated using the procedure outlined in Appendix 3. The deflators for Debt Service, Pensions and Employee Benefits, and the payment to the School District used the Philadelphia Consumer Price Index.

[2]The deflators used for the Health Department and Welfare probably underestimate total price increases. Both of these departments contract with outside agencies for the provision of services. A significant portion of these payments goes for wages and salaries. The rate of inflation for wages and salaries probably exceeds the deflator used here (110.7).

[3]Between 1969–70 and 1972–73 the Fairmount Park Patrol was shifted from the Recreation category (under the Fairmount Park Commission) to the Police Department. To reflect this change, Police and Recreation expenditures for 1969–70 have been adjusted by subtracting Park Patrol expenditures from the Recreation category and adding them to the Police Department. (Park Patrol amount equals $5.3 million.)

[4]The Street Department receives revenue from two State sources: the Special Gasoline Tax and the County Liquid Fuels Tax. In 1970 revenue from the two sources was $6.8 million; in 1973, $11.5 million. Although not part of the General Fund, these amounts are included in the Column 1 and 2 Streets Department expenditures and are also reflected in the expenditure totals.

# APPENDIX 5

## DETAILS OF EXPENDITURES ON SCHOOL SERVICES 1969–70 TO 1972–73

| | (1) 1969–70 Expenditures[1] ($Millions) | (2) Total Real 1972–73 Expenditures In 1969–70 Dollars ($Millions) Pre-Strike[2] Estimates | (3) Post-Strike[3] Actuals | (4) Percent Change in Staff Positions[4] 1969–70 to 1972–73 | (5) Percent Change in Student Enrollment[4] 1969–70 to 1972–73 |
|---|---|---|---|---|---|
| Early Childhood | $ 6.0 | $ 6.2 | $ 6.0 | −15.4% | −29.6% |
| Elementary Education | 66.6 | 61.6 | 56.5 | − 6.8 | −10.4 |
| Junior High | 37.4 | 41.1 | 31.0 | +11.5 | +12.0 |
| Senior High | 47.7 | 45.3 | 36.3 | − 2.2 | + 1.4 |
| Special Education | 14.6 | 13.9 | 12.1 | − 4.1 | −11.4 |
| SUB-TOTAL EDUCATION ELEMENTS | 172.3 | 168.0 | 141.7 | − 1.6 | − 5.7 |
| PLANT OPERATIONS AND MAINTENANCE | 27.4 | 30.4 | 30.2 | + 7.1 | |
| ADMINISTRATION AND SUPPORT AREAS | 33.5 | 29.3 | 27.1 | −4.7 | |
| DEBT SERVICE | 29.5 | 50.0 | 49.4 | | |
| EMPLOYEE BENEFITS | 18.6 | 23.0 | 21.2 | | |
| P.F.T. Settlement | | 4.9 | | | |
| TOTAL | $281.3 | $313.0 | $279.7 | − 0.6% | |

[1]Between fiscal 1970 and fiscal 1973 the School District changed its accounting procedures for Employee Benefits, from assigning the costs of benefits to each budgetary unit to a separate aggregation of total employee benefits. In 1969–70 Employee Benefits have been subtracted from each budget unit and counted separately.

[2]From the *Summary of the Proposed Operating Budget for the Fiscal Year Beginning July 1, 1973,* School District of Philadelphia. "Proposed Revised 1972–73 Budget" deflated by department specific price deflators (see Box 3).

[3]*Annual Financial Report Fiscal Year Ending June 30, 1973.* School District of Philadelphia, pp. 5–8. Expenditures were deflated by department specific price deflators (see Box 3).

[4]From the *Summaries of the Proposed Operating Budgets,* School District of Philadelphia, for fiscal 1970 and fiscal 1973.

**Enrollment.** According to the official School District figures, total enrollment has declined from 298,525 in 1969–70 to 279,427 in 1972–73. The last column in the table shows the percentage enrollment changes by educational levels. Declines have occurred in the early childhood and elementary grades while junior and senior high enrollments have grown.

## APPENDIX 5 (continued)

**Personnel Changes.** Increases and decreases in staff provide an indicator of changes in real effort. These changes also indicate where the School District has chosen to place its selective program emphasis, given the tight budget. For the District as a whole there was a slight decline in total positions, from 21,540 to 21,417. The declines were concentrated in direct educational positions (a drop from 15,316 to 15,074) and in administrative positions (from 2,711 to 2,581). There was an increase in the positions for plant operations and building maintenance (from 3,513 to 3,762). From this information, clearly the School District has limited growth in real costs by curtailing increases in staff positions.

From the distribution in personnel changes it is possible to see where the District is economizing most and where it is trying to expand services. A comparison of the fourth and fifth columns indicates that the bulk of the declines in direct educational positions accompanied declines in enrollment. Early childhood education and elementary education, the big losers in enrollment, had the steepest declines in staff positions. Junior high and middle education, registering the biggest increases in enrollment also scored the largest growth in staff. The one apparent anomaly was senior high education. Here enrollment grew slightly, but the number of positions declined. Among the administrative and support elements there was almost an across-the-board decline in positions. The only sharp percentage increase was in Municipal Services and this was because the City of Philadelphia increased its required contributions by the School District for tax collection and assessment.

**Total Real Expenditures.** Columns 2 and 3 compare the deflated School District's estimate of expenditures prior to the strike with the deflated actual expenditures for the fiscal year with the impact of the strike included. If the strike had not taken place and the revenues had been available, the total budget would have grown 11 percent. Almost all of this increase would have been concentrated in debt service (70 percent growth). Direct educational expenditures even without the strike would have declined $4 million.

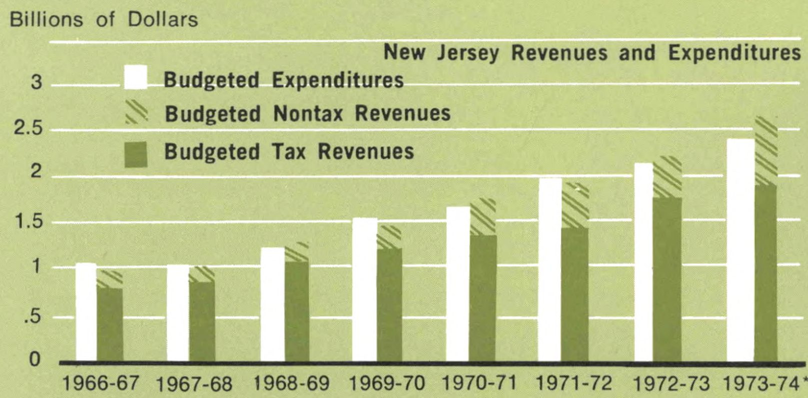
**Expenditures per Pupil.** The decline in real direct educational expenditures is deceptive because there also was a decline in enrollments. Expenditures per pupil is a better measure of services provided than just expenditures. A fairly rough calculation suggests that *without the strike* there would have been a 7 percent increase in real expenditures per pupil in elementary school and a 4 percent decline in real secondary school expenditures per pupil.

**Budget Change with the Strike.** A long teacher strike did of course take place. This strongly affected the overall budget picture. In real terms the District saved about $30 million, with the declines of course concentrated in direct educational expenditure areas.

# Sales Levy Crucial to New Jersey's Tax Revenues / by John Wentz

CHART 1

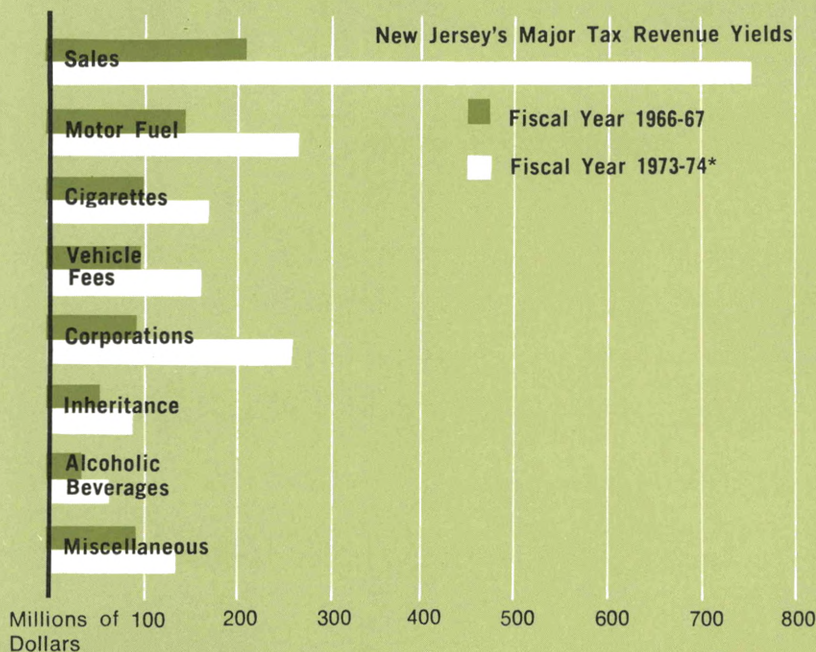
DESPITE INCREASING USE OF NONTAX SOURCES OF FUNDS (SUCH AS FEDERAL GRANTS AND LOTTERY REVENUES), NEW JERSEY STILL SATISFIES THE BULK OF ITS EXPANDING FINANCIAL NEEDS THROUGH TAXES.




* Estimated.

CHART 2

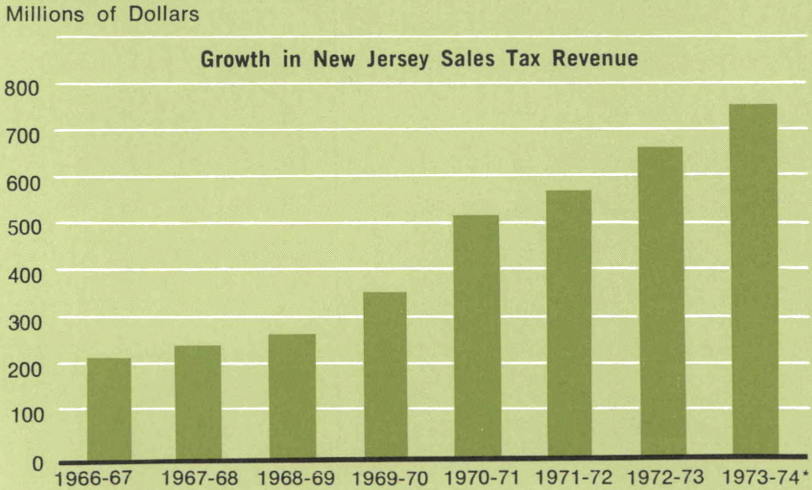
THE MOST PRODUCTIVE REVENUE-GENERATING SOURCE HAS BEEN THE SALES TAX . . .




* Estimated.

CHART 3

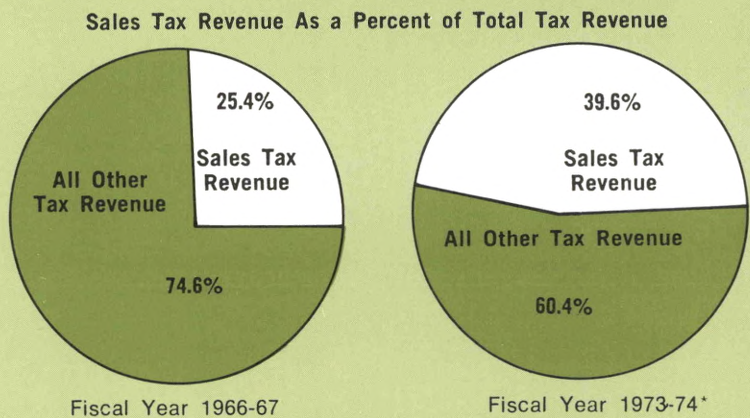
WHILE THE GARDEN STATE'S EXPANDING ECONOMY HAS BEEN AN IMPORTANT FACTOR IN THE STEADY CLIMB OF SALES TAX RECEIPTS, THE BIG JUMP IN COLLECTIONS AFTER '69 WAS CAUSED BY AN INCREASE IN THE RATE FROM 3 TO 5 CENTS PER DOLLAR IN MARCH '70.




* Estimated.

CHART 4

AS A RESULT, THE SHARE OF NEW JERSEY'S TOTAL TAX REVENUE RAISED FROM THE SALES TAX HAS CLIMBED SHARPLY SINCE '66.




Source: *Division of Budget and Accounting, State of New Jersey.*

* Estimated.

# Fighting Poverty With Jobs: Public and Private Payroll Weapons*

*By James L. Freund*

The controversy over "big government" has been raging for longer than most Americans can remember. In recent years the focus has been on the spiraling cost of the social programs of the Great Society as well as on the size and scope of military spending. Now, a major new issue is being raised.

Many people concerned with high unemployment rates and poverty are demanding that the Federal Government rush to the rescue with a "decent-paying" job for anyone who can't land one in the private sector. They feel that everyone who wants to work should have the opportunity, and that the only way to guarantee this is for Uncle Sam to become an employer of last resort. While most would agree with the goal of full employment, the laudableness of the objective should not mask the potential difficulties of direct Government job creation. A lower-cost alternative might achieve the same end by merely increasing incentives for private enterprise.

*This article is based on research started when the author was an economist in the Department of Research at the Federal Reserve Bank of Philadelphia. He is presently a research associate at the National Bureau of Economic Research.

## FILLING IN WITH PUBLIC ACTION

The magnitude of the problem of unemployment suggests that any remedial program would have to be large. In only seven of the last 25 years has the unemployment rate dipped below 4 percent—and usually only because of the "public employment" associated with wartime mobilization. In the average year during that period well over three million workers were out "pounding the pavement."

Even when unemployment is low, certain

groups suffer more than others. When unemployment fell to a recent low in October 1973, over twice as many nonwhites as whites were jobless. One in 14 teenagers (many getting a taste of the workaday world for the first time) was jobless, and black teenagers were only half as successful at landing a job than their white counterparts. Even finding employment does not necessarily mean the end of one's woes. Many of the low-skilled have jobs that do not afford enough income to lift their families above the poverty line—this group has been labeled the working poor. In short, for many Americans permanent and satisfactory jobs are an illusory commodity.

In many quarters the belief is growing that the economy just cannot create enough acceptable jobs. New opportunities are hard pressed to keep pace with the normal growth of the labor force. Further, business fluctuations often keep production below capacity, thus creating more unemployment.

**Past and Current Efforts.** Concern for those who have experienced difficulties in earning a living is not new. Welfare, Social Security, and unemployment insurance are available for those in need. Perhaps more important, the Federal Government has long been concerned with the underlying causes of unemployment; the Employment Act of 1946 pledged the Government to strive for maximum employment consistent with price stability.

Fiscal and monetary policies are the Federal Government's main tools in fighting joblessness; their target is those workers who are idle because of deficient demand. (See Box for a discussion of the different categories of unemployment.) Washington uses these tools to stimulate economic activity so that private firms will hire more workers. Help is also being directed at workers who are unemployed while job hunting—the "frictionally unemployed." As computerized job banks and public placement services make job hunting more efficient, the amount and duration of unemployment associated with finding a first job or changing to a new one is being reduced. Finally, major efforts have been directed at the hard-core unemployed and workers with habitually low incomes. Specifically, many of the social programs of the '60s sought to help by providing training and "proper motivation." The quality of the applicant, not the lack of well-paying jobs, was often considered the primary problem.

Critics claim that these efforts always seem to fall short. Fiscal and monetary policies eliminate some joblessness, but they don't create enough jobs without unacceptable inflationary pressures. Many low-skilled workers are never reached. In addition, these aggregate policies guarantee nothing about the quality and permanency of the jobs created. Programs aimed at "disadvantaged" workers (such as manpower training) undoubtedly enhance enrollees' productivity and ability to compete for existing positions. However, such programs can succeed only when they are tailored to existing job vacancies or coupled with job creation. Despite the progress made so far, the biggest obstacle has been the shortage of "well-paying," permanent jobs relative to number of workers trained. In short, it's argued that Government programs only partially fill the gap between those seeking a job and the positions available.

**U. S. Government: Employer of Last Resort?** Past efforts have fallen short of eliminating unemployment as a social problem, and so the call has been for a direct approach. Why not just have Uncle Sam hire those left out in the cold? The idea is hardly new. Unemployment, as we know it, is rare in countries with totally planned economies because the government provides for total employment in state-owned enterprises. Likewise, in Sweden's welfare state, there is a well-established program to provide employment for those unable to find a job.

Supplementing traditional economic policies with public employment isn't new in the United States, either. One of the most controversial of the New Deal programs to combat the Great Depression was the Works Progress Administration. At its peak, the WPA employed 5 percent of the labor force and absorbed 31 percent of measured unemployment. The cost to the nation

## LABOR MARKET MALADIES

The basis for meeting the problem of finding a good job for all is an understanding of the malfunctions of the present system. Different people are unemployed for quite different reasons. An attempt to aid one group may not address the problems of another.

**Frictional Unemployment.** In a modern, complex society it takes time for workers to find an appropriate job. New workers must spend time becoming familiar with the job market. Older workers will often quit (or are laid-off or fired) and must search for suitable new positions. Economists call such unemployment "frictional" and suggest that it is rational for workers to choose to be temporarily unemployed to search for a new job.*

**Demand-Deficient Unemployment.** Not all idleness is normal. When the economy slows down and firms find they cannot sell all they produce, output is curtailed. Firms lay off workers or just don't hire new ones. When unemployment is discussed, this type of idleness is what most people have in mind. Technically, it is labeled "demand-deficient" unemployment. The number of workers who are jobless for this reason would be zero when the economy is going full tilt—the term commonly used for this situation is full employment.

**The Hard-Core Unemployed and the Poor.** A large and diverse group of workers habitually do poorly in the competitive labor market. For convenience, many can be lumped under the general heading of "hard-core" unemployed. This group is largely made up of minority groups, younger workers, and residents of "depressed areas."

Other workers have jobs that are less than satisfactory. Many earn steady but low wages—a group that has been labeled the working poor. Others earn a decent wage but can't find steady employment. A common thread among these workers and the hard-core unemployed is that they are at a disadvantage because of personal characteristics not wholly within their control.

*An interesting discussion of this type of unemployment is that by Armen A. Alchian, "Information Costs, Pricing, and Resource Unemployment," *Western Economic Journal* 7 (1969): 109–28.

averaged about $1.4 billion in direct wages per year to support about two million workers. Its goal was simple: providing temporary income for citizens out of work as a result of adverse economic conditions. The jobs were meant to be temporary, and little or no training was involved.[1]

More recently, the Emergency Employment Act of 1971 created a limited number of temporary jobs to narrow the gap between the number of positions available and the number of job-seekers. As long as traditional policies failed to lower the unemployment rate to 4.5 percent, Federal funds were provided to local governmental units to hire area unemployed.

Proponents of public service employment consider such programs as only a start, arguing that efforts must be broadened and become permanent. As a true employer of last resort, the Federal Government would create jobs for anyone not finding employment. Further, many would argue that full Government responsibility

[1]See Alden T. Briscoe, "Public Service Employment in the 1930's: The WPA," Harold L. Sheppard *et al.*, eds., *The Political Economy of Public Service Employment* (Lexington, Mass.: Lexington Books, 1972), pp. 95–116. The author provides a comprehensive overview of the WPA experience in this selection. It is only one of this volume's many essays on public service employment.

includes providing a "decent-paying" job for those who work but don't earn an acceptable wage by society's standards.

Jobs would be reserved—through eligibility requirements—for those workers not likely to find employment elsewhere. Those who are only temporarily out of work (frictionally unemployed) should not be put on the Government payroll. Eventually they will land a job and are helped in the interim by existing unemployment compensation laws. The demand-deficient unemployed might be aided by public service employment as a stop-gap measure. As business conditions improve, these workers would move off the public payroll to private employment. The cornerstone of recent proposals, however, is the commitment to fight poverty by guaranteeing jobs to all those who suffer *competitive disadvantage* in free labor markets and habitually have high unemployment rates—the young, minorities, and those in depressed areas.

Thus, the main recipients would be the low-skilled for whom the Government is, in fact, a last resort. When these workers secure employment in the private sector, it's often with small and unstable firms. They are laid off and rehired frequently. Benefits are poor, and pay is frequently low. People limited to such jobs are unemployment-prone and their incomes often fall below the poverty line. Public employment would give them a regular job, breaking into the cycle of poverty and the job-market shuffle.[2]

**How It Would Work.** A public employment program would differ substantially from its predecessor, the Works Progress Administration. Although the WPA's primary purpose was to provide families with income, much of the disfavor it attracted can be traced to the public impression that recipients just stood around. Partly to avoid such criticism and largely because participants will need remedial training, proposals now stress the creation of positions which make meaningful contributions to society as well as to the individuals involved.

For those who might be expected to be on the public payroll for only a short period (demand-deficient causes), temporary positions might be designed to use their present skills. For the "hard-core," more formal plans are necessary. Since many of the recipients would not fit the job categories that are most in demand in the public sector, two schemes have been suggested for running the program.[3] Meaningful new job classifications could be created as spin-offs from established jobs. These would be semi-skilled tasks that would relieve present personnel of responsibilities by assigning part of their work to new employees. For example, local hospitals might train participants as paraprofessionals assisting in areas such as physical therapy and laboratory chores. Teaching aids could relieve educators of tasks such as attendance-taking and supervision of non-classroom activities. Street and highway departments could train participants to assist heavy equipment operators. Policemen could relinquish certain non-dangerous duties. In short, new positions would be created, and the new employees would be trained to fill them.

A more traditional approach is also possible. Public employment funds could be used to hire, train, and then employ workers for existing job classifications. In essence, it would be a training program that would meet the failure of many manpower programs in the past—there would be a guaranteed, meaningful position at the end of the training period. In this approach, participants would be employed as full-fledged firemen, building inspectors, nurses, and file clerks.

## COUNTING ITS BLESSINGS

When many programs vie for limited funds, any proposal's benefits must be weighed against

[2]For a discussion of the problems of the poor and these advantages of public employment, see Bennett Harrison, "Public Employment and the Theory of the Dual Labor Market." ibid., pp. 41–75.

[3]Harrison reviews the structure of such efforts in detail in "Public Service Jobs for Urban Ghetto Residents," ibid., pp. 231–69.

the concomitant costs—no matter how meritorious the basic objectives appear. The employer-of-last-resort idea is no exception. It must not only accomplish the goal of an adequate job for every qualified family, but it should do so more efficiently than any alternative method.

**A Chance to Do Better.** Any policy designed to aid people ultimately must rest or fall on its ability to make its recipients better off. Advocates point out several advantages of this proposal in the fight to help the distressed.

1. Public employment, once it is set up, is *fast* and *direct*. Fiscal and monetary policies create jobs through general economic growth and thus involve considerable time-lags and leakages. Disadvantaged workers are often the last to be hired, if they are reached at all, in economic expansions. Likewise, public programs for depressed areas based upon attracting industry may take years to work out. Expenditures on public employment benefit the jobless immediately.

2. For most recipients the program could provide an *accessible* and steady job. It could be tailored so that many low-skilled workers can be absorbed without lengthy training. Many Government installations are in areas accessible to ghetto residents who constitute a large portion of those left out of the mainstream of the labor market. Moreover, Government could make a conscious effort to locate future facilities (or relocated existing ones) in areas that are convenient to low-income and high-unemployment groups. But most important to the recipients, wages are "adequate," there are fringe benefits, and there is a reasonable degree of permanency.

3. The "workfare" concept would help to *build specific skills*. If the worker is suffering from an extended period of idleness, being able to work should help keep his knowledge current. For many recipients the scheme would, by providing a steady job, help develop and reinforce work habits. New skills would also be acquired. A possible secondary benefit of the program is the loss of many of these workers to the private sector as their improved qualities as workers merit better jobs.

**Advantages to Society.** By providing a job rather than a cash payment, the public employment proposal has the following basic advantages for society.

1. When idle resources are put to use, society is better off. A jobless worker is not producing clocks, building boats, or painting buildings; getting him to work at any job will create *additional output*. Conversely, if poverty breeds wrongdoing, Government employment may eliminate crimes of desperation.

2. Not only will more be produced, but especially *valuable services* could emanate from the program. Jobs could, for instance, be created at the state or local level. Any mayor or governor can cite many "urgent needs" that could be filled if Washington paid for the training costs and salaries of new employees. City streets could be cleaned, recreational facilities could be built, and neighborhood health clinics could be opened. In short, formerly inactive or low-productivity workers could provide vitally important social services.

## ASSESSING THE COSTS

To judge the job-guarantee proposal fairly one must identify all the costs so they may be compared with the benefits. While it's difficult to be precise, the salient cost considerations can be identified.

**Direct Program Costs.** The direct cost of the program to the taxpayer would depend on the salary levels and on the number of eligible recipients. The wage rate should provide a decent standard of living, but it must be low enough not to discourage returning to private sector jobs. The number of candidates is difficult to estimate because there has never been an exact count of those on the fringes of poverty—either at work or outside of traditional labor market pursuits.

Nevertheless, estimates have been made as to how big the program might have to be. "Realistic proposals" call for a half to a million jobs, with a million bringing the unemployment rate down more than a percentage point. Some who have studied the problems of the poor come up with numbers as high as three to five million.[4] In addition to those measured as unemployed, these figures include "discouraged workers" and those on a part-time basis who want full-time employment.[5]

Such an undertaking might cost anywhere from $5 billion annually for a million jobs to $20 billion for a comprehensive program. In terms of national output, the cost of a comprehensive program would run between 1 and 2 percent of our current national income. If remedial training and placement functions were part of the program, the outlay would be even higher. Any disruptions in normal work patterns of regular Government personnel would up the cost.

**Economic Costs.** The actual expenditures represent the cost to society of the program—net of output produced by previously idle labor. However, there are other costs to be considered. Absorption of many unemployed and low-paid workers will make labor more scarce for those who want to hire the low-skilled and will cause the wages of those remaining outside the program to rise. During the Great Depression this was apparently not a major problem (despite protests from many local businessmen), probably because the program never touched vast numbers of the unemployed. In the more prosperous economic climate of the 1970s, where wage pressures are sensitive to labor market conditions, even a modest program might cause wages to rise as employers compete for the low-paid workers who remain outside the program. Both higher wages costs and lack of availability will endanger the competitive existence of marginal firms and cause costly adjustments of existing production processes.

Having Government services produced by the new public servants is obviously better than having them just standing around or asking for no work in return. But this benefit should not be viewed as costless. By taxing the public to finance the plan, the products that otherwise would have been bought with a good portion of the taxes are not being produced. For instance, fewer automobiles, snowmobiles, and TV sets may be the price for cleaner cities. Or, if the scheme were funded from existing revenues, other programs would have to be curtailed. In this case, new services may be at the expense of superhighways, submarines, or stricter law enforcement. The most likely outcome, it would seem, is that the program would shift some production away from private goods. While better Government services may or may not have more merit than private goods sacrificed, employing the hard-core jobless should be considered on its own merits.[6]

Thus, while the employer-of-last-resort program would reduce unemployment and working poverty, the costs are not inconsequential. Furthermore, implementation of a plan as large as this one begets problems. Many of the expenses and benefits cannot be determined until operations start; setting up the administrative machinery would be both costly and time-consuming. The proposal would inevitably face a barrage of criticism from those who think that the Federal Government is just too large for

[4]For one discussion of the numbers involved, see Garth L. Magnum, "Guaranteeing Employment Opportunities," Robert Theobald, ed., *Social Policies for America in the 1970's: 9 Divergent Views* (Garden City, N. Y.: Doubleday and Company, 1968).

[5]"Discouraged workers" are those who have dropped out of the labor market because acceptable jobs are not available. It is difficult to pin down exactly how many are in this group, but their numbers are substantial in periods of high unemployment. They must be included as potential recipients because many will "drop in" if a good public sector job is available.

[6]Besides the fact that associating a work-relief program with an attempt to provide other social services would be a political liability, one can argue that society was already choosing what it valued most before the program was initiated. In other words, if society wanted cleaner streets rather than snowmobiles, it would have already increased expenditures in that area. While the argument is long-established that public services don't get a fair shake (see J. K. Galbraith, *The Affluent Society* [Boston: Houghton Mifflin Company, 1958]), the exact use to which the recipients of a program are put is really a secondary issue to whether we want such a program at all.

another "big spending" program. Finally, there is the contention that, because of the lack of profit motive, the new public employees will not be as efficiently used as they would be in the private sector.

All of this suggests that other policy alternatives for providing jobs for those not in the mainstream of the labor market should be explored, especially plans that motivate private firms toward the same end. To do this, a proposal must correct the circumstances that lead to the present deficiency of "decent" jobs.

## PROVIDING MORE JOBS IN THE PRIVATE SECTOR

**The Horns of the Dilemma.** A common thread running through explanations for low wages and unemployment is that private firms just do not find it profitable to hire workers at wages society feels are acceptable. For workers with outdated skills, their salaries plus retraining costs outweigh the value of their services. Likewise, some firms that might find hiring younger workers profitable at low wages may be precluded from doing so.

Textbooks often cite one way of eliminating the problem. If workers were willing to take lower wages, firms would find it profitable to put more workers on the job. Over longer periods, given product demand, businesses would use more labor relative to machines. As matters stand, many factors keep wages from falling in periods of high unemployment. Unions are one powerful force preventing wage cuts. Another institutional constraint for wages on the jobs normally available to marginal workers is the minimum wage law. This law prohibits firms engaged in interstate commerce from paying an employee less than a fixed minimum regardless of age, skills, or the value of his labor to the employer.

Thus, the problem of assuring a decent job for every American is double-edged. Present real wage levels are apparently too high to guarantee full employment. But even if wages fell low enough so that everyone could find a job, unemployment would merely be replaced with the working poverty of low wages. What is needed is a policy that will make jobs profitable for firms *and* mean enough income to keep working families above the poverty line.

**Two Ways to Help.** The problem can be viewed as a gap between minimum standards and profitable levels of wages for a large class of workers who are having difficulty finding permanent employment. One way to eliminate the gap and encourage private employers to absorb the unemployed is to let wages fall and supplement them with a payment to the worker. Minimum wage laws could be eliminated, and workers could accept the reduced wages dictated by economic conditions. The Federal Government would make up the difference between any substandard wage and the level which assures each family an acceptable standard of living. Plans that accomplish this, such as the negative income tax, have been on the drawing boards for many years; the beneficial employment effect of encouraging wage flexibility at the same time has not often been discussed.

Another plan, wage subsidies, would attack the gap from the other end. Recognizing the difficulty of convincing people to accept lower wages, private employers could be paid allowances for hiring the unemployed or for raising wages of very low-paid workers. In effect, the Government would be lowering the price of labor to the firm. Like a shopper tempted by a sale, it is expected that more of the sales item would be bought.

Such a wage-subsidy program has been attempted on a limited scale both at home and abroad—when dealing with problems of depressed areas and disadvantaged labor.[7] Clearly,

[7]The British have used a wage-subsidy program to stimulate employment in industries in lagging areas. See William Miernyk, "British Regional Development Policy," *Journal of Economic Issues* 3 (1969): 33–42. In the United States, the WIN II program attempts to find jobs for employable welfare recipients. AFDC (aid to families with dependent children) clients are evaluated to determine what they need to become

to be effective the details of such a program must be worked out. Like direct job-creation by the Federal Government, the full costs would only be known if the plan were actually implemented.

Income-maintenance and wage-subsidy schemes have several advantages. They would not require the vast administrative effort of direct public employment. In both cases business would still have the incentive to be as efficient as possible since it would be footing part of the bill. Although taxes would be used to finance the schemes, the preferences of the public would continue to determine what was produced. Theoretically, those industries that were the fastest-growing would be the most likely to hire new workers. This includes the already expanding government sector.

## FIGHTING POVERTY WITH JOBS

Giving everyone an opportunity for meaningful employment is a goal that has wide support. Movements in the unemployment rate and successes in the fight against poverty are everyday concerns in the press. However, the moot question is whether there is a viable way to provide income through jobs for all.

Claiming there's a need for new weapons hardly rules out traditional means. Creating jobs through stimulating the economy or by upgrading labor skills can be productive, but they have not been enough. One option for going further is *direct* Government action. Washington can create jobs and decide which programs should receive the additional personnel. Alternatively, one can rely on the mechanisms of the private sector to succeed where it previously had failed by providing subsidies as an incentive.

Using subsidies has the advantage of precedent. The Federal Government has a long history of subsidizing both worthy and questionable economic goals. Moreover, with certain exceptions, the private enterprise system has performed efficiently in the past. Combining the strong points of each sector may prove to be the most effective way of building jobs and income over the long haul.

employable and are then placed in on-the-job or classroom-training programs. Employers contract with WIN to hire trainees after graduation, receiving both a tax credit and a trained worker.

## NOW AVAILABLE
## BROCHURE AND FILM STRIP ON
## TRUTH IN LENDING

Truth in Lending became the law of the land in 1969. Since then the law, requiring uniform and meaningful disclosure of the cost of consumer credit, has been hailed as a major breakthrough in consumer protection. But despite considerable publicity, the general public is not very familiar with the law.

A brochure, "What Truth in Lending Means to You," cogently spells out the essentials of the law. Copies in both English and Spanish are available upon request from the Department of Bank and Public Relations, Federal Reserve Bank of Philadelphia, Philadelphia, Pennsylvania 19101.

Available in English is a film strip on Regulation Z, Truth in Lending, for showing to consumer groups. This 20-minute presentation, developed by the Board of Governors of the Federal Reserve System, is designed for use with a Dukane project that uses 35mm film and plays a 33 RPM record synchronized with the film. Copies of the film strip can be purchased from the Board of Governors of the Federal Reserve System, Washington, D. C. 20551, for $10. It is available to groups in the Third Federal Reserve District without charge except for return postage.

Persons in the Third District may direct requests for loan of the film to Truth in Lending, Federal Reserve Bank of Philadelphia, Philadelphia, Pennsylvania 19101. Such requests should provide for several alternate presentation dates.

# NOW AVAILABLE:
# INDEX TO FEDERAL RESERVE BANK REVIEWS

Articles which have appeared in the reviews of the 12 Federal Reserve Banks have been indexed by subject by Doris F. Zimmermann, Librarian of the Federal Reserve Bank of Philadelphia. The index covers the years 1950 through 1972 and is available upon request from the Department of Public Services, Federal Reserve Bank of Philadelphia, Philadelphia, Pennsylvania 19101.

FEDERAL RESERVE BANK of PHILADELPHIA
PHILADELPHIA, PENNSYLVANIA 19101

**business review**
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