

# BUSINESS REVIEW

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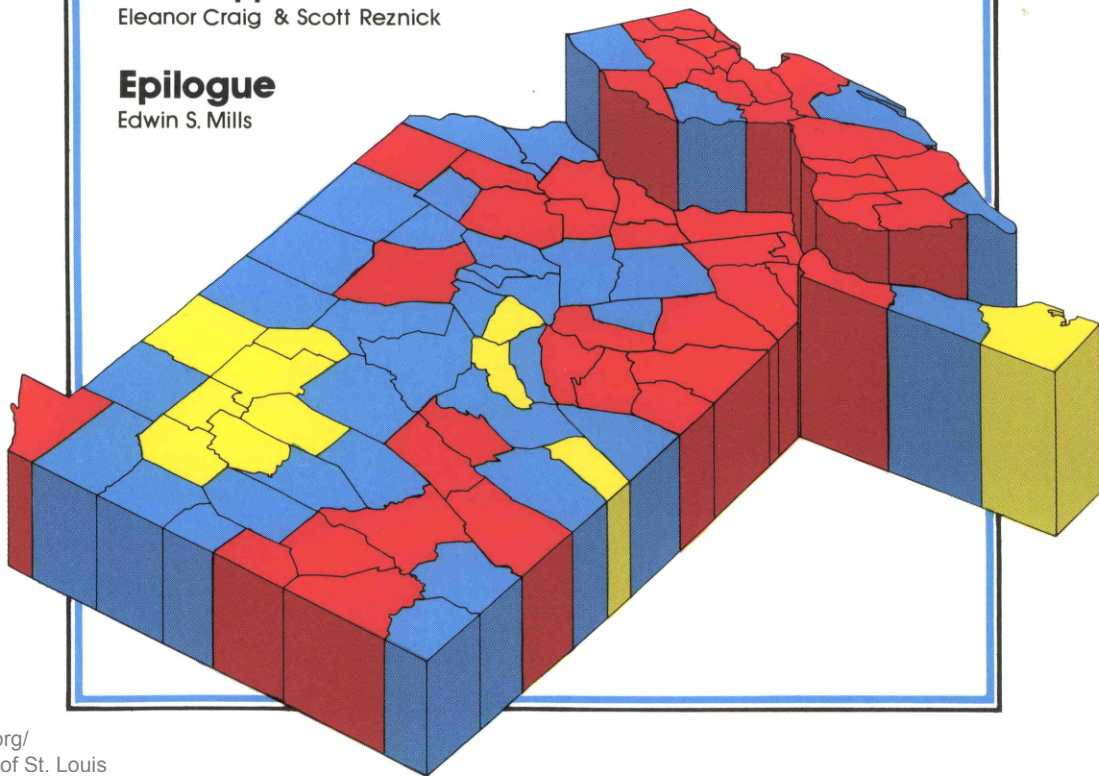
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Edwin S. Mills



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Federal Reserve Bank of Philadelphia  
Ten Independence Mall  
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This special *Business Review* is a part of the Federal Reserve Bank of Philadelphia's continuing commitment to explore the issues affecting economic development in the Third District and the fiscal health of its states and localities. This commitment goes beyond the Regional and Urban Section of the Research Department, which produced this volume. Our involvement as an organization and as individuals in the critical issues of our region is strong and steadfast. We hope that you find this special publication informative and useful.

*Edward G. Roach*  
President

## Introduction

*John M. L. Gruenstein\**

The articles in this special issue analyze some changing trends and their effects on the states and localities in the Third Federal Reserve District. The issues explored at the metropolitan, city, and state levels resonate through all regions of the country. Shifts of employment and people to new areas, the impact of these shifts on local governments' fiscal capacities, and the economic development efforts of state governments are the prime concerns of the authors.

The first article, by *Gerald Carlino*, notes that

employment growth in nonmetropolitan areas has outstripped metropolitan employment growth over the last twenty years. This striking but often overlooked reversal of a centuries-long trend pervades all regions of the country. Carlino presents evidence that *employment* deconcentration, especially in manufacturing, has *preceded* population deconcentration. He argues that such a sequence cannot be explained simply by people's preferences for rural living; it hinges, instead, on the dramatic changes in production, transportation and communications technology that have made it feasible to do business in nonmetropolitan locales.

The growth of jobs outside of metropolitan areas has combined with other movements of jobs

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\*John Gruenstein is Vice President and Research Officer in the Regional and Urban Section of the Federal Reserve Bank of Philadelphia.

and people—from cities to suburbs, from the Northeast and Midwest to the South and West—to cause fiscal problems for large cities in older areas of the country. *Robert Inman's* article dissects the fiscal crises of the 1970s that afflicted three large cities: New York, Cleveland, and Philadelphia. He argues that while the particular sequence of events leading to a crisis varies from city to city, the root causes are similar. As the number of jobs and people in a city declines, the tax base drops, but public service demands often rise. Budgets become increasingly hard to balance, and the painful remedies of raising taxes and reducing spending are supplemented or supplanted by a third strategy—putting the problem off into the future. Deficits accumulate, pension liabilities are underfunded, and maintenance expenditures are cut back. Inman argues that, because voters and politicians are short-sighted and because pension underfunding and infrastructure undermaintenance are hard to detect, the fiscal house of cards rises higher and higher until a relatively small sneeze sends it tumbling.

What can be done? Inman maintains that the solution lies in better monitoring of budgets, pensions, and infrastructure, and sound fiscal management. Strengthening local programs for economic development is just as important.

Similar themes are sounded by *Eleanor Craig* and *Scott Reznick*. The three states of the Third Federal Reserve District have also experienced adverse employment and population shifts and fiscal strains. The authors compare and contrast the current thrust of economic development efforts in response to these trends.

The economic development packages offered

by the Third District states include common elements, like Industrial Development Bonds and local property tax abatement, but the recent thrusts of their overall strategies have varied. Delaware has stressed fiscal issues, and has focused on deregulation, particularly in the area of banking. New Jersey has concentrated on improving the administration of its economic development programs and tax reform. Pennsylvania has moved toward sharper targeting of programs to areas of greatest potential or need.

Building on the themes raised in the three previous papers, *Ed Mills* regards the future of central cities of large metropolitan areas in Northeastern states with tempered optimism. Past employment and population shifts have worked particularly hard against these areas. But Mills argues that these shifts have been due partly to differences in wage costs and population densities, and therefore self-correcting forces will come into play as wages and densities become increasingly similar across different sections of the country. State and local government can also affect the pace of employment and population shifts to some degree. Mills agrees with the view that policy efforts should be directed at creating a better business climate for *all* industries, not just narrowly targeted ones. The basic steps toward that goal involve reducing red tape, managing fiscal policy with a firm hand, and giving the public a clear view of the fiscal realities. In sum, facing the future with a strong sense of realism—both about what goals are possible and how to achieve them—will prepare policymakers to lead the way to economic growth.

# New Employment Growth Trends: The U.S. and the Third District

*Gerald Carlino\**

In the not so distant past, urban economists predicted the continued concentration of people and jobs in comparatively few metropolitan places. They based this view on the economic advantages associated with spatial concentrations. Indeed, the ultimate vision was the development of "megapoloes," more or less continuous stretches of urban and suburban areas, encompassing a number of metropolitan places, such as BOS-WASH or CHI-PITTS.

Even while the predictions of a magnetizing megalopolis were being championed, other forces

were at work, and a new trend toward deconcentration of population and employment was well under way. During the past 160 years more people moved from nonmetropolitan to metropolitan places than vice versa; but this migration pattern turned around dramatically during the 1970s in many parts of the country. Now many nonmetropolitan places are among the nation's fastest growing places. Moreover, statistics show that the smaller the nonmetropolitan place, the faster its population growth is likely to be. The same pattern holds for metropolitan size as well: the smaller the metropolitan place, the faster its population growth rate is likely to be.

Some observers explain this reversal by pointing to upsurges in the mining and recreation industries in rural places. Others focus on the increase

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in the number of retirees who can live where they want, suggesting they prefer rural living. New evidence shows, however, that basic industrial growth in the countryside appears to have *led* this rural renaissance. As early as the 1950s, manufacturing employment was growing faster in many nonmetropolitan places. This shift of manufacturing to nonmetropolitan places has attracted other sectors as well as people.

## AGGLOMERATION ECONOMIES LEAD TO CONCENTRATION . . .

Manufacturing activity historically has tended to concentrate geographically as a means to hold down costs. Other nonmanufacturing activities (such as banking, wholesale and retail trade, services) have found it advantageous to join the cluster, supplying business services to firms or consumer services to residents. Consequently, people and jobs became concentrated in comparatively few places known as metropolitan areas. Analysts saw these economies of concentration as the main reason for the existence of large metropolitan places; indeed, many extrapolated the gains from spatial concentration to argue for the coming of megalopolis.

This tendency for economic activity to concentrate can be explained in terms of so-called agglomeration economies. Agglomeration economies can be defined as scale economies *external* to individual firms. In other words, a firm's cost per unit of output falls because of factors outside the firm. These agglomeration economies are of two types: localization and urbanization economies.

Localization economies are external to any one firm but internal to its *industry*. For example, the spatial concentration of an industry permits the development of "common pools" of highly specialized factors of production which are shared by all firms in the industry. The development of these "common pools" enables any one firm to reduce its level of inventories of these factors, and thereby lowers the average cost of production. Localization economies depend on the size of an industry, given its location. The larger the industry, the greater the scope for such economies.

Localization economies also arise when firms which specialize narrowly in the making of important intermediate inputs locate in an industry's concentration area. A classic example of vertical

complexes of this sort is the garment industry in New York.<sup>1</sup> The concentration of the garment industry permitted the specialization of firms within the industry, such as buttonhole and zipper manufacturers. If each firm in the industry produced its own buttonholes and zippers, production costs would increase, since no single firm could generate enough output to develop scale economies in making these inputs. A firm specializing in producing these inputs for a larger number of firms can achieve economies of scale.

The other types of agglomeration economies are urbanization economies. Urbanization economies are scale economies which are external to any one firm and external to any one industry, but are internal to the aggregate of *economic activity* in an urban area. The benefits of urbanization economies include the development of large and varied labor pools, the existence of entrepreneurial talent, and the presence of wholesaling facilities in urban areas which allow firms to economize on inventories. In addition, some firms can achieve economies of scale by specializing in intermediate inputs used by other firms in many industries, for instance, commercial, financial and banking services, and specialized business services (such as computer services, advertising agencies, accounting and legal facilities, and research and development agencies).

## . . . BUT TECHNOLOGY PAVES THE WAY FOR DECONCENTRATION

Agglomeration economies provide a powerful incentive for economic activity to concentrate. Indeed, the nineteenth and early twentieth century cities tended to be highly concentrated, with as much as 90 percent of total employment contained within a one-mile to three-mile radius of their central business districts.<sup>2</sup> The technology of the time placed certain limits on a firm's prosperity that could be overcome only by locating near other firms. But recently, these agglomeration economies appear to have declined. In research conducted at

<sup>1</sup>Robert M. Lichtenberg, *One-tenth of a Nation*, (Cambridge, Mass: Harvard University Press, 1960) pp. 79-84.

<sup>2</sup>Alex Anas and Leon Moses, "Transportation and Land Use in the Mature Metropolis," in C. L. Leven (ed.), *The Mature Metropolis*, (Lexington Mass.: Lexington Books, 1978) pp. 149-168.

the Philadelphia Fed, data were analyzed for 80 standard metropolitan statistical areas (SMSAs) for the 20-year period 1957-1977.<sup>3</sup> The results indicated that the extra productivity associated with agglomeration economies in manufacturing has declined. This may be the result of progress in production, transportation and communications technologies that have reduced the need for economic activity to concentrate spatially.

**Changing Production Technology.** The development of the assembly line, for example, revolutionized not only how products were manufactured, but also where. Because assembly lines require a horizontal flow of goods, the vertical spaces available in city factories were unsuitable. Moreover, with the price of land less expensive outside the city, those large open spaces provided relatively cheap sites for constructing assembly-line plants.

More recent developments also have aided both suburbanization and deconcentration.<sup>4</sup> Miniaturization and the development of lightweight materials have reduced incentives to locate in a metropolitan area to lower transportation costs. In addition, the substitution of electronic for labor-intensive mechanical processes makes it less necessary for firms to locate in metropolitan places to take advantage of their large skilled labor pools.

**Changing Transportation and Communications Technologies.** Innovations in transportation technology also have helped to spawn first suburbanization and more recently deconcentration. Prior to the motor truck, rail transport was one of the most rapid and efficient ways of transporting products to and from a plant. Plant location, therefore, was largely restricted to railroad siding locations. The increase in the use of trucks, together with improvements in the urban road network after World War II, cut transportation costs sharply and attracted firms to the less congested suburbs. At the same time, rising

automobile ownership opened up the suburbs for people as well as jobs.

Improvements in transportation technology have continued to encourage deconcentration. Technical improvements in trucks have increased both their size and efficiency, and the interstate highway network has expanded to connect many previously remote rural counties with metropolitan areas and with one another.

In addition, just as the introduction of the telephone aided suburbanization, continued improvements in long-distance communications now contribute to deconcentration. Low-cost long-distance WATS lines, improved information storage and retrieval systems, and the use of document-transmission equipment allow branch plants to be located in rural areas while maintaining good communications with the corporate office and other plants.

### EMPLOYMENT FOLLOWS A DECONCENTRATION PATTERN NATIONALLY . . .

During the past two decades, economic activity has tended to deconcentrate spatially. There are several aspects to this deconcentration pattern. Not only is employment in nonmetropolitan places growing faster than in metropolitan ones, but the smaller nonmetropolitan places tend to be growing fastest. This relation between smaller size and faster growth holds for metropolitan places, too: the smaller the metropolitan place, the faster its employment growth is likely to be.

According to Table 1, total employment in-

### NONMETRO COUNTIES SHOW LARGEST EMPLOYMENT GROWTH

TABLE 1  
Percent Change of Employment Growth

	1951-1959	1959-1969	1969-1979
U.S. TOTAL	14.3	35.7	34.4
Metropolitan	16.5	35.1	31.3
Nonmetropolitan	9.5	36.9	41.0
Adjacent	9.7	37.4	38.2
Nonadjacent	9.4	36.3	44.5

SOURCE: Compiled from County Business Patterns.

<sup>3</sup>See Gerald A. Carlino, "Declining City Productivity and the Growth of Rural Regions," forthcoming, *Journal of Urban Economics*.

<sup>4</sup>D. Garnich and J. Renshaw, "Competing Hypotheses on the Outlook for Cities and Regions: What the Data Reveal and Conceal," *Papers, Regional Science Association*, 45, (1980) pp. 105-124.

creased in metropolitan areas by over 16 percent, while employment elsewhere increased by less than 10 percent during the 1950s.<sup>5</sup> In the 1960s, employment growth rates accelerated in both metropolitan and nonmetropolitan communities. At the same time, the growth of jobs became more balanced between metropolitan and nonmetropolitan places. In fact, nonmetropolitan employment growth slightly exceeded that of metropolitan regions. During the past decade, however, the growth rate of metropolitan employment fell, while the nonmetropolitan rate continued its increasing trend to 41 percent.

The view of steadily increasing urban concentration is so entrenched in urban economics that the usual response to finding faster nonmetropolitan growth is to attribute it to nothing more than metropolitan spillover. But while counties contiguous to metropolitan ones did grow more rapidly than metropolitan ones, other nonmetropolitan counties experienced even more rapid employment growth. Nonmetropolitan counties adjacent to metropolitan areas saw rapid growth (38.2 percent) during the 1970s, but nonmetropolitan counties which are not adjacent to metropolitan ones showed the fastest growth of all (44.5 percent).

This tendency toward growth in small places shows up even when the focus is on "all rural places," that is, counties that do not contain an urbanized place (of at least 2,500 people). Table 2 indicates that employment in all rural counties

## SMALLER PLACES GROW FASTER

**TABLE 2**  
**Percent Change in Employment Growth**  
**by Size of Place: 1969-1979**

Nonmetropolitan <sup>a</sup>	
TOTAL	40.9
ALL RURAL	48.1
2,500 to 9,999	44.0
10,000 to 24,999	38.6
25,000 to 49,999	36.5
Metropolitan	
TOTAL	31.3
Under 250,000	42.3
250,000 to 500,000	41.6
500,000 to 1,000,000	33.1
1,000,000 to 2,000,000	41.9
Over 3,000,000	14.7

<sup>a</sup>Size classification provided by the U.S. Department of Agriculture.

SOURCE: Compiled from County Business Patterns.

grew by 48.1 percent, which is about one-third faster, for example, than the 36.5 percent rate in the largest category of nonmetropolitan counties, those containing between 25,000 and 49,999 people. In general, overall employment growth falls as the size of the nonmetropolitan place goes up. This relationship of small size and high growth holds for all subcategories of employment, except for the traditionally rural agriculture industry.<sup>6</sup>

Table 2 also shows that, in general, the smaller the SMSA, the faster its overall employment growth rate. During the 1970s, SMSAs with fewer than 250,000 people showed the fastest total employment growth, 42.3 percent. Employment growth, then, generally declines as SMSA population size

<sup>5</sup>Using County Business Patterns, employment data were collected by major one-digit SIC industrial codes by county type for three independent time periods, 1951-1959, 1959-1969, and 1969-1979, for some 3,000 counties. Counties were identified as metropolitan or nonmetropolitan, based on the 1979 definition of an SMSA. In general, SMSAs are statistical constructs used to represent integrated labor market areas that consist of the counties containing a central city of at least 50,000 people along with any contiguous counties, if such counties meet certain economic considerations. From these data it is possible to compute percentage changes in the various employment categories for the 1950s, 1960s and 1970s. One problem with this data set is that County Business Patterns coverage is restricted to employees covered by the FICA act. Thus, those not covered by Social Security (largely government, railroad, agriculture and domestic services) fall outside of County Business Patterns scope. Outside of the growth in government employment, this reduced coverage should not impart much bias.

<sup>6</sup>Gerald A. Carlino, "Declining City Productivity and the Growth of Rural Regions." The reason for the more rapid growth of agriculture in metropolitan counties appears to be the result of the fast employment growth in nurseries.

increases; it averaged only 14.7 percent for SMSAs with over 3,000,000 people. Thus rather than observing faster employment growth in the nation's largest SMSAs (as the proponents of the megalopolis predicted), places such as the Philadelphia SMSA are growing much less rapidly than SMSAs such as New Brunswick, York or Wilmington.

### ... AND IN THE THIRD DISTRICT

Employment grew faster in the nonmetropolitan counties of the states of the Third District, emulating the national pattern.<sup>7</sup> As Table 3 shows, during the 1970s, the tri-state area's nonmetropolitan counties experienced a 23.4 percent increase in employment, while its metropolitan ones gained jobs at a 15.8 percent rate. Faster nonmetropolitan employment growth was experienced by all three states.

Nationally, the nonadjacent nonmetropolitan counties grew faster than the adjacent ones during the 1970s. In the tri-state area, however, nonadjacent counties showed only a 16.7 percent increase in total employment, while adjacent counties grew at a 24 percent clip.

<sup>7</sup>The three states constitute a larger area than the Third Federal Reserve District, which includes roughly two thirds of Pennsylvania, half of New Jersey and all of Delaware.

The forces of continued suburbanization as well as deconcentration are at work in the tri-state region, as can be seen in the map (pp. 10-11). The lined areas represent counties that experienced employment growth in excess of the 34.3 percent average rate for counties nationally.

Most of the lined areas in the southwest corner represent the continuation of suburbanization out of Philadelphia County. The growth of Ocean County and Cape May County in New Jersey is related to the growth of the retirement population.

The lined counties in the northeast end represent suburbanization and spillover from New York City, Patterson, Jersey City, Newark, etc. The shaded area in central Pennsylvania represents a pocket of deconcentration. If we include Snyder County, which grew just below the national average, this eight-county region accounted for about 10 percent of the employment growth in Pennsylvania during the 1970s.<sup>8</sup>

<sup>8</sup>The eight counties are: Clarion, Jefferson, Indiana, Clearfield, Centre, Union, Snyder and Juniata. We have not included Butler County since its growth may be due to spillover from Pittsburgh. In the same sense we do include some adjacent nonmetropolitan counties because they are not appreciably influenced by their proximity to major metropolitan centers.

## EMPLOYMENT GROWTH IN THE STATES OF THE THIRD FEDERAL RESERVE DISTRICT

TABLE 3  
Percent Change of Total Employment: 1969-1979

	TOTAL	Metro	Nonmetro	Adjacent	Nonadjacent
Tri-State <sup>a</sup>	16.4	15.8	23.4	24.0	16.7
Delaware	18.8	18.4	22.0	13.7	29.9
New Jersey	19.2	18.5	76.6	76.6	None
Pennsylvania	12.8	12.0	17.5	18.2	13.7

<sup>a</sup>The numbers reported are for the total of the three states, a larger area than the Third Federal Reserve District, which includes roughly two thirds of Pennsylvania, half of New Jersey and all of Delaware.

SOURCE: Compiled from County Business Patterns.

**PERCENT CHANGE  
TOTAL EMPLOYMENT  
1979, BY TYPE OF COUNTY,  
STATES OF THE THIRD  
NATIONAL RESERVE DISTRICT**

**Legend:**

- Metropolitan
- Nonmetropolitan
- Adjacent
- Nonadjacent
- Counties where employment growth exceeded national average.

**SOURCE:** Compiled from County Business Patterns.

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This evidence of deconcentration is so striking that it cannot be explained away as simply a blip in the otherwise more or less uniform history of metropolitan concentration in employment. What causes are at work here? A look at employment growth across industries helps explain the new trend.

### MANUFACTURING LEADS THE RURAL RENAISSANCE

Manufacturing was the first industry to suburbanize, and now manufacturing leads the deconcentration pattern, too. But there is one quite important difference. Edwin Mills has shown that the suburbanization of the population *preceded* that of manufacturing.<sup>9</sup> In other words, business followed people to the suburbs. But the picture looks different for the deconcentration scenario. Manufacturing *attracted* population to nonmetropolitan counties rather than the reverse. In fact, manufacturing *employment* growth in nonmetropolitan counties exceeded that in metropolitan ones even as early as the 1950s. But nonmetropolitan *population* growth did not exceed the metropolitan rate until the 1970s.

In each of the past three decades, the growth of manufacturing employment in nonmetropolitan

counties has exceeded that in metropolitan ones. As Table 4 illustrates, during the 1950s when the growth of manufacturing jobs in metropolitan counties was about nil, nonmetropolitan counties experienced a 3.1 percent increase. The growth in manufacturing employment accelerated during the 1960s in both metropolitan and nonmetropolitan counties, but this growth was much larger for the latter. Finally, during the 1970s, the growth of manufacturing jobs in nonmetropolitan counties stood at 21.0 percent, vastly exceeding the growth rate in metropolitan places, which was only 2.6 percent.

In fact, by the decade of the 1970s employment in other major sectors—mining, construction, transportation, wholesale trade, retail trade, finance and services—was also growing more rapidly in nonmetropolitan areas. (See NONMETROPOLITAN PLACES GAIN A LARGER SHARE OF EMPLOYMENT.)<sup>10</sup>

These statistics undermine many popular conceptions about the causes of growth in nonmetropolitan areas. The media, for example, tend to

<sup>9</sup>E. S. Mills, *Studies in the Structure of the Urban Economy*, (Baltimore: The Johns Hopkins University Press 1972), p. 47.

<sup>10</sup>The surge in mining during the energy crises of the 1970s has been cited as a prime factor in employment growth in nonmetropolitan areas. While mining activity clearly has been on the increase, it can be an explanatory factor only for isolated instances. For data and details on employment growth for mining and the other industries mentioned, see Gerald A. Carlino, "Declining City Productivity and the Growth of Rural Regions."

### NONMETRO COUNTIES SHOW FASTER MANUFACTURING EMPLOYMENT GROWTH

TABLE 4  
Percent Change of Manufacturing Employment

	1951-1959	1959-1969	1969-1979
U.S. TOTAL	1.0	26.4	8.8
Metropolitan	0.1	21.4	2.6
Nonmetropolitan	3.1	37.5	21.0
Adjacent	2.0	36.3	18.3
Nonadjacent	4.9	39.4	25.0

SOURCE: Compiled from County Business Patterns.

## NONMETROPOLITAN PLACES GAIN A LARGER SHARE OF EMPLOYMENT

The correlation between fast employment growth and small size is not simply the result of starting with a small base, and, by adding a few jobs, coming up with relatively larger growth rates. The following table considers the changing *share* of employment accounted for by metropolitan and nonmetropolitan places, and illustrates the strength of growth in smaller places. For example, over the period 1951-1979, the share of manufacturing employment accounted for by nonmetropolitan places increased from 18 percent to about 23 percent. A similar increase was registered in construction, wholesale trade and finance.

**Percent Distribution of Employment by Metropolitan  
and Nonmetropolitan Place**

	Agriculture	Mining	Construction	Manufacturing	Transportation	Wholesale Trade	Retail Trade	Finance	Services	Total
<b>1951</b>										
Metropolitan	71.0	44.9	83.9	82.0	84.8	86.8	77.7	89.5	83.7	80.9
Nonmetropolitan	29.0	55.1	16.1	18.0	15.2	13.2	22.3	10.5	16.3	19.1
Adjacent	54.8	46.0	51.7	60.8	51.5	48.0	53.2	52.9	53.2	55.6
Nonadjacent	45.2	54.0	48.3	39.2	48.5	52.0	46.8	47.1	46.8	44.4
<b>1959</b>										
Metropolitan	70.5	43.5	81.7	81.6	84.2	86.4	78.2	88.9	85.0	81.8
Nonmetropolitan	29.5	56.5	18.3	18.4	15.8	13.6	21.8	11.1	15.0	18.2
Adjacent	52.6	48.2	52.2	60.2	52.6	48.3	53.6	53.7	53.9	55.6
Nonadjacent	47.4	51.8	47.8	39.8	47.4	51.7	46.4	46.3	46.1	44.4
<b>1969</b>										
Metropolitan	71.9	46.8	82.4	79.7	85.2	87.3	79.5	88.4	84.8	81.5
Nonmetropolitan	28.1	53.2	17.6	20.3	14.8	12.7	20.5	11.6	15.2	18.5
Adjacent	57.8	51.1	55.2	59.8	52.2	49.8	54.3	53.3	53.6	55.7
Nonadjacent	42.2	48.9	44.8	40.2	47.8	50.2	45.7	46.7	46.4	44.3
<b>1979</b>										
Metropolitan	81.1	46.5	81.0	77.1	84.5	83.5	79.0	86.6	84.8	80.5
Nonmetropolitan	18.9	53.5	19.0	22.9	15.5	16.5	21.0	13.4	15.2	19.5
Adjacent	60.4	48.0	53.4	58.1	52.6	50.0	54.1	54.2	53.4	54.7
Nonadjacent	39.6	52.0	46.6	41.9	47.4	50.0	45.9	45.8	46.6	45.3

SOURCE: Compiled from County Business Patterns.

focus on people's preferences for living outside the cities. A *Newsweek* cover story reports on recent arrivals to nonmetropolitan areas who make only half as much money as they did in the city, but who are compensated by the "cry of a loon" on nearby lakes.<sup>11</sup>

Several factors are cited to explain why a greater number of households are able to act on their presumed preferences for rural living. One is the increasing proportion of retirement-aged people who need not match location and employment decisions. Retirees appear to be migrating to amenity-rich, low-cost locations, many of which are nonmetropolitan. Another frequently mentioned factor is the large increase in the number of people seeking college education as a result of the maturing of the post-war baby-boom generation. Since many colleges and universities have nonmetropolitan locations, the increased demand for educational services is thought to lead to increased employment opportunities in such locations.

But, if these factors are the key to understanding nonmetropolitan growth patterns, the pattern of statistics would look very different. They would show population growth *leading* employment growth, not vice versa. Moreover, the largest rate of growth would be in sectors such as retail trade and services, in response to increased consumer demand in nonmetropolitan areas. This is also not the case. These explanations do shed some light

on the forces for growth in nonmetropolitan areas; however, they leave the forces that distinguish deconcentration from other patterns of employment growth in the shadows. The spotlight belongs on innovations in production, transportation and communications technologies, which have *significantly* reduced the economic advantages of concentrating economic activity.

## CONCLUSION

The very same forces that gave rise to the suburbanization of people and jobs have now made rural locations economically viable. Innovations in transportation, communications, and production technologies led to suburbanization of manufacturing and wholesaling employment, and they now underlie the deconcentration of these same industries. Now many nonmetropolitan places are experiencing the same sequence of development as did the suburbs: manufacturing and wholesaling are leading the influx of other industries and people.

This new trend towards deconcentration is short-lived, so it may be reversed in the near future. But since it appears to be based on technological change, this seems unlikely. While all of its consequences are not fully known, deconcentration is likely to have sobering effects on central cities, particularly in the northeast and midwest regions, the traditional centers of manufacturing. Having suffered job losses from suburbanization and moves to the Sunbelt, these cities now face additional drains due to deconcentration.

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<sup>11</sup>"America's Small Town Boom", *Newsweek*, (July 6, 1981).

# Anatomy of a Fiscal Crisis

*Robert P. Inman\**

The 1970s marked the beginning of a new era of austerity for the financial managers of our major cities. The economic boom of the 1960s and the enormous influx of state and federal dollars into the local public purse had come to an end. No longer could cities count on a continually expanding tax base or a new federal aid program to cover past excesses in public spending. For three cities—New York City, Cleveland and Philadelphia—the new reality proved harsh indeed. New York and Cleveland simply ran out of money and were unable to pay the required principal and interest due on city bonds. Philadelphia passed the single biggest tax increase in its history to

avoid a similar fate. All three cities now seem on their way back from the edge of financial disaster, but the path has not been easy.

What pushed these three cities to the brink of fiscal collapse? Commenting on the events leading to New York's fiscal crisis of April 1975, then Deputy Mayor James Cavanagh said: "Maybe we were dumb, but nobody... seemed to have understood what was happening..."<sup>1</sup> Well, just what *was* happening? The story is not New York's, Cleveland's, or Philadelphia's alone. The same fundamental forces which pushed these cities to the edge are at work in all major U.S. cities. Today's most prosperous cities may well be the cities in need of tomorrow's state or federal bailout.

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<sup>1</sup>Quoted in Charles Morris, *The Costs of Good Intentions*. (N.Y.: W.W. Norton, 1980) p. 239.

## CORPORA DELICTI: THE BODIES POLITIC

**New York.** In April, 1975, New York City ran out of money. There simply was not enough cash to pay the bills that were coming due. The immediate cause was that the banks of New York were unwilling to continue their usual practice of lending the city money for the short-term—usually three to six months—while the city waited for tax revenues to be collected. The banks were nervous. They saw in the city's fiscal future a serious threat to its ability to repay those loans. The cash-squeeze problem was resolved when the state of New York agreed to advance the city \$400 million in revenue-sharing funds due the city in June. But when the city tried to borrow from the banks in May, it was again rebuffed. Mayor Beame turned to the state for assistance once more. Governor Carey, now aware that the problem was not temporary, appointed a prestigious panel, headed by investment banker Felix Rohatyn, to advise him. The panel's recommendation was to create the Municipal Finance Assistance Corporation—locally known as "Big MAC"—to restructure the city's debt and to monitor the city's spending and accounting practices. Mayor Beame objected to the effective loss of control over the city's finances, but the necessity of state assistance was paramount. The summer of 1975 was long and difficult as MAC demanded a wage freeze for city workers, layoffs, an increase in the subway fare, and tuition at City University. By August all parties realized there was no choice: either the requirements of MAC were met, or the city stopped functioning. Over the following months, the debt repayment schedule of the city was restructured, state and federal assistance was provided, and the city's financial prospects assumed a measure of stability once again. Finally, four years later in early 1979, New York City issued and successfully marketed \$125 million in short-term notes. The worst was over.<sup>2</sup>

<sup>2</sup>For an excellent history of the crisis and the political events leading to the financial fall of the city, see Morris, *The Costs of Good Intentions*. For an economic overview of the causes and consequences of the New York City crisis, see Edward Gramlich, "The New York City Fiscal Crisis: What Happened and What Is to Be Done?" *American Economic Review*, (May, 1976), pp. 415-429.

**Cleveland.** On December 15, 1978 the City of Cleveland defaulted on \$14 million in municipal bonds. The proximate cause of default was that the six Cleveland banks were unwilling to refinance city notes that were coming due on December 15. Just why the banks were reluctant to refinance may never be known, for the decision was made in the midst of a bitter political battle between then Mayor Dennis Kucinich and the Cleveland business community. The bone of contention was the city's ownership of an electric power system called MUNY. MUNY was viewed by its opponents, which included most of the major banks, as an antiquated, inefficient utility that drained the city's budget of funds needed for more crucial public services. The investment community saw the sale of MUNY as an immediate new source of needed cash, as well as a step towards long-run fiscal solvency. And if MUNY were sold, the banks might view the city's fiscal prospects more favorably and lend the needed dollars to avoid default. MUNY's proponents, led by Mayor Kucinich, stressed its importance as a competitor to the area's private utility, Cleveland Electric Illuminating Company.

The banks chose not to refinance based on their assessment of Cleveland's declining financial position. Indeed, Moody's downgraded the city's bond rating from A to Baa in June 1978 and again from Baa to Ba in July 1978. To Mayor Kucinich the decision not to refinance was an example of the banks' desire to manage the city to their own ends. The mayor contended that the implied link of the sale of MUNY to city bond refinancing was a business-led effort to establish a monopoly position for the private utility. He proposed instead to keep MUNY under city control and to increase the city's income tax by 50% to handle the financial crisis. The 50% tax hike was imposed, but the issue of the sale of MUNY was not resolved, and no new bond financing was available for the remainder of Mayor Kucinich's term. In November, 1979, George Voinovich was elected Mayor with broad-based community support. A blue-ribbon team of financial experts was appointed to assist the city in re-organizing its system of financial accounts and to negotiate with the banks for refinancing the defaulted notes. The notes have since been refinanced, and Cleveland seems on the way back towards fiscal respectability. The city still owns MUNY.

**Philadelphia.** On July 1, 1976 the city of Philadelphia increased local taxes by 30 percent. The local wage tax rate rose from 3.3125% to 4.3125%, and the millage rate for property taxation (tax dollars per \$1,000/assessed value) was increased from 19.75 to 32.75. The immediate cause was a projected deficit of over \$100 million, on the heels of an actual deficit of \$73 million in the previous year. Lying behind the deficits was a six-year period of rising spending and lagging tax revenues.<sup>3</sup> While the tax increase closed the projected gap, it signaled to the investment community a fundamental weakness in the city's fiscal base. Moody's lowered the city's bond rating from A to Baa.

In 1976, Philadelphia took one small step back from the edge of default, but at the price of pushing up local taxes enormously. It is not clear that the city again can muster—or afford—such a sizable tax increase.

New York, Cleveland, and Philadelphia are simply examples—prominent ones to be sure—of cities which can rightly be described as having suffered fiscal crises. No doubt other cities have faced similar pressures too. Just why do these crises arise?

## THE HOWS AND WHYS OF A FISCAL CRISIS

Fiscal crisis in a city involves a complicated interplay of political and economic forces. Stagnant or declining private economies create unique pressures on local public officials: hard-pressed taxpayers, concerned investors, worried public employees, and needy residents each make their claim to a share of the shrinking real resource base. The politician's hope is to satisfy everyone, particularly the current voters. But when real resources are declining, someone is sure to lose. New money, money from outside the city, is required. Federal and state governments are one obvious and popular source of relief, but those dollars are limited. City officials have to tap sources other than the federal treasury. They have turned instead to the *taxpayers of the future* for assistance,

and, without asking for approval, have taken money from their pockets to finance current services. How is that possible? By borrowing from future tax revenues through deficit financing, underfunding pensions, and allowing the public capital stock to depreciate. When these "borrowings" finally fall due—when investors and retirees want their money and when roadways collapse into the river—then we observe, with graphic and dramatic force, the fiscal crisis.<sup>4</sup>

**How to Have a Fiscal Crisis.** How does New York, Cleveland, Philadelphia, or any city, manage to borrow from the future when there are legal requirements in state charters to have a balanced budget? The answer is clever book-keeping.<sup>5</sup> In most states the only formal check-point of a city's budget occurs when the city submits its *prospective* budget to the state. The *prospective* budget is always balanced. But the *prospective* budget need not be the actual, end-of-the-year budget. In the *prospective* budget, cities *estimate* revenues and expenditures. The temptation is always there to overestimate revenues—we *will* collect those delinquent taxes this year—and to underestimate expenses—didn't the *Farmer's Almanac* predict another mild winter? When these optimistic estimates fail to come true, a deficit results. How do cities fill the gap? The answer is to borrow money from one, or all, of the following three sources.

First, cities borrow from banks for periods of less than one year to cover the temporary mis-

<sup>4</sup>The argument can be offered that these current borrowings used to finance current services will be "capitalized" into reduced land prices in anticipation of a fiscal crisis. If, as a new resident, I expect to have to pay \$1,100 in taxes next year for a \$1,000 worth of services delivered yesterday (which I did not receive), then I will demand that those selling me my new home take a \$1,000 reduction in the home price, so that I might invest the \$1,000 savings in a 10% Treasury bill to yield \$1,100 next year which I will allocate to next year's taxes. When current borrowings for current services are fully capitalized into land prices, then a fiscal crisis need not occur. Future taxpayers have anticipated the crisis and have saved accordingly.

Is there any persuasive evidence that past borrowings are actually capitalized? Not yet; see R.P. Inman, "Public Employee Pensions and the Local Labor Budget," *Journal of Public Economics*, (November 1982), particularly pp. 69-70.

<sup>5</sup>For an introduction to the accounting "games" that cities play, see N. Noto and D. Raiff, "Philadelphia's Fiscal Story: The City and the Schools," pp. 18-21.

<sup>3</sup>See N. Noto and D. Raiff, "Philadelphia's Fiscal Story: The City and the Schools," this *Business Review*, (March/April, 1977), pp. 3-47.

match of expenditures (which occur weekly as pay checks and bills fall due) and revenues (which are collected quarterly or annually). These short-term borrowings are called tax-anticipation notes, and are to be paid back in full at the end of each fiscal year. But short-term loans often overlap fiscal years. Last year's debt can be carried into next year's budget. As debt is passed on from year to year, so, too, is the current account deficit that debt has financed.

Cities may also borrow to cover current expenditures by underfunding public-employee pension funds. This may reflect an explicit decision to postpone the required contribution to the pension fund, or it may occur because the required contribution, though paid, is an underestimate of the contribution likely to be needed in an inflationary economy. Regardless of the cause, the effect of underfunding pensions is to put off current expenditures until a later date, and thereby create a loan from future to current taxpayers.<sup>6</sup>

Cities can tap future tax dollars in a third way. Just as cities can put off current spending until some future date by failing to fund public employee pensions, cities also can shift current expenses onto future taxpayers by failing to maintain the present public infrastructure. Good financial management requires that as physical assets (such as city streets) wear out, they be expensed on the current accounts budget at an appropriate depreciation rate. These expenditures can then be allocated to maintain the decaying asset or to replace it at a later date. If maintenance funds are not allocated either directly or as capital debt retirement, a liability is created by current taxpayers which must be repaid by future residents. The size of this debt can be significant. A series of careful studies of the capital needs of six large U.S. cities by the Urban Institute has estimated that the required *annual* replacement costs of neglected public infrastructure over the next

ten years will range from \$15/resident to as much as \$100/resident for these cities.<sup>7</sup>

The sum of the annual increase in short-term debt, unfunded pension obligations, and neglected replacement or maintenance expenditures constitutes the city's short-term deficit. Each form of borrowing is easy to do, but hard to detect. One needs to be an accountant, an actuary, and an engineer all at once. Barring such expert analysis, a simple early-warning device to signal a potential problem would be helpful. A working rule of thumb might be to compare the level of a city's current accounts surplus per capita to the *average* level of pension underfunding and infrastructure depreciation for large U.S. cities, which is \$50/resident per year.<sup>8</sup> If the measured surplus exceeds this

<sup>7</sup>Urban Institute, *America's Urban Capital Stock, Volumes 1-6*: New York City (vol. 1), Cleveland (vol. 2), Cincinnati (vol. 3), Dallas (vol. 4), Oakland (vol. 5), Boston (vol. 6), George Peterson, Project Director and General Editor, Washington, D.C., 1979-1981. The low cost cities are Cincinnati and Dallas while Boston, New York, and Cleveland are all near \$100/resident.

Knowing that the public capital stock has declined is not by itself sufficient to conclude that the city has borrowed from the infrastructure to pay for current services. Long-term debt liabilities may have declined as well, so that the *net* wealth associated with the public capital stock (asset value minus debt liability) is unaffected. In fact, however, long-term debt liabilities in all five cities have *risen* over the past decade: Dallas (from \$256/resident to \$386/resident), Cincinnati (from \$409/resident to \$435/resident), Boston (from \$371/resident to \$963/resident), New York (from \$744/resident to \$1,072/resident), and Cleveland (from \$338/resident to \$346/resident).

<sup>8</sup>Recent work by Robert Inman for the Federal Reserve Bank of Philadelphia indicates that cities may fund only 1/3 to 1/2 of their annual pension obligations. (See R.P. Inman, "Public Employee Pensions and the Local Labor Budget.") If so, and if the typical city budget has an actual pension obligation of approximately 10 percent of its \$300/capita public labor budget, an annual pension deficit of about \$15.00 per resident results ( $= .5 \times .10 \times \$300/\text{capita}$ ).

The Urban Institute studies of city capital needs estimate additional annual expenditures ranging from \$15/resident per year to \$100/resident per year for their sample cities to replace neglected capital stock. See footnote 7. A conservative estimate of capital budget needs in most large cities is probably nearer to \$35/resident per year. A reasonable guess as to the average annual deficit from neglected pension and infrastructure financing in large U.S. cities is therefore about \$50/resident per year ( $\times \$15/\text{resident} + \$35/\text{resident}$ ).

How do the budgets of Philadelphia, New York City, and Cleveland stand up against this simple test? For the pre-crisis period, 1970-1976, each city was right at the critical threshold. Philadelphia averaged an annual current accounts surplus of \$70/resident. New York City averaged an annual current

<sup>6</sup>In a previous article for this *Business Review*, I have estimated the size of unfunded state and local public employee pension obligations in the United States at \$500/person for the year 1976. There are good reasons to think this debt has grown even larger in recent years. See Robert P. Inman, "Paying for Public Pensions: Now or Later?" this *Business Review*, (November/December, 1980).

critical threshold, the city passes this rough test for fiscal soundness. If the measured surplus falls short of the critical threshold of \$50/resident, then the city fails the working test. The city *may* be accumulating serious short-term deficits, and a detailed look at the city's current accounts budget, and its pension and capital financing programs is in order. Such cities may be on the edge of a fiscal crisis.

**Why There is a Fiscal Crisis.** Cities are driven to the brink of bankruptcy by two different sets of forces, one political and the other economic. When the political environment encourages a shortsighted, "what have you done for me lately" mentality, and when economic fortunes stagnate or decline, then we are on our way to a fiscal crisis.

City budgets are political statements. They reflect the judgments of elected officials about the needs of their voting constituents for public services and their tolerance for taxes. Two facts about voting behavior shed light on the rationale of city politicians when they set the city's budget. First, an average U.S. urban household moves once every five years. To be sure, some families remain in the same location for twenty years, but then four other families move once every one or two years. Families move for a variety of reasons: new jobs, transfers, children get older, children move away. When families move they take their votes with them; so old favors and long-run promises are politically useless in a mobile society. Second, some evidence on voting behavior in response to economic policy suggests that even for those voters who stay put, *current* services and incomes appear to be all that matter.<sup>9</sup> When voting, we simply ask: "what have you done for me lately?" The combined effect of a mobile population and myopic voters creates pressure on those

who set the city budget to "deliver" today. Politicians seeking re-election really have only two concerns: *today's* services and *today's* taxes. The future, even the five- or ten-year future, is politically irrelevant.

The budgetary myopia encouraged by the local political process has little consequence for an economy with adequate and constantly expanding real resources. In high growth regions, "overdoing it today" can be paid for from future growth dividends. It is in stagnant or declining local economies that political reality and economic reality collide.

Cities whose private economies are in decline, or in transition to a new economic base, face a unique set of conflicting demands on their public budgets. As tax revenues are falling, spending needs are rising. As existing economic activity declines—manufacturing usually leads the way—jobs and residents leave the city. The city's tax base consequently declines. Closed firms no longer pay property taxes and departed workers don't pay wage or sales taxes. Those are the direct losses, and they have been most evident in Philadelphia and Cleveland. There are secondary effects as well. The demand for commercial and residential property in the city declines, and this naturally lowers the price at which those properties sell. This general fall in property values may also reduce the city's tax base.

Economic stagnation also creates pressure to increase city spending. A significant fraction of most large city budgets is allocated towards services that assist low and modest income families. Public housing, public health and hospital services, and public welfare are now in greater demand. Philadelphia, for example, allocates 18 percent of the city's budget to such services. As the city's economy declines, the pressure to increase spending for these services increases. Economic stagnation creates indirect pressure on spending, too. Rising unemployment often leads to rising crime rates, which, in turn, requires more police spending. In addition, maintenance of household and commercial structures will fall, producing increased fire protection expenditures and sanitation costs in the declining neighborhoods. Finally, education expenditures may rise as the city responds to unemployment with training programs.

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accounts surplus of about \$95/resident, but it should be remembered New York's capital and pension account needs were well over \$100/resident per year (see fn. 7). It is easy to see why the New York banks were nervous about additional short-term credit. Finally, Cleveland averaged \$60/resident in the annual current accounts surplus for this period, but Cleveland too has an estimated annual deficit of over \$100/resident on the capital and pension accounts (see fn. 7).

<sup>9</sup>See Ray Fair, "The Effect of Economic Events on Votes for President," *Review of Economics and Statistics*, (May, 1978), pp. 159-173.

The economic pressures on city tax base and city spending created by a declining local economy are the root causes of local fiscal problems. A beleaguered city can adopt one of three fiscal strategies. The first is to raise tax rates on the existing tax base, but this may well accelerate the decline. Increased taxation is likely to further discourage firm and housing investment in the city. For example, recent estimates by the staff at the Federal Reserve Bank of Philadelphia predict that for every 10% rise in Philadelphia's wage tax, between 8,000 and 32,000 jobs will be lost to the city.<sup>10</sup> And, the response is likely to occur quickly in our mobile society. Both economically and politically, a tax increase is an unappealing option.

The second strategy is to reduce spending. Here the city may have very little leeway in the short-run. Labor expenses compose more than 70 percent of most cities' non-capital expenditures, and most labor costs are determined through city-employee bargaining over wages and employment levels. Politicians can try to convince city unions of the need to control spending through modest wage settlements and flexible, efficient staffing procedures. This may be politically difficult to achieve, however, especially if public employee unions are strong.<sup>11</sup> Nevertheless, it is important to strive for efficiency in the provision of local services, not just to avoid fiscal dilemmas, but also to allow cities to be viable competitors for new firms or new residents. There appears to be substantial variability across cities in efficiency in providing public services (see THE TAX PRICE INDEX).

This leaves city officials with the third strategy:

to run a deficit. As the tax base declines and as spending obligations rise, the temptation is to pay for current services by borrowing against the future. When voters are myopic, accurate accounting is difficult, and when politicians have very short horizons, deficits emerge as the most attractive strategy. The debt will not fall due until current residents and current political leaders have long since left the scene.

Fiscal crises do not just happen, nor are they planned. The long-run economic forces of change and transition have forced the private economies of many urban areas into periods of stagnation and decline. Politics is more likely to contribute to the problem than to solve it. Rather than isolated events, the fiscal crises of New York City, Cleveland, and Philadelphia may be the first of many in the local public sector—unless, of course, we head them off.

## WHAT CAN BE DONE?

There is no easy deterrent to the threat of an urban fiscal crisis. The strategy of borrowing against future wealth through short-term deficit financing only *postpones* the inevitable need to conserve resources in declining or changing urban economies. Furthermore, the presence of such deficits may weaken the chances for a successful transition to renewed strength in the private sector. A history of deficit financing may dissuade firms and households from moving into the city. No one wants to be around when the fiscal crisis finally erupts.

The solution in the past has been to look to Washington or the state capital for financial assistance. While federal and state grants-in-aid have helped on occasion, cities cannot count on these monies in the future. Fiscal conservatism at the federal and state level has slowed the growth of these programs, and a decline in the real value of assistance for cities is likely. This will increase, not lessen, the pressure to run local deficits.<sup>12</sup>

A sensible strategy involves sound fiscal management and a local program for new economic

<sup>10</sup>See John Gruenstein, "Jobs in the City: Can Philadelphia Afford to Raise Taxes?" this *Business Review*, (May/June, 1980), pp. 3-11. For related work, see Ronald Grieson "Theoretical Analysis and Empirical Measurement of the Effects of the Philadelphia Income Tax," *Journal of Urban Economics*, (July, 1980), pp. 123-137; and Ronald Grieson, et al., "The Effect of Business Taxation on the Location of Industry," *Journal of Urban Economics*, (April, 1977), pp. 170-185.

<sup>11</sup>Edward Gramlich, "The New York City Fiscal Crisis," p. 417, has estimated that if each member of a public union in New York City could persuade two other voters (for example, a spouse and a friend) to support the union position, public unions would control over 30 percent of the voters in New York City. It is easy to see why this second strategy did not work in New York City.

<sup>12</sup>For estimates of the effects of President Reagan's new federalism on local budgets, see S.G. Craig and R.P. Inman, "Federal Aid and Public Education: An Empirical Look at the New Fiscal Federalism," *Review of Economics and Statistics*, (November, 1982), pp. 541-552.

## THE TAX PRICE INDEX

The *tax price index* (TPI) is a price index which measures the relative cost in tax dollars of providing a unit of public service facilities to households and firms within a city. The index has two components: (1) an index of local government labor and material input costs to measure the relative costliness of providing local government service inputs, and (2) an index of the relative share of these input costs which must be paid by households and firms within the city. The second component is important because a significant fraction of local governments' costs are now paid by state and federal governments. The TPI allows us to compare the costliness to residents of purchasing a bundle of local service inputs in one city to the costliness of purchasing that identical bundle in another city. The higher the TPI, the more costly it is to buy the bundle of public service inputs. The TPI compares each city to a "base" city, which, for this index, is that city with the national average public employee wage structure, the average cost of materials, and the average level of state and federal support for local services. A TPI of 100 means the sample city can provide local services at the same per unit costs as the nation's average city; a TPI of 120 means the sample city must pay 20 percent more than the average city for its local service inputs. All data are for the fiscal year 1979-80, the most recent year for which comparative data are available.

When using TPI for comparisons, we must be careful on two points. First, the TPI only measures the relative cost of labor and material inputs. TPI does not include a measure of the relative costs of public capital nor does it measure the cost of providing a standard unit of public *output*, such as school test scores or the prevention of a highway accident, a fire, or a robbery. It is only an index of current account input costs. TPI measures an important part of local government efficiency but it is not the whole story. Second, a high value of TPI alone does not signal a fiscal crisis. Though some cities may have costly public services they may also be rich in taxable resources to pay the cost. Los Angeles and San Diego are examples. Alternatively cities may be relatively inexpensive when it comes to providing local services, but they may also be very poor in taxable resources. Cleveland is an example. In summary, the TPI tells an important part of the story of a fiscal crisis, but it clearly does not tell the whole story.

	Index of Labor and Material Costs	Index of Own Revenue Contribution	TPI
Baltimore	87.3	79.7	69.6
Chicago	116.7	68.3	79.7
Cleveland	104.3	90.3	91.0
Detroit	115.3	79.5	91.6
Houston	96.1	126.0	121.1
Los Angeles	124.9	95.1	118.8
Minneapolis	113.2	81.1	92.0
New York	109.0	114.8	125.2
Philadelphia	109.2	111.4	121.7
Pittsburgh	101.0	110.3	111.5
San Diego	115.3	103.6	119.5
Washington D.C.	115.0	87.3	100.4
<b>National Average</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

The index of labor and material costs is described in detail in R.P. Inman, "Dissecting The Urban Crisis: Facts and Counterfactuals," *National Tax Journal*, (June, 1979).

The index of own revenue contributions is the ratio of the share of current expenditure from own revenues for the sample city to the share of current expenditures from own revenues for the national average city.

TPI is calculated as the product of columns (1) and (2) for the sample city divided by the product of columns (1) and (2) for the national average city and then returned to index form by multiplying by 100.

development. Efficiencies in public service provision must be exploited when they are available.<sup>13</sup> Negotiated public wage increases must be fair but consistent with the economic trends within the region. Cities must begin to fund public employee pensions and maintain public infrastructures. Services elsewhere in the budget may have to be curtailed to help reduce past deficits. Such stringent budgetary measures will require strong political resolve and an ability to convince current residents of the long-run economic advantages of sound fiscal performance.

Both the resolve and the promise of long-run economic benefits are enhanced if the city has a clear program for reversing the downward trend in its local economy. The objective of any development strategy must be the full utilization of the city's people, its capital, and its natural resources. In Philadelphia, this means developing the port, encouraging tourism and convention business, and expanding business activities that complement the city's strong health-care system and its

medical and scientific research centers.<sup>14</sup>

The city's political leadership can, and must, play a role in the development of a long-run economic strategy, but the city government cannot, and should not, become an active investor in the private sector. There is no convincing evidence that large tax breaks attract many new jobs or that city governments are particularly adept at spotting leading firms in high growth industries. Investment decisions are best left to private investors. What city governments can do, in addition to ensuring a stable long-run tax environment, is to assist new firms through the many local regulations which often stand in their way of actually doing business. But top priority should go to keeping the city's financial affairs in order. The promise of sound fiscal management and administrative assistance for new establishments may be the most effective contribution that local governments can make to the revitalization of the private sector.

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<sup>13</sup>The use of contracting local public service provision to private, competitive firms is one avenue which must be explored. See E.S. Savas, *Privatizing the Public Sector*, (New York: Chatham House Publishers, 1982).

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<sup>14</sup>For some recent evidence that these sectors are the likely leaders in Philadelphia's economic revitalization, see John Gruenstein, "Can Services Sustain a Regional Economy?" this *Business Review*, (July/August, 1981).

# Economic Development in the Third District: Three Approaches

*Eleanor Craig and Scott Reznick\**

Delaware, New Jersey and Pennsylvania aggressively compete for businesses to stimulate their economic growth and provide new jobs. Each offers an extensive array of business incentive and assistance programs. Businesses are, in a sense, the consumers of these state and local economic development programs. They shop among state and local governments for programs that will lower their costs and enhance their competitive position.

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One of the most heated controversies in urban economics is the question of whether these economic development incentives make a difference in business location decisions. The divergence of feeling on the topic is suggested by the following recent statements. Vaughan, on the negative side, writes, "There is no evidence that these concessions have had any significant effect on local growth."<sup>1</sup> Small, however, in support of incentives, says, "Since average state and local business taxes constitute one third of profits, and local rates vary

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<sup>1</sup>Roger J. Vaughan, *State Taxation and Economic Development*, (Washington, DC: Council of State Planning Agencies, 1979), p. 99.

by a factor of two or more, these local variations are substantial enough to imply an important impact on locational decisions."<sup>2</sup>

Since all states provide locational incentives to businesses, each state must perceive beneficial results from these policies. The first state with a successful economic development program is almost certain to reap the benefits of innovation. As this program is copied, competition among states reduces these gains. Each development program is experimental in nature, and the precise employment and income gains from any individual program cannot be accurately calculated. Different programs can be compared and contrasted, however, to try to gain some rough sense of what works and what doesn't.

Each of the three Third District states has its own distinctive approach to economic development. Delaware's efforts in recent years have focused on restoring the state to fiscal stability and eliminating vestiges of poor economic management. New Jersey has centralized its economic development activities in its Department of Commerce and Economic Development. Pennsylvania has continued to decentralize its economic development programs and to target them to particular segments of the state's economy. Despite these differences in emphasis and approach, there are similarities among the three states' economic development programs. All three, for example, use industrial development bond financing and property tax abatement as tools to promote development.

## INDUSTRIAL DEVELOPMENT BONDS

Industrial Development Bonds (IDBs) offer loans to eligible businesses at interest rates below going market yields. Reduced interest charges are possible because lenders are not required to pay taxes on the interest payments they receive from IDB borrowers. Fifteen years ago IDBs were an innovative economic development tool and most states offered them. In 1982, Delaware placed more than 100 IDB loans, and the state recently

created an umbrella agency to extend low interest loans to small businesses. The New Jersey Economic Development Authority helped finance more than 400 IDB projects in 1982 with average loans of \$1.4 million. Many of these loans were earmarked for urban retail and commercial establishments owned by minorities. Pennsylvania's IDB program provides tax exempt mortgages as well as bonds, and the Keystone state has consistently led the nation in the volume of its tax exempt financing. In 1982, Pennsylvania placed approximately \$2.2 billion in tax exempt bonds and mortgages, more than twice as much as any other state.

Recently enacted federal legislation has, however, made continued reliance on tax exempt IDB financing a highly risky proposition. The Tax Equity and Fiscal Responsibility Act of 1982 severely undercut the subsidy given to "large-issue" IDBs (over \$10 million) and requires phasing out "small-issue" IDBs (under \$10 million) by the end of 1986. States that stress IDBs strongly, like Pennsylvania, may find themselves at a competitive disadvantage unless they generate other financing programs to replace the interest yield subsidies provided by the IDB tax exemption.

## PROPERTY TAX ABATEMENT

The outlook for the property tax abatement programs relied upon by the three states is more certain than that of their IDB programs. Under state legislation, local governments in all three states are empowered to exempt *increments* in the assessed valuation of qualified property from real estate taxation. The programs differ, however, in their definitions of qualified property, as well as in the size of the abatement and its duration.

The City of Wilmington and New Castle County in Delaware grant property tax reductions for that portion of an increased assessment attributable to qualified new construction and improvements to existing buildings. The city provides a 100 percent credit against increased assessment for five years and extends the credit to ten years in certain targeted areas. The county exempts qualified new construction and improvements from county taxes at a rate of 100 percent for the first year, followed by 10 percent decreases each year until the full rate of taxation is reached.

Under New Jersey's tax-abatement statute, a

<sup>2</sup>Kenneth A. Small, "Geographically Differentiated Taxes and the Location of Firms," Working Paper from the Princeton Urban and Regional Research Center, (Princeton, NJ, 1982), pp. 4-23.

municipality may grant a property tax exemption on improvements to commercial or industrial facilities for a period of five years. Improvements may not increase the volume of a commercial or industrial building by more than 30 percent. Where a project involves construction of new facilities, or enlargement of existing facilities by more than 30 percent in total volume, a municipality may draft a written agreement allowing for payment in lieu of full property taxes for five years according to one of three possible formulae: 2 percent of the cost of the new facility, 15 percent of the annual gross revenue, or phase-in at 20 percent increments for a five year period. To qualify, a project or improvement must be located in an area "in need of rehabilitation" as determined by the Commissioner of the Department of Community Affairs or by the local governing body or planning board.

Pennsylvania's property tax-abatement programs are targeted toward deteriorated property and declining neighborhoods. These programs are available for residential as well as commercial and industrial properties, and they exempt increments in assessed valuation from property improvements through optional abatement schedules. Taxpayers may be provided with a ten-year schedule beginning with a 100 percent exemption in the first year, reduced by 10 percent per year for subsequent years, a five-year schedule permitting a 20 percent reduction per year, or a schedule of taxes stipulating the portion of improvements to be exempted in each year for a maximum of ten years.

Industrial development bond financing and property tax abatement programs are strategies for economic development that have been used over a long period of time in the three states in the Third District. In more recent years, the states have formulated other strategies with somewhat different emphases.

## DELAWARE

Delaware's financial integrity was threatened in the mid-1970s. Since 1977 the state's primary economic development focus has been to restore its fiscal health. Delaware had five deficits in its operating budget between 1971 and 1977, had enacted twenty-two tax increases in the same period, and still had one of the heaviest debt

burdens in the nation. Not surprisingly, it also had the lowest bond rating of any state in the U.S. in 1977. To top things off, the bank where the state maintained its entire cash balances had come to the brink of failure. This saga of poor management, of "surprise" deficit spending, and of financial instability meant lost jobs and reduced income. The situation deteriorated to the point where Delaware officials concluded that a necessary bond issue for capital projects in 1977 could not be marketed successfully to the public. The twenty-two banks in the state bought the issue privately, following extensive negotiation and the enactment of several temporary and pledged taxes.

In the past six years, Delaware has worked hard to improve its fiscal position. Budgets have been balanced for five consecutive years, and the Governor and General Assembly worked together and tightened their belts to achieve a sixth balanced budget in fiscal 1983. A budgetary reserve fund was established and has remained fully funded (at 5 percent of budget) for the past four years. Appropriation limits have been mandated—spending plans must remain within the state's ability to finance them. A three-fifths majority voting rule for tax increases was incorporated into the constitution, on the grounds it would enhance prospects for a stable tax climate for businesses. Capital authorization limits were passed reducing the debt load on the state budget from 17 percent in 1977 to 12 percent in 1983.

Despite the recession and federal spending cutbacks, Delaware has lowered personal income tax rates by 9 percent, and is firmly committed to a second personal tax reduction. These efforts to restore fiscal health, indeed, are seen by the state as the *cornerstone* of its economic development approach. Other policies have played a role, too.

In early 1981, the Financial Center Development Act was passed; it removed usury ceilings on credit transactions and provided financial institutions a favorable tax climate with rates as low as 2.7 percent on net income in excess of \$30 million.<sup>3</sup> Fourteen banks from Maryland, Pennsylvania, and New York have located significant operations in

<sup>3</sup>For further details on this act, see Jan Moulton, "Delaware Moves toward Interstate Banking: A Look at the FCDA," this *Business Review* (July/August, 1983).

Delaware, and 1,600 new jobs have been created in the state. In addition the Delaware Development Office was opened in 1981 and has been influential in attracting cyclically stable businesses. This is the first time the state has had a cabinet-level agency designed to deal exclusively with the promotion of economic development.

State government has taken an active role in fostering business expansion in Delaware. Under the Lt. Governor's direction, task forces have been developed and new legislation implemented which resulted in significant cuts in the red tape facing small business firms in the state. The state has also begun to act as a broker for firms needing skilled labor. Delaware puts new and expanding companies in contact with local community colleges and other training institutions. The state helps the training facilities and the firms gauge labor needs, then recommends certain training options in the private sector, rather than having the state provide the education and training itself.

## NEW JERSEY

New Jersey's principal economic development focus has been to centralize the administration of its economic development programs in a single state agency. The Garden State's development initiatives were scattered throughout various state and local agencies until 1981, when the state created a Department of Commerce and Economic Development to serve as a "focus" within the state government for economic and business concerns.

The New Jersey Economic Development Authority (NJEDA) is by far the most active and important of the divisional offices within the state's Department of Commerce and Economic Development. Its powers are broad: NJEDA can borrow and lend money, issue tax-exempt industrial revenue bonds, buy and sell land, buildings, and other property, and conduct research studies of the state's economic development environment. The Authority is self-supporting. The only significant limitation on its powers to promote economic development is that it cannot pledge the credit of the State.

NJEDA also administers a program to guarantee loans and bonds for the benefit of private businesses. The Authority insures repayment of portions of tax-exempt bonds and certain conven-

tional loans, and grants limited funds when a project has failed to obtain bank financing. The Authority estimates that its volume of loan and bond guarantees averaged nearly \$244 million in 1982 and helped create almost 6,000 jobs.

NJEDA operates a number of smaller programs which provide incentives to businesses contemplating opening or expanding operations in New Jersey. Under the Authority's Urban Centers Small Loan Program, loans are made directly to urban retail and commercial establishments in amounts up to \$30,000 for a maximum term of ten years at below market interest rates. NJEDA also operates an urban industrial park program; it acquires parcels of land, constructs improvements and markets sites to businesses and developers in packages that contain a number of tax and low-interest financing incentives. Through 1981, this program has generated over \$47 million in combined public- and private-sector investment. With four additional parks scheduled for completion in the near future, NJEDA estimates this figure will soon rise to over \$134 million, creating over 34,000 jobs for New Jersey residents.

The Authority also has been empowered to subsidize trainee wages for a private sector employer. And the Office for Promotion of Technical Innovation administers a Technical Innovation Financing Fund, seeking to encourage and promote New Jersey's developing "hi-tech" business sector.

Finally, during the latter part of the 1970s, New Jersey undertook a series of revisions to its tax laws designed to create a more favorable business investment climate. For instance, the state has recently repealed its unincorporated business tax, its retail gross receipts tax, the business personal property tax, and the sales tax on production machinery and equipment, and it is phasing out the net worth component of its corporation business tax.

## PENNSYLVANIA

Pennsylvania's principal economic development focus has been to strengthen its decentralized business incentive and assistance programs by targeting its resources to small businesses, high-technology industries, and economic revitalization in distressed urban areas.

Pennsylvania encourages capital investment in

new and expanding businesses through direct loans, loan guarantees, and direct grants, as well as through its IDB program. The Pennsylvania Industrial Development Authority (PIDA) provides long-term, low-interest financing to businesses and industry wanting to locate or expand in Pennsylvania. PIDA's annual appropriation from the Legislature has quadrupled in the last four years, and it has begun to target its financing activities. For example, PIDA loans to small businesses have increased 500 percent in the last two years, and over 43 percent of its loans have been placed in areas of high unemployment.

PIDA's financing activities have been supplemented for minority-owned businesses by the low-interest loans granted by the Pennsylvania Minority Business Development Authority. This Authority received \$6 million in new funding in the last three years and has loans available for land, buildings, machinery and equipment, and working capital.

The Commonwealth has recently introduced a new financing program designed specifically to assist new businesses. The Pennsylvania Capital Loan Fund has \$4.7 million for low-interest loans to small, young, industrial companies in need of funding for machinery and equipment, working capital and facility development. These loans have been specifically designed to fill gaps in the capital markets facing emerging businesses. A Small Businesses Action Center provides "one-stop shopping" to small businesses seeking to comply with state licensing and permit requirements, and expedites the resolution of regulatory problems. Free technical assistance is also provided through the Small Business Development Centers established at eleven Pennsylvania institutions of higher education. As in Delaware, a Small Business Task Force, under the direction of the Lt. Governor, seeks new ways of assisting small businesses in Pennsylvania.

Fostering high technology business has been the objective of an array of economic development policies in Pennsylvania, including tax incentives for research and development, low-interest loans, and programs to improve workers' skills. Recently the state established the Ben Franklin Partnership to provide \$1 million in so-called Challenge Grants for the creation of Advanced Technology Centers. These Centers are

consortia of academic institutions and private industry, established to carry on joint research and development activities, scientific education and technical training, and to assist in the creation and expansion of high technology businesses.

A Customized Job Training Program has also been designed to provide training to unemployed and underemployed individuals in specific skills for specific jobs. The program is both an incentive to businesses to locate in Pennsylvania, as well as a means of improving the prospects for unemployed workers to find jobs.

Pennsylvania also has employed the tax mechanism as a development tool. It has tried, for instance, to reduce the amount of paperwork facing business taxpayers. It has also enacted tax provisions, including net loss carry forward and phased-in accelerated cost recovery, to assist businesses to grow and create new jobs. Recent legislation provides employers with a tax credit of up to \$3,600 over three years for hiring a welfare recipient, and has made \$25 million available per year for this Employment Incentive Payment Program.

Regulatory relief has been undertaken in two ways in Pennsylvania: substantive regulatory requirements have been updated, and the regulatory process has been streamlined, not only to speed and simplify enforcement, but also to reduce the adversarial nature of regulatory determinations. For example, the state has just completed its first comprehensive review (since 1955) of its regulations promulgated under the Pennsylvania Fire and Panic Act. A Governor's Task Force on Regulatory Reform is continuing Pennsylvania's effort to modernize its regulatory system.

To enhance the economic development benefits of its diverse financing programs and tax and regulatory relief efforts, Pennsylvania recently instituted an Enterprise Development Area Program. It is geographically targeted on sites in Pennsylvania with both a significant need for revitalization and a potential for recovery. The program is designed to reduce existing financial, tax and regulatory disincentives to business efficiency, and where necessary, to provide incentives for the efficient and equitable use of limited private sector resources. Twenty-one Enterprise Development Areas will be designated in the first year of the program.

## CONCLUSIONS

Each of the Third District states—Delaware, New Jersey, and Pennsylvania—has a basic package of economic development incentives with strong similarities, but the “extras” offered by each state differ considerably, as do the degrees of emphasis. The obvious question both public and private decisionmakers might raise about the similarities and differences among the three states’ economic development programs is, “How can we best judge their success?” An extensive economic literature on the subject suggests that the overall success of such programs is difficult to gauge, and a statistical comparison of the relative economic performance of these states and the nation does not give definite answers. What is certain is that policymakers and the business community must continue to make decisions.

For policymakers, these decisions involve tradeoffs among alternative courses of action in the face of budget constraints and scarce public sector resources: they try to strike a balance between expenditures on economic development programs and on general public services, given the size of state tax revenues. How much states tip the balance toward development depends on both political and economic factors. The political factors include voter preferences and policymakers’ perceptions about the relative effectiveness of the trade-offs among programs, services, and taxes. The economic factors include the strengths and weaknesses of each state’s service and manufacturing base, its demographic profile, and the income levels of its citizens.

The business incentive and assistance programs offered by these states stand the best chance of generating economic growth and jobs if they are responsive to the needs and strengths of each state’s economy. While it is difficult to identify winners and losers among the programs, there are some broad guiding principles that seem likely to enhance the prospects for their success. For the sake of both policymakers and business, simplicity is better than complexity. Predictability and stability also are desirable, to help both make future plans that have a reasonable chance of being fulfilled. And programs which are administratively efficient, in the sense that public and private compliance costs are low, are preferable.

Economic development is a dynamic process, in which policymakers, businesses, and citizens all play a role. Policymakers weigh the relative success of programs, bolstering or even copying those that are successful, and dropping those that are unsuccessful or costly. Businesses planning to relocate, start up, or expand may thrive by taking advantage of the different programs offered by the states, and choosing the package most advantageous to them. To the citizens of Delaware, New Jersey, and Pennsylvania, the development programs now in place, and those yet to come, present an important set of policy choices and opportunities. Indeed, over the long haul, a state’s citizens play a key role in selecting an economic development strategy through a simple exercise called voting. In view of the recent vigorous development activity in the three states, their citizens appear to be pleased with their prospects.

# Epilogue

*Edwin S. Mills\**

The preceding papers provide instructive analyses of recent trends and public issues related to the nation's and region's economic growth. This epilogue provides some speculations about the future and some judgments about state and local government policies to encourage business and employment growth, with particular focus on the Third District and other eastern states.

It is easy to view the future with pessimism. Although recovery appears to be underway after a long and deep recession, no one knows whether it will be sustained enough to produce widespread

prosperity, or whether eastern states will achieve a large share of the gains.

As Carlino showed, employment shares have shifted from central cities to suburbs, from large to small metropolitan areas, from metropolitan to non-metropolitan areas, and from eastern and north central to sunbelt and western states. These trends are likely to work against prospects in eastern states, in the large metropolitan areas that are concentrated here, and especially in metropolitan central cities that are already the sites of difficult economic conditions. It is possible that more central city fiscal crises like those discussed by Inman will occur in other eastern cities.

Yet it is also possible to be optimistic. Some of the adverse trends of the 1970s and early 1980s—such as the national reductions in living standards

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since 1979 and the metropolitan exodus of the 1970s—were themselves reversals of earlier trends. No law says they cannot be reversed again.

As Carlino argued, the geographical movements of the 1970s that have hurt eastern states, metropolitan areas, and central cities result basically from the fact that manufacturing and other industries face fewer constraints each year on where to locate their businesses. In shorthand terms, businesses are becoming increasingly footloose. One consequence of this is that during the 1970s businesses moved from high to low wage areas: from eastern and north central to southern states, from large to small metropolitan areas, and from urban to rural areas. But this trend may be reversed because regional wage and earnings differences are now much smaller than they were thirty years ago, and by now probably reflect little more than regional differences in amenities, taxes and living costs. In addition, much of the west that was easy to settle is by now relatively densely populated. Thus, regional movements of jobs and people that have hurt the eastern and north central states since 1970 may be a less important factor in the future.

It is also possible to be somewhat optimistic about slowing the movements of jobs and people from central cities to suburbs and beyond. The result of massive suburbanization for more than thirty years is that many metropolitan central cities hardly differ from their suburbs in overall densities of jobs and people and, indeed, in the industrial composition of employment. It seems unlikely that suburbs will become more thickly settled than central cities, unless central cities become especially undesirable places to live and work. Otherwise, central city population and employment should grow about in proportion to such growth, at least in their inner suburbs. In most metropolitan areas, that performance would be considerably better than during any decade since World War II.

The faster growth of population and employment in non-metropolitan areas is still somewhat new, and its causes and consequences are harder to pinpoint. If it should continue and accelerate, it would certainly reduce the chances for population and employment growth in Third District and other eastern states. Those states contain relatively few nonmetropolitan counties and even fewer that

are not adjacent to metropolitan counties. Until now, however, there has been only a small reduction in the share of people living and working in metropolitan areas. We will know more about this when publication of the 1980 census is complete. Meanwhile it seems safe to assume that deconcentration will not be great enough to do substantial harm to eastern states in the 1980s.

Having set this optimistic mood, let us suppose that national economic policies produce an environment that permits steady economic growth during the remainder of the 1980s. If firms are fairly footloose, and regional wage differences are diminished, the implication is that Third District and other eastern state and local governments can do much to attract or repel businesses. But policy goals should be realistic. It is neither possible nor necessarily desirable for governments to undo the massive movements of jobs and people that have taken place during the last two or three decades. It should be possible, though, for eastern states, metropolitan areas, and central cities to capture a larger share of employment growth than they have in recent expansions.

The key to achieving this goal is for state and local governments to be aggressive in providing a favorable climate for businesses and residents. There are by now almost no businesses that lack alternatives to locations in eastern states and especially in their metropolitan central cities. These businesses will expand their employment there only if these locations are attractive places to do business and attractive areas for employees and their families.

The Craig and Reznick article documented many of the specific efforts of the Third District states to enhance their attractiveness to businesses and residents. From these specifics, we can extract some general considerations about what can help create a better business climate.

First, many regulations on businesses that impede growth could be removed or reformed and simplified at no reduction in public benefit and at savings to taxpayers. Dozens of occupations and industries require special state and local government registration, licenses and permits, most of which serve no public purpose. States permit too much discretion on the part of local governments to formulate land use controls that impede both business and residential development. Con-

sequently, business growth is often caught in the crossfire between development agencies that are desperately promoting business growth, and licensing and regulatory agencies that act as though permission to do business in the jurisdiction were a great blessing that is theirs to bestow. Big city governments routinely engage in excessive business regulation and politicization of business activity and suburban governments often exclude many types of business and residences. All metropolitan governments place needless impediments in the path of economic growth compared to small town and rural governments.

Second, it seems inevitable that jobs will remain sufficiently scarce for the foreseeable future that severe competition for businesses will continue. This appears to have taken the form of granting tax concessions designed to meet the demands of individual firms. But careful studies by state and local governments of the likely or actual effects of alternative packages of concessions are as scarce as hens' teeth. In order to form realistic goals and programs to achieve them, states need to consider carefully their ability to respond to recent trends toward business location and expansion in metropolitan suburbs and nonmetropolitan counties. Until now, they hardly seem to be aware of the trend toward deconcentration of employment. States also need to study the extent to which particular locational policies may mean that businesses simply locate in other states. Local governments, especially those in central cities, need to ensure that their taxes are in line with those of nearby jurisdictions. They also need to monitor the uses of tax and other revenues, so that they will be effective in providing services that are important to actual and potential residents.

Third, state and local governments could re-evaluate their programs to pinpoint particular industries to attract. Dozens of state and local governments all over the country have identified high tech industries as targets for growth in recent

years. Almost none have studied what circumstances attract such firms or have even decided what they mean by the term "high tech." There are legitimate grounds for governments to concern themselves with the nature of businesses that locate in their jurisdictions. For example, some businesses provide particular environmental or traffic hazards, or require special government services. It is also legitimate for governments to concern themselves with special advantages in the jurisdiction that can attract particular businesses. But programs directed to attracting narrowly defined industries go beyond the legitimate concerns and competence of governments. The primary concern of state and local governments should be to establish a good business environment.

Finally, steps need to be taken to improve the level of responsibility of metropolitan central city governments. As Inman showed, central city fiscal crises result from a combination of economic and political conditions. For reasons beyond their control, central cities face both eroded tax bases and large numbers of citizens who have special needs for government services. But those facts do not explain why central city governments failed to inform voters of the financial problems they faced so that the democratic process could make rational choices. Instead, elected officials have hidden the facts from voters by disguising deficits, in the ways analyzed in Inman, until crises overwhelmed normal democratic procedures. Elected officials must be motivated to lay out the facts and choices clearly to voters. The consequences otherwise are crises in meeting bond interest payments, and in providing public transit and other basic local government services, as well as sudden large tax increases, that are inevitably accompanied by conflict between local government and the business and banking communities. These cannot possibly be good economic development policies.



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