Research Department
Federal Reserve
Bank of
San Francisco

April 23, 1976

City Hall Fights Back

The skies have brightened over the nation's city halls and state houses in recent months, and present indications suggest that the state-local fiscal situation will strengthen even more as the year goes on. The main reason, of course, is the increasingly robust national economy, but another important factor is the budget-tightening activities of policy makers who are trying mightily to avoid the New York syndrome.

The situation is not yet comparable to that of the early 1970's, when most state and local governments recorded substantial surpluses as a consequence of increased aid from Washington, increased revenues from their own tax boosts, and decreased demand for certain services such as primary education. In the intervening years, governmental agencies went through the worst recession and the worst inflation of the past generation, and these events forestalled a rapid return to health.

For several years, state-local expenditures rose sharply because of the impact of inflation on costs, because of the demands of strong public-employee unions for inflation-offsetting wage increases, and because of the recession-related rise in demand for local services. Revenues meanwhile failed to keep pace. Inflation reduced the real impact of the massive $30-billion Federal revenue-sharing program. Inflation also meant a loss of revenue, in real terms, from that half of the state-local tax structure that generally responds slowly to rising prices—primarily property taxes and gasoline and liquor taxes. Also, the recession slowdown in employment and business activity meant a slower flow of revenues from income and sales taxes.

Improvement in '75

Conditions improved significantly in 1975, however, especially since receipts increased by $23.0 billion to $232.5 billion—a greater gain than in any other year except 1972. Almost one-half the increase came from a sharp rise in Federal aid, due largely to court-ordered releases of impounded funds and higher grants for public-service jobs and income-maintenance programs. The rest of the gain in receipts mostly reflected the higher taxable incomes generated by the business recovery. Unlike the early years of the decade, legislators imposed few new or additional taxes. However, many jurisdictions raised charges for educational and health services in an attempt to recover some of the increased costs of hospitals and higher-education facilities.

The growth of state-local spending moderated somewhat in 1975, with a $21.3-billion increase to $222.6 billion. This slowdown reflected the reduced rate of inflation affecting many important budget items, such as fuel and electric power. In addition, state-local employment (except for Federally-financed public-employment programs) grew only 2.5 percent for the year, as against a 4-percent gain in 1974. Purchases of structures rose only 4 percent for the year, and in fact

(continued on page 2)

Research Department
Federal Reserve
Bank of
San Francisco

stabilized somewhat after the 1973-early 1974 boom. On the other hand, the lingering recession induced large increases in welfare outlays, especially medical-vendor payments and aid to families with dependent children.

The results looked even better with the second-half recovery period considered separately. Because of the business upturn, own-source receipts (taxes and fees) rose at an 11.6-percent annual rate during the second-half, compared with a 6.7-percent rate of increase in the first-half of the year. Meanwhile, as budgets tightened, employee compensation rose at an 8.2-percent rate in the second half, as against an 11.6-percent rate during the first half-year. Consequently, state-local operating budgets (exclusive of social-insurance funds) shifted from a $5.0-billion deficit to a $1.7-billion surplus, at annual rates, between the first and third quarters of the year.

Moderate spending in '76

The easier fiscal position should persist as these budget trends continue into 1976. According to a recent Commerce Department analysis, expenditure growth may well continue to slacken. The construction sector could weaken for several reasons: the heavy 1973-74 allocation of revenue-sharing funds for construction has sharply reduced the backlog of capital projects, school construction has declined along with the drop in the school-age population, and widespread voter rejections of bond proposals have tended to inhibit capital-spending plans. In addition, the spending surge for medical and other payments for welfare recipients should slacken as the economy improves further. Employee compensation may pick up, but at a relatively modest pace because of still-straitened budgets.

Fears of excess spending will continue, of course, although a recent study by the Congressional Budget Office suggests that no other big city is in as unfortunate a position as New York in this regard. (The analysis measures expenditure and debt data for all local governments serving the central county or counties in each major metropolitan area.) The data show that per capita government expenditures in 1972-73 ranged from 17 percent lower than New York (San Francisco) to 53 percent lower (Chicago), and that per capita government debt ranged from 17 percent below New York (Boston) to 64 percent below (Baltimore).

Larger receipts in '76

The state-local receipts picture looks generally favorable, beginning with the continuation of heavy Federal grants, which now account for almost one-fourth of all state-local receipts. The rise in grant funds may be somewhat less than last year's unprecedented $10.4 billion increase, in view of Congress' tightening budget stance and the slackening of recession-induced demands. Consequently, proposals for "countercyclical" aid to unemployment-impacted com-

munities may get short shrift in Congressional committees. But general revenue sharing, now the centerpiece of the Federal grants program, seems a certainty to continue with perhaps $6.5 billion earmarked for fiscal 1977.

Further increases in own-source receipts may be expected as the economy continues to recover. Receipts in certain jurisdictions will be boosted by tax increases legislated either in 1975 or 1976, although the general mood is just the opposite of the tax-raising spirit that dominated legislatures at the beginning of this decade. Increases in certain levies are probable, especially gasoline taxes, but they may be offset by reductions in other state taxes or local property taxes. Most legislatures will rely on a recovering economy, plus a hold-the-line budget stance, to keep their books in balance.

Borrowing boom

They will be helped by a continued reliance on borrowing to finance long-term projects. New municipal-bond issues jumped 26 percent above the 1972-74 average to $29.2 billion last year, and much to everyone's surprise, a comparable increase has been recorded to date this year. The net increase in funding may be less imposing because of the record volume of issues maturing this year—even greater than in the 1974-75 period—but a vast improvement in liquidity is still likely because of the heavy borrowing calendar.

The twin specters of New York City and New York State will stalk the halls of municipal office buildings throughout the land, encouraging state and local officials to make do and to do without. Still, the overall improvement in state-local financing, with operating budgets (in the aggregate) now in surplus again after several years of deficit, suggests that many necessary reforms have already been accomplished. But most of the credit, in this as in so many other sectors of the economy, must go to an accelerating economy with a decelerating rate of inflation.

William Burke

California Energy Study

Eleven economists from a variety of educational and research institutions present their views on the energy problem in the report, "California Energy: The Economic Factors," which will be published in late April by the Federal Reserve Bank of San Francisco. This publication is designed to provide information on the economic aspects of energy usage and energy technology, with special emphasis on California nuclear power.

Single copies of this publication may be obtained free upon request to the Public Information Section, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco, CA 94120. Phone (415) 544-2184. (Academic and nonprofit institutions may obtain multiple copies by contacting this same office.)

Research Department
Federal Reserve
Bank of
San Francisco
Alaska • Arizona • California • Hawaii
Idaho • Nevada • Oregon • Utah • Washington

FIRST CLASS MAIL
U.S. POSTAGE
PAID
PERMIT NO. 752
San Francisco, Calif.

BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 4/07/76	Change from 3/31/76	Change from year ago Dollar	Change from year ago Percent
Loans (gross, adjusted) and investments*	87,871	+ 685	+ 1,542	+ 1.79
Loans (gross, adjusted)—total	65,156	+ 295	– 933	– 1.41
Security loans	1,468	+ 348	– 525	– 26.34
Commercial and industrial	22,788	– 263	– 1,491	– 6.14
Real estate	19,484	– 33	– 236	– 1.20
Consumer instalment	10,739	+ 81	+ 891	+ 9.05
U.S. Treasury securities	10,088	+ 371	+ 2,523	+ 33.35
Other securities	12,627	+ 19	– 48	– 0.38
Deposits (less cash items)—total*	89,374	+ 1,015	+ 3,857	+ 4.51
Demand deposits (adjusted)	25,674	+ 1,279	+ 1,301	+ 5.34
U.S. Government deposits	377	+ 154	+ 180	+ 91.37
Time deposits—total*	61,649	– 356	+ 2,058	+ 3.45
States and political subdivisions	6,144	– 42	– 482	– 7.27
Savings deposits	25,690	+ 97	+ 6,030	+ 30.67
Other time deposits‡	27,241	– 446	– 2,415	– 8.14
Large negotiable CD's	12,320	– 236	– 4,058	– 24.78

Weekly Averages of Daily Figures	Week ended 4/07/76	Week ended 3/31/76	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves	62	21	20
Borrowings	0	1	0
Net free(+)/Net borrowed (–)	+ 62	20	– 20
Federal Funds—Seven Large Banks			
Interbank Federal fund transactions			
Net purchases (+)/Net sales (–)	+ 812	+ 599	+ 2,107
Transactions of U.S. security dealers			
Net loans (+)/Net borrowings (–)	+ 779	+ 194	+ 1,184

*Includes items not shown separately. ‡Individuals, partnerships and corporations.

Editorial comments may be addressed to the editor (William Burke) or to the author. . . .Information on this and other publications can be obtained by calling or writing the Public Information Section, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco 94120. Phone (415) 544-2184.