

Remarks By

David P. Eastburn, President
Federal Reserve Bank of Philadelphia

Before The
Pennsylvania Chamber of Commerce
State Affairs Conference
Hershey Convention Center
Hershey, Pa.
April 25, 1978

PENNSYLVANIA CHAMBER OF COMMERCE
STATE AFFAIRS CONFERENCE
HERSHEY CONVENTION CENTER
APRIL 25, 1978

Why is the State Chamber of Commerce concerned about fiscal prospects for Philadelphia? The answer is obvious. Philadelphia is the State's largest city. It has all the problems of a large old northeastern metropolis: a sluggish economy, a heavy concentration of low income residents, poor housing, massive welfare, educational and transportation needs and all the other urban attributes so familiar to all of you.

But the State is made up also of suburbs and rural areas with few of these problems, but with problems unique to their characteristics. The men and women elected to represent the people of the Commonwealth in Harrisburg therefore have varied and conflicting views about what action they should take. And, naturally, most of these conflicting views come to a focus in the fiscal arena; it is money or the lack of it that makes action possible or impossible; budgets are the medium for expressing priorities.

As I say, this is obvious, but recalling it does help to explain a couple of realities. It helps to explain why State government has had so much trouble in recent years making up its mind on budgets and taxes. It explains why so much acrimony exists in the Legislature. These priorities are hammered out in the political process and that process can be slow and painful.

With this as background, I'd like to consider three questions: first, what is the basic cause of Philadelphia's fiscal problems?; second, what are the current and prospective fiscal conditions?; and third, how much help should come from the State?

Basic Causes

Philadelphia suffers from a chronic tendency for its financial needs to outstrip its financial resources. The needs for services to a highly concentrated, low-income population seem almost insatiable. This population has been contained within narrow geographical barriers because of zoning restrictions, commuter costs, discrimination, the lack of low-cost housing elsewhere, and sociological tradition.

Growth in local revenue has been sluggish and has not even kept up with inflation. Tax sources are tied to a non-growth area, bounded by the geographical limitations of the City of Philadelphia. Growth in revenue from property taxes consistently lags behind market values. Although the market values of assessed real estate increased by 48 percent between 1970 and 1976, assessment values rose only 19 percent. This hit the School District particularly hard because property taxes make up three fourths of its local revenue. A sharp increase occurred in 1976 to correct the lag, but, in the absence of updated procedures, will occur again. Revenues from wage taxes have kept up with inflation, but because of declining employment, revenues have been sluggish--and have been maintained only through a substantial tax increase.

The significant issue for the State is that the pressure of the income-outgo gap has called forth larger and larger financing from the outside--partly because of the urgencies of the deficits, and partly because of increased acceptance that concentrations of poverty (and the problems they create) concern citizens beyond the City's boundaries.

Current and Prospective Fiscal Conditions

Had it not been for this outside financing, Philadelphia would be in deep trouble. In fiscal 1977, the City ended with a deficit of \$8.2 million, after covering the previous year's deficit of over \$70 million. This was made possible by a sharp tax increase in July 1976 and some curtailment of

spending. For fiscal 1978 the City is expected to have a small general fund deficit, largely related to costs of snow removal. In fiscal 1979 the City expects a balanced budget, primarily because of personnel cuts. Thus the City's situation, so precarious not long ago, looks better, at least for now. To meet future problems, more elasticity has to be built into revenues through better assessment practices and rising employment. More control has to be built into expenditures through productivity improvements. It is still too early to tell what President Carter's new urban policies will mean for Philadelphia, but there is nothing in the package to suggest a great change in Federal support. But it is important to note one statistic: between 1970 and 1977, 60 percent of the increase in the City's revenues came from the State and Federal governments. This shows how vital outside funding will be for the City's future.

A much more serious problem is the School District. In fiscal 1977 the School District ended, as it had in most of the previous decade, with a deficit. In that year the deficit was \$67 million. The School District has made its way through fiscal 1978 to an estimated deficit of \$3 million. This was possible partly by spending cuts, but mainly by new State subsidies, a debt postponement by the State and a loan from a consortium of Philadelphia banks. Compared with the City, an even larger proportion of the growth of the School District's revenues has come from the State and Federal governments. From 1970 to 1977 that proportion was 73 percent.

Even with this aid, the School District's fiscal problems are not under control. In order to meet the bankers' requirement of a truly balanced budget, the School District has a long list of cost cuts to be made for the next fiscal year--a 23 percent cut in personnel over two years, reductions in "prep time", larger classes and reduced bussing. The strength of the Philadelphia Federation of Teachers makes for high costs because the real choice

for the citizens of Philadelphia is one of higher wages or a strike. Spending pressures are still urgent as outlays for special education, bussing of private school students and increased debt service are mandated. On the income side, almost total dependence on the property tax continues to make for very inelastic receipts.

So, outside financing, especially from the State to the schools, is a particularly critical issue as we look ahead.

More Help from the State?

Two major factors bear on the question of who should finance a given activity of government. One is the geographical, political boundaries of an area. In the case of Philadelphia these were fixed in 1858 and have not changed. The other factor is who benefits from a given activity. In the case of fire protection, for example, the beneficiaries are property owners in the city of Philadelphia, so Philadelphia citizens pay for virtually all their fire protection. In the case of urban development programs, the nation's citizens are regarded as the beneficiaries, so almost all is Federally funded.

When it comes to education--our biggest financial problem in Philadelphia today--the beneficiaries clearly spill over into a larger geographical area than the city. So there is some reason, aside from desperation, for Philadelphia to get help from outside. The critical question is how much?

There are good arguments for full funding of education by the State. Is it appropriate for different students in the State to get different amounts spent on their education depending on the wealth of the community? Spending per pupil is higher in some Main Line communities than in Philadelphia, for example. But Philadelphia, in fact, has much higher per pupil expenditures than most. While, in some states Supreme Courts have found this kind of inequality to be unconstitutional, Philadelphia would not end up with more money if wealth inequality alone were the basis for a redistribution of

funding. A more promising legal basis exists, however. The State constitution guarantees all students a "thorough and efficient" education, but many in Philadelphia do not have this. Because so many students in Philadelphia start out very disadvantaged in their abilities to absorb education, equal funding, it is argued, is not equal opportunity. A "thorough and efficient" education requires compensatory expenditures. This question is being tested here now in the courts, and has won in other states including neighboring New Jersey.

On either ground, one can argue that state, rather than local government, has a responsibility for education, that benefits from a better educated public accrue not only to the individual but to the larger public. Because education contributes to a more informed electorate and a more productive labor force, the argument goes, the benefits involve a larger group, and so should the costs.

On the other side is largely the question of power and control. If the State funds all of education, it may take complete control. This result isn't guaranteed, but where state funding has occurred there has been more overseeing by state legislatures. The change also might mean higher taxes. The first states to increase their funding responsibilities spent more than before, but not states which have gone this route in recent years.

I conclude that economic principles call for heavier State funding of education; the benefits clearly spill over city boundaries. And political realities call for more State funding. I predict we'll be seeing more of it. The challenge will be to increase State aid but build more effective local, grass roots control.

Conclusion

Right now and for the immediate future we live in an uneasy calm so far as Philadelphia City finances go. Tremendous fiscal problems of the School District are hanging over our heads. One way out that makes economic and political sense is to increase State financing of the schools, though individual School Districts should not be relieved of the need to engage in rigorous expenditure control.

The longer-run fiscal difficulties for both the City and School District are almost overwhelming. These stem from the basic realities of an urban society that I spoke of at the beginning. These problems will require the best talents at our command--statewide--and a good bit more understanding and cooperation in Harrisburg than we have seen in recent years.

David P. Eastburn, President
Federal Reserve Bank of Philadelphia