907

LOCAL DISTRESS, STATE SURPLUSES, PROPOSITION 13: PRELUDE TO FISCAL CRISIS OR NEW OPPORTUNITIES?

HEARINGS

BEFORE THE

SUBCOMMITTEE ON THE CITY

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS HOUSE OF REPRESENTATIVES

JULY 25 AND 26, 1978

TOGETHER WITH THE

JOINT ECONOMIC COMMITTEE

JULY 25, 1978

NINETY-FIFTH CONGRESS

SECOND SESSION

Printed for the use of the House Committee on Banking, Finance and Urban Affairs, and the Joint Economic Committee

LOCAL DISTRESS, STATE SURPLUSES, PROPOSITION 13: PRELUDE TO FISCAL CRISIS OR NEW OPPORTUNITIES?

HEARINGS

BEFORE THE

SUBCOMMITTEE ON THE CITY

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS HOUSE OF REPRESENTATIVES

JULY 25 AND 26, 1978

TOGETHER WITH THE

JOINT ECONOMIC COMMITTEE

JULY 25, 1978

NINETY-FIFTH CONGRESS

SECOND SESSION

Printed for the use of the House Committee on Banking, Finance and Urban Affairs, and the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE

33-595 O WASHINGTON : 1978

For sale by the Superintendent of Documents, U.S. Government Printing Office Washington, D.C. 20402

JOINT ECONOMIC COMMITTEE

(Created pursuant to sec. 5(a) of Public Law 304, 79th Cong.)

RICHARD BOLLING, Missouri, *Chairman*
LLOYD BENTSEN, Texas, *Vice Chairman*

HOUSE OF REPRESENTATIVES	SENATE
HENRY S. REUSS, Wisconsin	JOHN SPARKMAN, Alabama
WILLIAM S. MOORHEAD, Pennsylvania	WILLIAM PROXMIRE, Wisconsin
LEE H. HAMILTON, Indiana	ABRAHAM RIBICOFF, Connecticut
GILLIS W. LONG, Louisiana	EDWARD M. KENNEDY, Massachusetts
PARREN J. MITCHELL, Maryland	GEORGE McGOVERN, South Dakota
CLARENCE J. BROWN, Ohio	JACOB K. JAVITS, New York
GARRY BROWN, Michigan	WILLIAM V. ROTH, Jr., Delaware
MARGARET M. HECKLER, Massachusetts	JAMES A. McCLURE, Idaho
JOHN H. ROUSSELOT, California	ORRIN G. HATCH, Utah

JOHN R. STARK, *Executive Director*
LOUIS C. KRAUTHOFF II, ASSISTANT DIRECTOR
RICHARD F. KAUFMAN, *General Counsel*

ECONOMISTS

WILLIAM R. BUECHNER

THOMAS F. DERNBURG	L. DOUGLAS LEE	DEBORAH NORELLI MATZ
KENT H. HUGHES	PHILIP MCMARTIN	GEORGE R. TYLER

MINORITY

CHARLES H. BRADFORD	STEPHEN J. ENTIN	M. CATHERINE MILLER
	MARK R. POLICINSKI	

HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

HENRY S. REUSS, Wisconsin, *Chairman*

THOMAS L. ASHLEY, Ohio
WILLIAM S. MOORHEAD, Pennsylvania
FERNAND J. ST GERMAIN, Rhode Island
HENRY B. GONZALEZ, Texas
JOSEPH G. MINISH, New Jersey
FRANK ANNUNZIO, Illinois
JAMES M. HANLEY, New York
PARREN J. MITCHELL, Maryland
WALTER E. FAUNTROY, District of Columbia
STEPHEN L. NEAL, North Carolina
JERRY M. PATTERSON, California
JAMES J. BLANCHARD, Michigan
CARROLL HUBBARD, Jr., Kentucky
JOHN J. LaFALCE, New York
GLADYS NOON SPELLMAN, Maryland
LES AUCOIN, Oregon
PAUL E. TSONGAS, Massachusetts
BUTLER DERRICK, South Carolina
MARK W. HANNAFORD, California
DAVID W. EVANS, Indiana
NORMAN E. D'AMOURS, New Hampshire
STANLEY N. LUNDINE, New York
EDWARD W. PATTISON, New York
JOHN J. CAVANAUGH, Nebraska
MARY ROSE OAKAR, Ohio
JIM MATTOX, Texas
BRUCE F. VENTO, Minnesota
DOUG BARNARD, Georgia
WES WATKINS, Oklahoma
ROBERT GARCIA, New York

J. WILLIAM STANTON, Ohio
GARRY BROWN, Michigan
CHALMERS P. WYLIE, Ohio
JOHN H. ROUSSELOT, California
STEWART B. McKINNEY, Connecticut
GEORGE HANSEN, Idaho
HENRY J. HYDE, Illinois
RICHARD KELLY, Florida
CHARLES E. GRASSLEY, Iowa
MILLICENT FENWICK, New Jersey
JIM LEACH, Iowa
NEWTON I. STEERS, Jr., Maryland
THOMAS B. EVANS, Jr., Delaware
BRUCE F. CAPUTO, New York
HAROLD C. HOLLENBECK, New Jersey
S. WILLIAM GREEN, New York

PAUL NELSON, *Clerk and Staff Director*
MICHAEL P. FLAHERTY, *Counsel*
GRASTY CREWS II, *Counsel*
MERCER L. JACKSON, *Minority Staff Director*
GRAHAM T. NORTHUP, *Deputy Minority Staff Director*

SUBCOMMITTEE ON THE CITY

HENRY S. REUSS, Wisconsin, *Chairman*

EDWARD W. PATTISON, New York
MARY ROSE OAKAR, Ohio
JAMES M. HANLEY, New York
JOHN J. CAVANAUGH, Nebraska
JIM MATTOX, Texas
WES WATKINS, Oklahoma

RICHARD KELLY, Florida
STEWART B. McKINNEY, Connecticut
MILLICENT FENWICK, New Jersey

ELIZABETH STABLER, *Subcommittee Staff Director*
SYLVAN KAMM, *Professional Staff*
MICHAEL BELL, *Professional Staff*
CHERYLANN SUMMERS, *Administrative Assistant*

CONTENTS

APPENDIX: ADDITIONAL MATERIAL SUBMITTED FOR INCLUSION IN THE RECORD

I. BACKGROUND MATERIALS ON THE GROWTH OF THE PUBLIC SECTOR, TAX AND SPENDING LIMITATIONS, AND MATCHING REQUIREMENTS IN FEDERAL GRANT PROGRAMS

II. PROPOSITION 13 AND ITS AFTERMATH

III. PROPOSITION 13, TAX REFORM, AND EFFICIENCY IN GOVERNMENT

LOCAL DISTRESS, STATE SURPLUSES, PROPOSITION 13: PRELUDE TO FISCAL CRISIS OR NEW OPPORTUNITIES?

TUESDAY, JULY 25, 1978

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON THE CITY OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
AND THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committees met at 9:35 a.m. in room 2128 of the Rayburn House Office Building; Hon. Henry S. Reuss and William S. Moorhead presiding.

Present from the Subcommittee on the City: Representatives Reuss, Pattison, Cavanaugh, Mattox, Watkins, Kelly, McKinney, and Fenwick. Present from the Joint Economic Committee: Representatives Moorhead and Long.

Senators present: McGovern and Javits.

Chairman REUSS. Good morning. The joint session of the Joint Economic Committee and the Subcommittee on the City of the House Committee on Banking, Finance and Urban Affairs will be in order for its consideration of: After proposition 13, what?

I am honored to be joined by Congressman Moorhead of Pennsylvania, who will share with me the chairmanship of the various panels. We have until noon, or a little after noon today, to do an awful lot of work, so I want to get right to it.

The antitax sentiment that surfaced recently in California is sweeping across the Nation, posing challenges to government at all levels.

The message from proposition 13 is that Americans want to halt unreasonable and ineffective programs. Economizing, as the President has discovered, is easier said than done. The fat and frills decried by some, are defended by others as essential. So what services to cut, or which agencies to consolidate are tough decisions, and taxpayers need more credible and persuasive explanations of the tradeoffs.

Yet the choice is clear: Officials must find orderly ways to cut costs, or await the day when irate citizens impose crude and insensitive instruments of their own.

The prospects aren't all dismal. Some States use their revenues to provide local tax relief. A number have made property taxes more acceptable through such devices as circuit breakers and abatements for rehabilitation.

When the library in the California town of Ojai was slated to be shut down recently for lack of funds, citizens rallied with volunteer staffing and donations. This approach may have limited applicability, but it indicates the resourcefulness and creativity of Americans that communities can capitalize on.

We two committees are meeting today concluding the Joint Economic Committee's midyear review of the economy. When Representative Moorhead and I learned that we were separately planning to touch on closely related issues, we agreed, in the spirit of economy and efficiency to combine forces.

I am happy that Representative Moorhead will cochair the sessions.

Today's hearings comprise three panels. The first will discuss the rationale of measures such as proposition 13 and how they will affect cities, counties, and the States.

The second will examine the fiscal status of State and local governments—how extensive surpluses are, and what they imply.

The third will look at the prospects for curbing local government spending, developing new revenue sources, and devising more efficient governmental structures.

Tommorrow, the Subcommittee on the City meets again to focus on local government productivity, how to cut costs without sacrificing essential services. Further hearings and reports on these vital issues will be scheduled in the months ahead.

The first panel will focus on the subject of why the taxpayers are in revolt, and what are the consequences for local government and their citizens. The panel consists of Prof. Neil H. Jacoby of the Graduate School of Management at UCLA, and a former and respected member of the Council of Economic Advisers; Senator Jason Boe, president of the Oregon State Senate and National Conference of State Legislatures; Stephen B. Farber, executive director of the National Governors Association; and Fred F. Cooper, county supervisor of Alameda County, Calif.

Representative Moorhead, would you like to make an opening statement now? Or would you like to wait until the second panel?

Representative MOORHEAD. Well, I think, Mr. Chairman, I would like to proceed now, if I may. First, I would like to thank you for the courtesy you have extended us in joining forces.

We are fortunate that we both serve on the Joint Economic Committee and the Banking Committee, of which you chair. There is a slightly different thrust to these studies of our respective subcommittees, but I would agree with you, Mr. Chairman, there is so much overlap that we would have had to call some of the witnesses twice if we held separate hearings.

The focus of the Joint Economic Committee's hearings is the fiscal condition of State and local governments. The future of many State and local governments is at a critical threshold. I have seen estimates that in 1978 direct aid, as a percent of own-source general revenue, will be on the order of 53 percent in Philadelphia, 60 percent in Cleveland, and 58 percent in Phoenix, and as high as 76 percent in Detroit.

More than 40 months into the recovery, many localities are still faced with reduced levels of employment, reduced capital expenditures, and great reliance on Federal aid.

These chronically ill municipalities have experienced reductions in employment and population which have resulted in declining revenue bases.

The situation is exacerbated by a capital stock which is in disrepair. Unfortunately, the list of such problem localities is all too long. At the same time—and this is our dilemma—the National Income Account Data indicating large surpluses in the State and local sectors tend to reorient the focus of national attention away from the problems of fiscal distress.

The media, in particular, have used the surplus to suggest that municipal fiscal strains are now part of history and that we can turn our attention to other national problems.

I regret that I cannot share in this opinion. The NIA data indicates that in 1977, the State and local sector had a surplus of $29 billion. I am extremely concerned about what this surplus really means. Can the mere existence of a surplus be equated with a healthy local economy? Are the surpluses widespread? Are local units of government in surplus States sharing its wealth?

I hope the witnesses today—particularly in the second panel—can shed some light on these important questions.

In the coming months, we in Congress will begin to consider a host of intergovernmental assistance proposals. This task is never easy, but at this point in time it is particularly difficult because of the confusion the State and local government budget surplus data has generated.

Congress will have to grapple with and ultimately decide whether States themselves should be eligible for additional assistance. Or should it in fact be required to assist their own localities? And moreover, whether Federal fiscal assistance should be continued; and, if so, what form it should take.

I hope that the testimony today will help to clarify the fiscal needs of our municipalities, as well as the meaning and extent of the budget surplus.

I believe that these joint hearings can be of great benefit to future considerations of the Congress.

Thank you, Mr. Chairman.

Chairman REUSS. Thank you, Representative Moorhead.

We are privileged to have with us a distinguished member of the Joint Economic Committee from the other body, Senator Javits. Would you like to make an opening statement?

Senator JAVITS. Yes; I would, Mr. Chairman. Thank you for the privilege.

First, Mr. Chairman, I thoroughly approve of the joint hearings, and I compliment the Chair, the Chairman of the Joint Economic Committee, and Representative Moorhead, chairman of our subcommittee, for arranging it.

It seems to me that you are serving a very critical purpose here. That is—and perhaps I am coining a word—to "demythify" proposition 13. I don't think the voters of the United States have lost their marbles. They gave us a message, but they didn't intend to dismantle the country.

And I think that it is critically important that this be put in focus; that we share with the people our problems. In my own city of New York, for example, suppose we tried to apply what the citizen wants to pay in taxes to the cost of operating and maintaining the public services and facilities he wants to have so the citizen can enjoy an environment in which he and his family can live a reasonable life. The problem is that we would literally collapse from lack of maintenance under those circumstances, for maintenance is often a low priority activity.

So I think you are performing a great service, within the limits of our other problems, and in the Senate I will do my utmost to participate.

I thank you very much.

Chairman REUSS. Thank you, Senator.

Are there other members who at this time would like to make an initial statement?

[No response.]

Chairman REUSS. If not, let's get straightaway to work. All the members of the panels have turned in compendious and very helpful papers, and under the rule and without objection they will be received in full into the record.

That will enable the witnesses to proceed in their own way, either elaborating, magnifying, or whatever suits them best.

We will hear first from Professor Jacoby.

STATEMENT OF PROF. NEIL H. JACOBY, DEAN, GRADUATE SCHOOL OF MANAGEMENT, UNIVERSITY OF CALIFORNIA, LOS ANGELES

Professor JACOBY. Thank you, Mr. Chairman.

You have invited me to speak about the meaning of California's Proposition 13, and legal limits on government spending in general.

I should like to take the brief time allotted, if I may, to elaborate briefly on five points.

First, that there is a systemic bias toward—a structural flaw in—our democratic political system that leads to overspending by government, in the strict sense that the total of government spending is more than the citizens would approve if they had a chance to vote on the total.

Second, that the two major causes of this bias are pressure-group politics, and unbalanced collective bargaining with the increasingly powerful public employees' unions. And these are, I think, causes of increasing strength and power.

My third point is that effective legal limits on spending can help to correct the bias by giving people a chance to vote on aggregate spending, by making collective bargaining with public employees unions less unbalanced, by stimulating market pressures on government for efficiency—that is to say, we have lacked, in the field of government, pressures for efficiency which the market brings to bear on business. Spending limits can function as a substitute. And I believe these points are all borne out by the experience of California, so far, with proposition 13.

My fourth point is that the longrun effects of proposition 13 spending limits in California are proving to be favorable, and will be favorable. They are and will produce, in California, economic expansion, with less inflation. What is even more important, they have, I think, revived the faith of the people in the democratic process—a feeling that they can effectively participate in and control their government. There has been no special sacrifice visited on the poor. In fact, their private job opportunities are being and will be enhanced.

Which leads me to my fifth point: That we need, now, limits on Federal spending to stimulate investment and to restore world confidence in the dollar—which is, as we see in the morning press, continuing to hemorrhage in value. We need to strike a decisive blow against inflation.

Let me now just comment briefly on each of these points.

It is clear that our political processes contain a strong systemic bias toward overspending by government. The basic causes of this, I believe, are numerous, but two factors stand out: The first is pressure-group politics—our political representatives naturally respond to the strong demands of small goups for spending programs that benefit them greatly, because those demands are only weakly opposed by the majority who benefit little, or not at all.

Every spending proposal has a small group of organized supporters and a large and inarticulate group of unorganized opponents. The payoff to the politician of meeting the demands of the strong minority outweighs the political cost of flouting the will of the weak majority.

Add to this the familiar phenomenon of "log rolling" for reciprocal political benefit, and it is easy to understand why spending mounts ever higher, even though the majority of voters, including members of favored pressure groups, would oppose a higher total if given a chance.

Without a legal limit on aggregate government spending, the public is never able to vote directly on the total size of the budget.

The second factor is unbalanced collective bargaining by powerful unions of public employees. The case of New York City is illustrative.

To operate in the public interest, collective bargaining requires approximately equal bargaining power on both sides of the table. In business, the union's power to strike is opposed by management's imperative to hold down costs and stay competitive in the market. This makes for tough bargaining. The manager who fails loses his job.

In government, history shows that politicians normally accede to the demands of employee unions because a docile electorate shoulders the higher cost of government, and there is no competitive market to penalize the manager of a high-cost government. Hence, unbalanced bargaining power has become a central cause of overspending by government.

Now, effective legal limits on spending can, I believe, help to cure this serious fault in the political process. It does give the people a chance to decide how large their government should be in relation to the private sector; it increases the bargaining power of the public official; and it stimulates market pressures for efficiency that operate in the business field.

In the private sector, as I have noted, market competition forces the business firm to stay reasonably efficient if it is to survive. In the public sector, there is no counterpart to the market to compel the public officials to engage in house cleaning. And for some 40 years, public spending at all levels has grown almost continuously; there has never been an occasion to house clean.

Meanwhile, budgets have become laden with unnecessary positions, spending programs continue after they are obsolete, there is no pressure to modernize methods and equipment, civil service rules protect the inefficient while foreclosing rewards to the efficient, and the evidence shows that productivity, motivation, and morale in the public sector are low.

I think California's experience under proposition 13 shows that a legal limit on government spending can be a substitute for the market in forcing efficiency.

What has happened in California was that tough priority-setting decisions that had been avoided for many years by public officials, while revenues were rising, began to be made. Unfilled and unnecessary jobs were struck out of budgets; marginal and obsolete programs were eliminated; moratoria were put on hiring and on increases in pay and benefits; and to date less than 9,000 government employees have been laid off, although it had been predicted that 450,000 would lose their jobs.

California governments will cut their spending about 10 percent under budgeted levels during this fiscal year. Now this leaves about an equal amount of economizing for future years, assuming no new taxes—which Governor Brown has said he will not approve.

Because public budgets in California have been expanding 10 percent or more a year, adjustment to proposition 13 merely means stopping government's growth for about 2 years. It has not meant massive layoffs as were earlier predicted.

The longrun effects of proposition 13 will be salutory. And I may point to the fact that the Congressional Budget Office has confirmed my own forecast: that proposition 13 will have a positive effect upon California employment and income in 1980 and beyond, and will reduce inflation by cutting housing costs, which is a material factor in the Consumer Price Index.

Now let me come to the lesson for the Federal Government. I think the California experience, to date, indicates that legal limits on government spending would be beneficial in all American States, but most of all they are needed in Federal Government.

The persistence of a $50 billion Federal deficit in an economy now close to full employment is a root cause of inflation and dollar depreciation. Ending inflation is our primary national problem, and it calls for bold action, now, on the fiscal front as well as on the energy front.

The imperative need, I believe, is to end the Federal deficit by cutting spending. That will release savings now used to finance government for productive investment in the private sector, and by restoring confidence in the dollar it will induce an inflow of foreign investment.

I commend the anti-inflationary proposals of Federal Reserve Chairman G. William Miller, who proposed to cut the deficit from an estimated $50 billion in the present fiscal year to $30 billion in fiscal 1980, to $17 billion in fiscal 1981, to 0 in fiscal 1982; and over the same period, he would cut Federal spending from 22 to 20 percent of the gross national product. These figures may be high—and if so, they should be adjusted, to put pressure to cut the ratio of the size of government spending to GNP.

These spending limits that I suggest—which Chairman Miller suggested—are liberal. California governments are cutting spending by 10 percent in 1 year; whereas, we are proposing here a 10-percent cut over 3 years.

Nor does 10 percent, by any means, measure the amount of fat on the body politic. We have estimates that there is 20-percent fat in California government.

I propose, gentlemen, that these limits be written into law by a joint resolution of the Congress; and that that resolution would mandate a proportional cutback of all Federal programs whenever the total exceeded the prescribed limits.

I believe that proposition-13-type effects would soon follow. The opportunities for billion-dollar-savings, without sacrifice of national security or essential services, are legion.

Examples are: Food stamps, farm subsidies, pork barrel water projects, redundant military bases, and nonproductive health, education, and welfare programs.

HEW itself recently acknowledged $7 billion of discovered annual waste through fraud, and I suggest there must be twice as much through maladministration.

The expansionary effects of a congressional action of this kind I believe would be dramatic. Private investment would boom. Confidence in the dollar would surge upward around the world. I fear that most foreigners think we've lost control of our fiscal affairs. Interest rates would stay at moderate levels, encouraging housing and other private investment. The inflation that is undermining American society and weakening our economy would be brought under control. And, what is more important, the shaken confidence of Americans in their Government would be restored.

Mr. Chairman, the times call for decisive action.

Thank you very much.

[Professor Jacoby's prepared statement follows:]

CALIFORNIA PROPOSITION 13 AND LEGAL LIMITS ON GOVERNMENT SPENDING

(A statement to the Subcommittee on the City of the House Committee on Banking, Finance and Urban Affairs by Neil H. Jacoby, Graduate School of Management, UCLA. Washington, D. C., July 25, 1978.)

You have invited my comments on the causes and probable effects of Proposition 13, which was overwhelmingly approved by the voters of California last June 6th. It immediately cut property taxes by 60 percent and total state-and-local revenues by 21 percent, and it rigorously limits the future growth of property tax revenues. Governor Brown and the California legislature subsequently agreed that the $6.5 billion state surplus should be allocated to the local governments to ease the burdens of adjustment, that there should not be any new state taxes, and that the State government should share with the local governments the tasks of fiscal austerity. Proposition 13 is now reducing state-and-local spending in California. It is functioning as an effective legal limit on government expenditures. Such an explicit limit is likely to be adopted by the voters of California next November.

The Systemic Bias toward Governmental Over-Spending

Events of recent years have demonstrated that legal limits on government spending are needed to correct the bias toward overspending in our political system. Government spending has boomed. It is shocking that, after three years of economic expansion, the federal government continues to run an estimated $50 to $60 billion annual deficit. Powerful public employees unions have exacted pay levels that much exceed those in the private sector for equivalent jobs. They have gained retirement benefits that threaten the solvency of our governments. Government spending at all levels is excessive; in the federal government it seems to be out of control.

It is now clear that our political processes contain a strong, systemic bias toward overspending by government. They do not produce an optimum allocation of income as between governmental and private expenditures. Californians voted for Proposition 13 because they believe they are getting smaller benefits from the marginal dollars collected from them and spent by government than they would derive from the opportunity to spend those dollars themselves. They are convinced that government is trying to do too much; and what it is doing is done inefficiently.

What are the basic causes of systemic overspending by governments? Although the reasons are numerous, two factors stand out: pressure group politics and unbalanced collective bargaining in the public sector.

Pressure Group Politics

Democratic governments generally suffer from a disease that can be fatal if not checked. Total government spending expands irrationally as a result of "pressure group" politics. Our political representatives naturally respond to the strong demands of small groups for spending programs that benefit them greatly, because those demands are only weakly opposed by the majority who benefit little, or not at all. Every spending proposal has a small group of organized supporters and a large and inarticulate group of unorganized opponents. The payoff to the politican of meeting the demands of the strong minority outweighs the political costs of flouting the will of the weak majority. Add to this the familiar phenomenon of "log rolling" for reciprocal political benefit, and it is easy to understand why spending mounts ever higher, even though the majority of voters—including members of favored pressure groups—would oppose a higher total if given a chance. Without a legal limit on aggregate government spending, the public is never able to vote directly on the total size of the public budget.

Unbalanced Collective Bargaining

The second important factor in explaining the systemic bias toward governmental overspending is unbalanced collective bargaining by powerful unions of public employees. As the case of New York City illustrates, excessive pay and benefits for public employees has emerged as a dominant cause of municipal fiscal distress. The problem of unfunded pension obligations looms menacingly over our heads. Public employees unions have wrested excessive compensation from public officials through the collective bargaining process, on threats of slow-downs, "sick-outs" and strikes.

One must question the validity of transferring to the public sector—where employees already enjoy the job security of civil service—the institutions used in the private sector to determine wages, hours and fringe benefits. To operate in the public interest, collective bargaining requires approximately <u>equal bargaining power</u> on both sides of the table. In business, the union's power to strike is opposed by management's imperative to hold down costs and to stay competitive in the market. This makes for tough bargaining. The manager who fails loses his job. In government, history shows that politicians normally accede to the demands of employee unions, because a docile electorate shoulders the higher costs and there is no competitive market to penalize the manager of a high-cost government. Pay and benefits for employees make up the bulk of government expenditures. Hence, unbalanced bargaining power has become a central cause of government over-spending.

Effective Legal Limits Can Reduce the Over-spending Bias

<u>Effective legal limits on government spending can help to cure defects</u>

in the political process. Such limits give the people a chance to decide how large their government should be in relation to the private sector. The people can determine what proportion of their income should purchase public goods and services, and what part should remain for private allocation. As a result, incomes are allocated more effectively. The benefits derived by the public from a given level of income increase.

Effective legal limits on government spending also increase the bargaining power of public officials. As has been observed, "There is no way in which the politicians could be pursuaded to stand up to (public employees') unions without something like Proposition 13 to provide the necessary backbone."[1/] It put their political futures on the line.

Legal limits on government spending must be effective if they are to correct the overspending bias. They must actually reduce the budgeted growth of government spending. Merely nominal formulae for limiting expenditures, that do not compel public officials to take economizing actions, are worse than nothing. California voters decisively rejected Proposition 8 at the last election. It would have limited the annual percentage increase in State government spending to the inflation rate plus 1.2 times the percentage increase in California income—a formula that would have permitted the State to grow as fast as it had been growing. Although the politicians and bureaucrats felt comfortable with this limit the people did not. Two-to-one, they endorsed Proposition 13 instead.

The reason why the legal limitation on government spending in California

---

[1] Irving Kristol in the Wall Street Journal, June 28, 1978.

took the form that it did was that California has been over-zealous in taxing and spending. Furthermore, it has been collecting 50 percent more property tax revenue than the nationwide average percentage. It has used this revenue to finance welfare, medical and school costs, as well as the costs of property-related services. Over-reliance on property taxation, combined with booming assessed valuations of property as a result of inflation, was threatening the ability of many citizens—both owners or renters—to keep their homes. Any democratic government that threatens the tenure of people in their homes is courting disaster. Proposition 13 therefore killed two birds with one stone: It stabilized property taxes at a reasonable and predictable level, and it forced state and local governments to economize. States that now tax property moderately do not need Proposition 13. But all states share with California the problem of streamlining governments that have grown fat and flabby during years of rising revenues. They do need legal limits on government spending.

Effective Spending Limits Simulate Market Pressures for Efficiency

History teaches that all human organizations need to "clean house" periodically—to streamline their organizations and processes—in order to stay vital and efficient. Over time, organizations tend to accumulate deadwood personnel, obsolete programs, out-moded methods and unproductive expenditures. In the private sector, market competition forces the business firm to stay reasonably efficient if it is to survive. A firm with slack management loses market share and profitability, and new management comes in to eliminate unproductive products, plants and personnel, and to restore efficiency. Remedial action is usually swift and certain, because the alternative is bankruptcy.

In the public sector, there is no counterpart to the competitive market to compel public officials to engage in house cleaning. For more than forty years—since Franklin Roosevelt's New Deal—government spending has risen almost continuously. Public officials have grown accustomed to an ever richer diet of revenue to finance more public spending. They have never had to clean house. Meanwhile, governmental manpower has become redundant. Budgets are laden with unnecessary positions. Spending programs continue long after they have become obsolete. There is no pressure to modernize methods and equipment. The bureaucracy opposes labor-saving changes. Civil service rules protect the inefficient while foreclosing rewards to the efficient. The evidence shows that productivity, motivation and morale in the public sector are abysmally low.

Effective legal limits on government spending can be a substitute in the public sector for the market competition that enforces efficiency in the private sector. California's experience under Proposition 13 offers convincing proof of this proposition. Faced for the first time in their political careers with the prospect of less money to finance public services, California's public officials at first reacted with a dismay that approached panic. They predicted "chaos," announced "doomsday" budgets, proposed massive layoffs of government employees, and threatened drastic cuts in essential public services. Initially, none proposed that spending should be trimmed by higher productivity and tighter management. Years of disuse had attenuated their capacities for economizing.

Soon, however, hard necessity worked to rejuvenate thees capacities. The tough, priority-setting decisions that had been avoided in the years of "easy come" began to be made. Unfilled and unnecessary jobs were struck out of budgets. Marginal and obsolete programs were eliminated. Moratoria were put on hiring and on increases in pay and benefits. More efficient methods were introduced. Hitherto unknown surpluses and reserve funds were discovered. To date, less than 9,000 government employees have been laid off, although it had been predicted that 450,000 would lose their jobs. No essential public service has been eliminated. More than one public official has told me privately: "Proposition 13 is the best thing that has happened in this state in years. We can now get rid of waste that was politically impossible to eliminate before. We can say "no" to the pressure groups."

California's adjustment to the sharp revenue cuts of Proposition 13 is not over. The house-cleaning process will continue for several years. Overall, California governments will cut spending 10 percent under budgeted levels during this fiscal year. This leaves an equal amount of economizing for future years, assuming no new taxes. Because their budgets have been expanding 10 percent a year, adjustment to Proposition 13 merely means stopping government's growth for two years. Meanwhile, Governor Brown has appointed a Commission on Government Reform composed of 11 prominent citizens from various walks of life to recommend efficiency-promoting reforms in the organization and in the revenue and expenditure structures of the state. He has expressed the wish to make California government "a model for the nation."

Long-run Effects of Proposition 13

How will Proposition 13 affect California in the long run? Let us first dispose of adverse criticisms that have been made of the measure—social, political and economic.

Throughout the nation the measure has been attacked by the Liberal Left. To this group it is an article of faith that America's social salvation lies in an ever-expanding government. They interpreted the overwhelming public support of Proposition 13 as a signal that the public would no longer tolerate rising government spending. Predictably, their reaction to this unexpected change in public sentiment bordered on the hysterical.

Senator George McGovern insulted two-thirds of California voters by describing their action as "degrading hedonism" which was "motivated by racism" and which would impose heavy burdens on the poor.[1] Professor J. K. Galbraith described Proposition 13 as a "disguised attack on the poor."[2] Henry Fairlie, a British journalist, branded it "an irresponsible use of the initiative," which he wrote has been "peculiarly the brainchild of the Western states with their primitive fascination with the forms of democracy."[3] Adverse economic consequences have also been predicted. Business Week stated that "Californians have threatened the strength and stability of the boom, and have raised serious doubts about the state's ability to accommodate future growth."[4]

Not one of these criticisms is valid. The effort to distort Californians' legitimate complaints about governmental inefficiency and inequitable property taxation into racism and class warfare is reprehensible. It comes with poor grace from the Senator of a state which spends only $20 per $1,000 of personal income on public welfare, versus an average of $25 by the nation and $33 by "hedonistic" Californians! Proposition 13 has not caused any essential public service to be curtailed, nor any legitimate welfare payment to be cut.

---

[1] See Los Angeles Times, July 2, 1978.

[2] See Los Angeles Times, July 9, 1978.

[3] See Los Angeles Times, July 2, 1978

[4] Business Week, July 17, 1978, p. 54.

Mr. Fairlie should be reminded that it was not their "primitive fascination" with the referendum that led Californians to support Proposition 13. It was the failure of the California legislature for three years to resolve the problem of property taxation which was threatening peoples' ability to keep their homes while mountainous surpluses were piling up in the State treasury. The referendum bridged a breakdown in representative government.

The doleful economic predictions of Business Week have been contradicted by the Congressional Budget Office and by Chase Econometric Associates. Both agencies confirmed my own forecast that Proposition 13 will have a positive effect upon the California and national economies in 1980 and beyond, and will reduce inflation.[1/] It will prolong and expand the present level of construction in California, with all of the multiplier effects this industry has upon income and employment. No investor in residential real estate, no businessman seeking to build a factory, warehouse, office building, hotel or shopping center, will ignore the inducement of California's stabilized low-rate property tax. It has raised the prospective rate of return to investment. Both economic theory and history demonstrate the powerful influence of higher prospective rates of return upon the volume of investment.

If tax reduction by a state really produced economic recession and unemployment, then the road to prosperity must be ever-higher taxes! Economic reasoning that leads to such an absurd result must be rejected. The stimulative economic effects of a tax reduction are well established.

The political and social effects of Proposition 13 may prove to be even more beneficial than its economic consequences. Californians feel that they

---

[1] Los Angeles Times, July 7, 1978. Wall Street Journal, July 12, 1978.

have recovered control of their government. They have a revived faith in democracy. They feel more secure in their homes. Proposition 13 has put in motion changes that are making California a better state. It is bringing more efficient government, more equitable taxation, less social tension, and an improved climate for business.

Proposed Federal Spending Limits

The California experience indicates that legal limits on government spending would be beneficial in all American states. Most of all, however, spending limits are needed in the federal government. The persistence of huge federal budget deficits, in an economy now close to full employment, is a root cause of inflation and dollar depreciation. Ending inflation calls for bold actions on many fronts. But the imperative need is to end the federal deficit by cutting spending. This will release savings now used to finance government for productive investment in the private sector. By restoring confidence in the dollar, it will induce an inflow of foreign investment. At this time the U.S. economy would benefit far more from spending reduction and budget balance than from tax reduction.

The anti-inflationary proposals of Federal Reserve Chairman G. William Miller merit strong endorsement. He proposed to cut the deficit from $50 billion in fiscal 1979, to $30 billion in fiscal 1980, to $17 billion in fiscal 1981 to zero in fiscal 1982. Over the same period, he would cut federal spending from 22 percent to 20 percent of the GNP.[1]

These spending limits are liberal. California governments are cutting spending by 10 percent in one year, whereas we propose a 10 percent

---

[1] Reported by *Time*, July 17, 1978, p. 62

cut in federal spending over three years. Nor does 10 percent by any means measure the amount of fat on the body politic. Nathan Shapell, Chairman of California's "Little Hoover" Commission on Government Economy and Efficiency, has evidence that California government spending can be cut at least 20 percent without impairing any essential service. Who will contend that the margin of fat in federal government is less?

Why not write these limits into law by a joint resolution of the Congress? The resolution would mandate a proportional cutback of all federal programs whenever the total exceeded the legal limits. Proposition 13-type effects would soon follow. Opportunities for billion-dollar savings without sacrifice of national security or essential services are legion. Examples are food stamps, farm subsidies, pork-barrel water projects, redundant military bases, and unproductive HEW programs. HEW itself recently acknowledged $7 billions of annual waste.

The expansionary effects of such an action would be dramatic. Private investment would boom. Confidence in the dollar would surge upward around the world. Interest rates would stay at moderate levels, encouraging housing and other private investment. The inflation that is undermining American society and weakening our economy would be brought under control. The shaken confidence of Americans in their government would be restored. The times call for decisive action. Political cynics may say this proposal is visionary. I would remind them of the words in the Scriptures—"Where there is no vision, the people perish."

Chairman REUSS. Thank you, Dr. Jacoby.

We are fortunate in having with us in the hearing room Representative Robert Duncan, of Oregon.

Congressman Duncan, we would be honored to have you introduce your colleague, Senator Jason Boe.

Representative DUNCAN. Mr. Chairman, Senator, and members of the committees, I know that those on the House side, at least, are aware of the total and complete modesty with which those of us from the State of Oregon view the accomplishments of our State and our favorite sons. Accordingly, it is an honor to me today to be able to introduce one of our Oregonians who has been honored and whose abilities have been recognized in his selection as president of the National Conference on State Legislatures.

Senator Boe and I have known each other for many years. We have campaigned up and down the Umpqua River, at Mapleton, at Reedsport; we have been up in Florence. I have known him since before he got in the State legislature, where he quickly distinguished himself and moved into a leadership position in the house of representatives, moved over to the senate, was elected president of the senate after one term, and has been successively reelected three times.

Now, that is an unprecedented event in the State of Oregon. Senator Boe and his supporters attribute it to a recognition of brains and diligence and hard work and ability. Some of his detractors attribute it to the irrationality which some of us in the House of Representatives—with apologies, Senator Javits—sometimes attribute to the actions of the Senate, whether at State or Federal level.

I count myself as one of Senator Boe's friends. I am not sure what he is going to tell you today. Perhaps he will tell you to cut Federal spending but increase aid to the States. If he says that, I know that he will say much more, and I commend to you what he says.

I am honored to be able to introduce him as he participates in this panel. I am a former member of the legislature. I was a former member of the Council on Intergovernmental Relations. I am one who believes strongly in the federal system. I commend the committees for inviting this testimony and the testimony of the panel to the committees.

Thank you.

Chairman REUSS. Thank you, Congressman Duncan.

Senator Boe with a "Golden Fleece Award" like that, you may proceed. We are grateful to have you.

STATEMENT OF SENATOR JASON BOE, PRESIDENT, OREGON STATE SENATE, AND PRESIDENT, NATIONAL CONFERENCE OF STATE LEGISLATURES

Senator BOE. Mr. Chairman, I have lied about Bob Duncan for years, and it is only fair he return the honor today.

[Laughter.]

Senator BOE. Mr. Chairman, cochairman, Senator Javits, members of this House Subcommittee on the City and Joint Economic Committee, it is a pleasure to appear here before you today to discuss the impact of proposition 13 and the structure of fiscal federalism in our country today.

I serve as the president of the Oregon Senate, and I am also president of the National Conference of State Legislatures, the NCSL, which is the official representative of the country's 7600 State legislatures and their staffs, now representing all 50 of the States in the United States.

NCSL works to help lawmakers meet the challenges of our complex Federal system through a variety of State and State-Federal services provided by our headquarters in Denver and our State-Federal relations office in Washington, D.C.

The NCSL, for those of you who are not familiar with it, is a nonpartisan organization funded by the States, governed by a 43-member executive committee.

We have three basic objectives: To improve the quality and effectiveness of the State legislatures; to assure States a strong and cohesive voice in the Federal decisionmaking process; and to foster interstate communication and cooperation.

I have been asked to speak today about the effects of the taxpayer revolt on local governments. I believe that the causes of the taxpayer revolt extend far beyond State boundaries. I believe those of you at this table and the rest of your colleagues in Congress must assume at least a large responsibility for the passage of proposition 13 in California.

And to further qualify my statements, just recently in the State of Oregon, an identical copy of the Jarvis-Gann proposition—with the only difference being that instead of a 1-percent limitation, it contains a 1½-percent limitation—but other than that, a Xerox copy of Jarvis-Gann recently was placed on the November ballot through the initiative process.

Requiring only 63,000 signatures, it went on the ballot with well over 200,000 signatures of Oregonians.

So, while we are looking at California, I want you to remember that we in Oregon are facing some of the same problems and perhaps some of the same opportunities that are presented by proposition 13.

I believe that the taxpayer revolt is a loaded gun, and that gun is pointed directly at Congress. The first bullet hit local government. The second bullet may hit State government. But the Federal Government is the ultimate target. And in my opinion, and in discussing this with the legislative leaders from across the United States, I believe that the third bullet is already on its way toward Washington, D.C., and that unless you act—and act quickly—the voters are going to take the matter completely now not only out of our hands but out of your hands also.

And I must tell you it is my considered opinion, Mr. Chairman—and this is a complete reversal of an opinion I have held for many years—that I firmly believe that within the next 5 years we will see a constitutional convention called of this United States. I firmly believe that. I did not, but I do now, because the mood of the people out there is to grab hold and grab hold wherever they can. As they see the initiative and referendum process working in the 23 States that have that today, there is going to be increased pressure on the rest of the States that do not have the initiative and referendum to move in that direction. And that is happening right now.

There will be over 6,000 State legislators up for election or reelection this year. Every one of those legislators are going to have the finger pointed at them: Where do you stand on Jarvis-Gann?

And I suspect you and your colleagues who are up for reelection this year, and those in the Senate who are up this year, are going to be asked that same question, and you are going to be having to respond to those same types of questions.

We in the State legislatures are at the battlefront of the war on high taxes, and we have been so for many years.

Let me go now into the effect on State governments. In the California situation, and possibly the Oregon situation, the passage of proposition 13 has attracted widespread popular attention. It reminds us once again that most people believe in the American tradition of limited government and that when government becomes too expensive or too luxurious for public taste, voters can find ways to send a message to their elected officials about scaling back government outlays and programs.

The California Legislature was able to temper the effects of proposition 13 through quick, decisive action, but most of States do not have the large budget surpluses that were available in California.

And I am going to let my colleague, Mr. Farber, who is going to be representing the Governors, go into the fallacy of some of your statisticians in the Federal Government who have been claiming that there is a $36 billion surplus out there. And we will commend to you an article from the Wall Street Journal, this morning, pointing out the fallacy of some of your statisticians' basic assumptions.

But most of the States do not have the large surpluses that were available in the State of California. The passage of a measure like proposition 13 would result, in most cases, in immediate and widespread financial hardships in almost every other State.

The 1-year emergency relief plan devised by the California Legislature makes effective use of that State's $5 billion surplus, since over $4.4 billion of that surplus is returned to provide relief to that State's counties, cities, and school districts.

But I would hasten to add that there are many States like Oregon who have used whatever resources they have to develop homeowner and renter property tax relief proposals. And, by the way, one of the great faults with Jarvis-Gann among many other things, is the fact that the renter is absolutely left out. In California today they are in the throes of attempting to come to grips with that by some voluntary rental controls or rollbacks of rentals, which, in my opinion, are not going to be terribly successful and will be for a limited time only.

The 1-year emergency relief plan devised by the California Legislature does make good use of their money. Among the special provisions in the relief plan in California are State assumption of the county public assistance costs and the like. Other significant aspects of the California legislation include the provision that most cities and counties will operate at 80 percent of the previous budget levels, and the provision that most school units will have about 85 to 91 percent of last-year expenditures, which may mean that regular programs will not suffer if certain extracurricular and summer programs are reduced in school budgets.

Delegation of greater authority to California counties to allocate over $125 million annually, and assurance that cities and counties maintain such essential services as police and fire protection at levels existing prior to proposition 13 were included.

All State legislatures are going to be watching what happens in California, and possibly in Oregon if it passes—as it appears likely that it might.

It is apparent that the California Legislature has largely been successful in meeting many of the measure's immediate challenges. But the real effects of the Jarvis-Gann meat-ax approach to tax reform may not be known for several years, and I do not believe that anybody, no matter how distinguished they are as economists, can really foresee what the ultimate effect of proposition 13 may be when these surpluses have dried up and are no longer available.

I believe that the California Legislature was right in not looking to Congress for a Federal bail-out, because, my friends, the people of this country are not looking for that type of bail-out. They are not looking for something to fill the sock up again from another source. They are looking for ways to cut—to cut severely—and to cut all types of waste.

I want to give you just a brief history on State limits on spending. Proposition 13 is the latest development in a rather long and extensive history of State limitation of local government budgets, beginning in the thirties, when citizens were seeking relief from depression troubles, and again in the late sixties and early seventies, when they felt the strain from rising property taxes, and continuing in 1978 because of the increases in all forms of taxes.

Over the last decade, the impetus for States to play a more extensive role in local fiscal affairs has been derived from many factors. I am going to skip through a good deal of this because I know your time as well as ours is somewhat limited.

Let me point out that despite the tremendous publicity given to proposition 13, most States have had considerable experience with limitations on State and local spending, that the States are acutely aware of the fiscal problems of property value inflation, and are moving almost universally to develop property tax assessment and relief programs that will reduce the burdens of rising taxes.

It is clear to me that proposition 13 is ushering in an era of fiscal restraint for State and local governments throughout the country. This is a new era of fiscal prudence, and I think it will produce several major events in State finance policies in the years ahead. States will continue to experiment with self-imposed limits on State and local spending, rather than have such limits approved through popular initiative.

Tennessee's recent enactment of constitutional limits on increases in State spending and the various types of fiscal limits that other States have imposed on local school districts in the course of school finance reform are ample indication that legislatures often need little prodding to curtail State and local spending, especially during these times of double-digit inflation.

As I said earlier, Congress must assume certain responsibilities as a result of the taxpayer revolt. I do not make this statement lightly. I sincerely believe that much of the anger behind the taxpayer revolt is aimed at inflation and is aimed at Federal spending practices that appear to be fueling this inflation.

Forty-eight of the fifty States operate on a balanced budget by constitutional mandate. We cannot print additional money or operate on a deficit. This is wise, and the Congress would do well to follow the lead of the States in this matter.

My home State of Oregon is just one of many States that have passed a resolution calling for a constitutional convention to require the Federal Government to live within a Federal budget except in times of war or true national fiscal emergencies.

The voters view your current $51 billion deficit as one of the main reasons for today's skyrocketing costs, and they appear to be right.

Mr. Chairman, I am going to ask that the rest of my testimony be entered into the record.

In conclusion, let me just state that proposition 13 has provided both State and Federal Governments with what I think is a rare opportunity. With all of the bad things that can be said about it, it has provided States and Federal Government with a rare opportunity to reassess the structure of fiscal federalism in this country. Both State and Federal Governments will have to better balance their revenue and expenditure structures. The State and Federal Governments most certainly will have to address the impact of continued Federal deficits and their impact on inflation. They will have to apply the same scrutiny to the economic impact of their regulations and other preemptive measures that unduly raise the cost of governments.

We in the States are terribly concerned with the increasing intrusion of the Federal bureaucracy in literally, by bureaucratic edict, ripping pages from the law books of every single State in this Nation, not by an act of Congress duly signed by the President of the United States and enacted into law, but by a bureaucratic edict from the Federal Trade Commission, from the Federal Communications Commission, and others who are, without the benefit of passage by Congress, writing, rewriting, and ripping up State laws in all 50 States today as we sit here.

This is a dangerous thing, and I must communicate to you the concerns of the States with regard to what is happening on this level. The Federal Trade Commission, gentlemen and ladies, is your responsibility. They are an arm of the Congress, and you must watch them carefully.

As both Federal and State Governments begin to revise their fiscal policies in light of proposition 13, we must have a more constructive and fruitful dialog between State legislatures and the Congress on such matters as Federal tax reform, welfare revisions, general revenue-sharing, and regulatory reform.

As president of the Oregon Senate and president of the National Conference of State Legislatures, I will assure you that the State legislatures will help in steering the course of fiscal prudence for this Nation's intergovernmental fiscal system. And I urge the members of the committees and your colleagues to do likewise in order to assure the American public that their representatives are ones that can responsibly live up to the challenges and to the opportunities that are presented to us today by proposition 13.

Thank you, Mr. Chairman.

[Senator Boe's prepared statement on behalf of the National Conference of State Legislatures follows:]

STATEMENT BY

SENATOR JASON BOE
PRESIDENT, OREGON SENATE
AND
PRESIDENT, NATIONAL CONFERENCE OF STATE LEGISLATURES

"PROPOSITION 13 AND THE FUTURE OF FISCAL FEDERALISM"

BEFORE

THE U.S. HOUSE SUBCOMMITTEE ON THE CITY
AND
THE JOINT ECONOMIC COMMITTEE

WASHINGTON, D.C.

JULY 25, 1978

INTRODUCTION

CHAIRMAN REUSS AND CHAIRMAN MOORHEAD AND DISTINGUISHED MEMBERS OF THE HOUSE SUBCOMMITTEE ON THE CITY AND THE JOINT ECONOMIC COMMITTEE, IT IS A PLEASURE TO APPEAR BEFORE YOU TODAY TO DISCUSS THE IMPACT OF PROPOSITION 13 ON THE STRUCTURE OF FISCAL FEDERALISM IN OUR COUNTRY TODAY.

MY NAME IS JASON BOE, AND I SERVE AS THE PRESIDENT OF THE OREGON SENATE. I AM ALSO THE PRESIDENT OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES (NCSL) WHICH IS THE OFFICIAL REPRESENTATIVE OF THE COUNTRY'S 7,600 STATE LEGISLATORS AND THEIR STAFFS. NCSL WORKS TO HELP LAWMAKERS MEET THE CHALLENGES OF OUR COMPLEX FEDERAL SYSTEM THROUGH A VARIETY OF STATE AND STATE-FEDERAL SERVICES PROVIDED BY OUR HEADQUARTERS OFFICE IN DENVER AND OUR STATE-FEDERAL RELATIONS OFFICE IN WASHINGTON, D.C.

THE NCSL IS A NON-PARTISAN ORGANIZATION FUNDED BY THE STATES AND GOVERNED BY A 43 MEMBER EXECUTIVE COMMITTEE. NCSL HAS THREE BASIC OBJECTIVES:

—TO IMPROVE THE QUALITY AND EFFECTIVENESS OF STATE LEGISLATURES.

—TO ASSURE STATES A STRONG, COHESIVE VOICE IN THE FEDERAL DECISION-MAKING PROCESS; AND

--TO FOSTER INTERSTATE COMMUNICATION AND COOPERATION.

33-595 O - 78 - 3

I HAVE BEEN ASKED TO SPEAK TODAY ABOUT THE EFFECTS OF THE TAXPAYER REVOLT ON STATE AND LOCAL GOVERNMENTS. BUT I BELIEVE THE CAUSES OF THE TAX-PAYER REVOLT EXTEND FAR BEYOND STATE BOUNDARIES. I BELIEVE THOSE OF YOU AT THE TABLE — AND THE REST OF YOUR COLLEAGUES IN CONGRESS -- MUST ASSUME A LARGE PART OF THE RESPONSIBILITY FOR THE PASSAGE OF PROPOSITION 13 IN CALIFORNIA. I BELEIVE THE TAXPAYER REVOLT IS A LOADED GUN POINTED DIRECTLY AT CONGRESS. THE FIRST BULLET HAS HIT LOCAL GOVERNMENTS AND THE SECOND BULLET MAY HIT STATE GOVERNMENT. BUT THE FEDERAL GOVERNMENT IS THE ULTIMATE TARGET, AND THE THIRD BULLET IS ALREADY ON ITS WAY TO WASHINGTON, D.C. UNLESS YOU ACT -- AND ACT QUICKLY — THE VOTERS WILL TAKE THE MATTER COMPLETELY OUT OF YOUR HANDS.

STATE LEGISLATURES ARE AT THE BATTLE FRONT OF THE WAR ON HIGH TAXES -- AND HAVE BEEN FOR MANY YEARS.

PROPOSITION 13: ITS EFFECT ON STATE GOVERNMENTS

THE CALIFORNIA SITUATION. THE PASSAGE OF PROPOSITION 13 IN CALIFORNIA HAS ATTRACTED WIDESPREAD POPULAR ATTENTION. IT REMINDS US ONCE AGAIN THAT MOST PEOPLE BELIEVE IN THE AMERICAN TRADITION OF LIMITED GOVERNMENT AND THAT WHEN GOVERNMENT BECOMES TOO EXPENSIVE OR TOO LUXURIOUS FOR PUBLIC TASTE, VOTERS CAN FIND WAYS TO SEND A MESSAGE TO THEIR ELECTED OFFICIALS ABOUT SCALING BACK GOVERNMENT OUTLAYS AND PROGRAMS.

THE CALIFORNIA LEGISLATURE WAS ABLE TO TEMPER THE EFFECTS OF PROPOSITION 13 THROUGH QUICK, DECISIVE ACTION. BUT MOST OF THE REST OF THE STATES DON'T HAVE THE LARGE BUDGET SURPLUSES THAT WERE AVAILABLE IN CALIFORNIA. THE PASSAGE OF A MEASURE LIKE PROPOSITION 13 WOULD RESULT IN IMMEDIATE AND WIDESPREAD FINANCIAL HARDSHIPS IN ALMOST ALL OTHER STATES.

THE ONE YEAR EMERGENCY RELIEF PLAN DEVISED BY THE CALIFORNIA LEGISLATURE MAKES EFFECTIVE USE OF THE STATE'S $5 BILLION SURPLUS SINCE OVER $4.4 BILLION OF THAT SURPLUS IS RETURNED TO PROVIDE RELIEF TO THAT STATE'S COUNTIES, CITIES AND SCHOOL DISTRICTS.

AMONG THE SPECIAL PROVISIONS IN THE RELIEF PLAN ARE: STATE ASSUMPTION OF THE COUNTY PUBLIC ASSISTANCE, THE SUBORDINATION OF PREVIOUSLY INDEPENDENT SPECIAL DISTRICTS TO THEIR RESPECTIVE COUNTIES, AND A FREEZE ON STATE EMPLOYEE SALARIES AND BENEFITS FOR PUBLIC WELFARE RECIPIENTS.

OTHER SIGNIFICANT ASPECTS OF THE CALIFORNIA LEGISLATION INCLUDE:

--PROVISION THAT MOST CITIES AND COUNTIES WILL OPERATE AT 80% OF PREVIOUS BUDGET LEVELS

--PROVISION THAT MOST SCHOOL UNITS WILL HAVE ABOUT 85-91 PERCENT OF LAST YEAR EXPENDITURES WHICH MAY MEAN THAT REGULAR PROGRAMS WILL NOT SUFFER IF CERTAIN EXTRACURRICULAR AND SUMMER PROGRAMS ARE REDUCED IN SCHOOL BUDGETS

—DELEGATION OF GREATER AUTHORITY TO CALIFORNIA COUNTIES TO ALLOCATE OVER $125 MILLION ANNUALLY FOR THE OPERATION OF SPECIAL DISTRICTS WITHIN THEIR JURISDICTION

--ASSURANCE THAT CITIES AND COUNTIES MAINTAIN SUCH ESSENTIAL SERVICES AS POLICE AND FIRE PROTECTION AT LEVELS EXISTING PRIOR TO PROPOSITION 13

ALL STATE LEGISLATURES WILL BE WATCHING CALIFORNIA CLOSELY OVER THE NEXT FEW YEARS TO SEE THE LONG-TERM IMPACTS OF PROPOSITION 13. IT IS APPARENT THE CALIFORNIA LEGISLATURE HAS BEEN LARGELY SUCCESSFUL IN MEETING MANY OF THE MEASURES' IMMEDIATE CHALLENGES. BUT THE REAL EFFECTS OF THE JARVIS-GANN MEAT AX APPROACH TO TAX REFORM MIGHT NOT BE KNOWN FOR SEVERAL YEARS.

THE CALIFORNIA LEGISLATURE WAS RIGHT IN NOT LOOKING TO CONGRESS FOR A FEDERAL "BAIL-OUT". I DON'T BELIEVE THAT MANY STATES-- IF ANY -- WILL LOOK FOR FEDERAL ASSISTANCE SHOULD MEASURES LIKE PROPOSITION 13 MAKE IT ON THE BALLOT. YOU IN CONGRESS HAVE YOUR OWN RESPONSIBILITIES IN THIS SITUATION, AND I WILL GET TO THEM SHORTLY.

STATE LIMITS ON SPENDING: A BRIEF HISTORY. PROPOSITION 13 IS THE LATEST DEVELOPMENT IN A RATHER LONG AND EXTENSIVE HISTORY OF STATE LIMITATION OF LOCAL GOVERNMENT BUDGETS, BEGINNING IN THE 1930'S, WHEN CITIZENS WERE SEEKING RELIEF FROM DEPRESSION TROUBLES, AND AGAIN THE LATE 1960'S AND EARLY 1970'S WHEN THEY FELT THE STRAIN FROM RISING PROPERTY TAXES, AND CONTINUING IN 1978 BECAUSE OF THE INCREASES IN ALL FORMS OF TAXES.

OVER THE LAST DECADE THE IMPETUS FOR STATES TO PLAY A MORE EXTENSIVE ROLE IN LOCAL FISCAL AFFAIRS HAS BEEN DERIVED FROM THE FOLLOWING FACTORS:

(1) A GREATER PUBLIC DEMAND FOR PROPERTY TAX RELIEF

(2) COURT-MANDATED UPGRADING OF ASSESSMENT PRACTICES TO ENCOURAGE EQUALIZATION

(3) THE ASSUMPTION OF AN INCREASING SHARE OF STATE/LOCAL EXPENDITURES RESPONSIBILITIES BY THE STATE

(4) AN EFFORT BY THE STATE TO CONTROL AND EQUALIZE SCHOOL DISTRICT EXPENDITURES

THE USE OF PROPERTY TAX AND EXPENDITURE LIMITATIONS ORIGINATED IN THE LATE 19TH CENTURY. NINE STATES HAD SUCH LIMITATIONS BEFORE 1940. SINCE 1970, FOURTEEN STATES AND THE DISTRICT OF COLUMBIA HAVE ENACTED SOME FORM OF TAX AND/OR EXPENDITURES LIMITATIONS.

CURRENTLY STATE TAX AND EXPENDITURE CONTROLS ON LOCAL GOVERNMENTS ARE DIRECTED PRIMARILY AT LIMITING THE USE OF PROPERTY TAXES IN AN EFFORT TO BRING RELIEF TO THE TAXPAYERS IN THE STATE.

THE TWO MOST COMMON TAX RELIEF METHODS USED BY STATES TO EFFECT A DECREASE IN CITIZEN PROPERTY TAX BURDENS ARE HOMESTEAD EXEMPTIONS AND CIRCUIT-BREAKER PROGRAMS. A HOMESTEAD EXEMPTION REDUCES THE ASSESSED VALUE OF A PROPERTY BY A SPECIFIC DOLLAR AMOUNT. A CIRCUIT-BREAKER PROGRAM EXTENDS A REBATE OR CREDIT TO FAMILIES WHOSE PROPERTY TAX EXCEEDS A STATE DETERMINED PERCENTAGE OF THE FAMILY'S INCOME. CIRCUIT-BREAKER PROGRAMS ARE USUALLY ADMINISTERED THROUGH THE STATE INCOME TAX SYSTEM BUT CAN BE ADMINISTERED SEPARATELY.

BOTH PROGRAMS HAVE GENERALLY BEEN TARGETED TO ELDERLY OR DISABLED HOMEOWNERS AND RENTERS; HOWEVER, WITHIN THE LAST TWO YEARS SEVERAL STATES HAVE REVISED ELIGIBILITY REQUIREMENTS SO THAT A LARGER NUMBER AND A BROADER RANGE OF THEIR TAXPAYERS ARE ELIGIBLE TO RECEIVE SOME RELIEF. INDEED, STATE APPROPRIATIONS FOR CIRCUIT-BREAKER REACHED CLOSE TO $1 BILLION IN FY1977. THIS IS NOT AN INDICATION OF THE GROWING CONCERN AMONG THE STATES ABOUT EVER INCREASING PROPERTY TAXES AND THE CITIZEN RESPONSES TO THESE INCREASES.

FINALLY, SINCE 1976 FIVE STATES HAVE PASSED TAX OR EXPENDITURE LIMITATION LEGISLATION TO CHECK THE GROWTH IN STATE SPENDING. EIGHT STATES DELIBERATED ON SUCH MEASURES IN THEIR 1978 SESSIONS. AT LEAST SIX STATES ARE ATTEMPTING TO GET SUCH LEGISLATION ON THE BALLOT IN THEIR STATES THIS FALL. MANY OTHER STATES ARE ACTIVELY INVOLVED IN DRAFTING LEGISLATION ON THESE MATTERS FOR CONSIDERATION IN THE NEAR FUTURE. AS MORE CITIZENS IN EACH STATE CONTINUE TO EXPRESS THEIR CONCERN ABOUT THE RISING COSTS OF SERVICES AND EVER INCREASING PROPERTY TAXES, LEGISLATURES WILL CONTINUE TO RESPOND PROMPTLY, BUT RESPONSIBLY.

SCHOOL FINANCE PRESSURES. PART OF THIS STRAIN FROM RISING PROPERTY TAXES HAS BEEN REFLECTED IN THE WIDENING GAPS IN LOCAL SPENDING FOR PUBLIC EDUCATION. SEVERAL STATE COURTS IN THE 1970'S MANDATED THAT EDUCATION OUTLAYS COULD NOT DEPEND DIRECTLY ON REAL ESTATE VALUES UNLESS STATES EQUALIZED THE YIELD FROM LOCAL PROPERTY TAX EFFORT. LAWS PROHIBITING UNCONTROLLED LOCAL SPENDING HAVE, THEREFORE, BEEN PUT ON THE BOOKS OVER THE LAST DECADE.

STATE LIMITS ON LOCAL SCHOOL OPERATING BUDGETS ARE COMMON TO EVERY REGION OF THE COUNTRY, WITH EXCEPTION OF THE NORTHEAST. NO NEW ENGLAND STATE EXCEPT MAINE IMPOSES LIMITATIONS ON LOCAL EDUCATION BUDGET AUTHORITY (SEE TABLE 1).

ELSEWHERE IN THE NORTHEAST, THE ONLY STATEWIDE CONTROLS ON SCHOOL BUDGETS ARE CONFINED TO PENNSYLVANIA, WITH NEW YORK AND NEW JERSEY APPLYING LIMITS ONLY TO LARGE CITIES.

LIMITS ARE GENERALLY IMPOSED IN THREE WAYS: ON PROPERTY TAX RATES, PROPERTY TAX LEVIES, AND EXPENDITURES. RATE LIMITS ARE USED IN 26 STATES; LEVY LIMITS IN 6; AND EXPENDITURE CONTROLS IN 4. RATE LIMITS SET THE MAXIMUM PERCENTAGE OF THE LOCAL PROPERTY TAX BASE THAT MAY BE USED ANNUALLY FOR SCHOOL REVENUES; ALTHOUGH THE REAL MEANING OF THE RATE LIMITS DEPENDS IN PART, HOWEVER, UPON WHETHER STATE PROPERTY ASSESSMENT PRACTICES ARE STANDARDIZED. WHILE RATE LIMITS ARE THE MOST POPULAR FORM OF BUDGET CONTROL, LEVY AND EXPENDITURE CONTROLS HAVE BEEN INCREASINGLY ACCEPTED. SCHOOL DISTRICTS ARE PERMITTED TO RAISE LOCAL TAX REVENUES EQUAL ONLY TO A LUMP SUM PUPIL OR PERCENTAGE AMOUNT. IN STATES WITH EXPENDITURE LIMITS, SCHOOL DISTRICTS ARE PERMITTED TO INCREASE THEIR EXPENDITURES ANNUALLY BY A LEGISLATIVELY DETERMINED PERCENTAGE; EXPENDITURE LIMITS CAN ALSO FUNCTION ON A LUMP-SUM BASIS THAT PERMITS EACH SCHOOL DISTRICTSTO INCREASE ITS OUTLAYS ONLY BY A CERTAIN DOLLAR AMOUNT FOR EACH PUPIL.

ALTHOUGH ONLY VERY SPARCE INFORMATION ON ACTUAL FISCAL RESULTS HAVE BEEN DOCUMENTED, THE EVIDENCE INDICATES THAT STATE CONTROLS ON LOCAL BUDGETARY AUTHORITY HAVE MINIMALLY AFFECTED EDUCATION. STATES WHICH LIMIT LOCAL SCHOOL DISTRICT EXPENDITURES SPEND AN AMOUNT COMPARABLE TO SCHOOL IN STATES WITHOUT LIMITS. LIKEWISE, STATES WITH LIMITS RAISE APPROXIMATELY THE SAME SHARE OF EDUCATIONAL REVENUES FROM LOCAL SOURCES AS DO STATES WITHOUT LIMITS. MOREOVER, THERE IS INSUFFICIENT EVIDENCE CONCLUSIVELY TO SUPPORT THE FINDING THAT EXPENDITURE LIMITATIONS DEPRESS EDUCATIONAL QUALITY.

But, limits have had these effects: States rely less on the local property tax as a source of educational revenue, and especially so when limits are part of major reform in school finance legislation. Limits often assist low-wealth, low-expenditure districts which can justify budget increases that would otherwise be suppressed in the name of holding down rising educational costs.

<u>Federal Aid Policies and Spending Limits.</u> Increased federal funds, together with increased latitude in the use of these funds, can undermine state legislative control of expenditures. Federal funds now make up an average of 21% of states' budgets, for a FY78 total of $80 million on its official civilian payroll. These persons include the swelling numbers of workers who receive indirect federal monies through government contracts, research grants and federal matching payments for local government officials. Indeed, state executive agencies often use federal grants to support programs and functions which the legislature has expressly denied budgetary authority. Thus, the state's responsibility for sound fiscal planning and management is critically at stake.

Scant consideration has been given to the fit between federal and state programs. For example, some states which have enacted school finance reform laws, consider federal impact and payments as part of the basic state aid contribution to local school finance budgets. Yet, for the most part, federal, and state-local monies operate independently. Often the federal government provides marginal monies for educational programs that later become major state-local fiscal burdens. In the absence of general aid support, this burden strains the ability of a state to adequately fund its own

EQUALIZING GENERAL AID FORMULA.

ADDITIONAL PROBLEMS WILL BE GENERATED WHEN STATES WHICH MAY PASS SPENDING LIMITS FIND DIFFICULTY IN MEETING FEDERAL REQUIREMENTS PROHIBITING SUPPLANTING OF STATE MONIES. WHETHER CALIFORNIA WILL BE ABLE TO MEET THIS REQUIREMENT AFTER CURRENT STATE SURPLUSES DRY UP, REMAINS TO BE SEEN. BECAUSE STATES PASSING LIMITS MAY NOT BE ABLE TO MAINTAIN OUTLAYS IN THE LONG RUN, MANY PROGRAMS, PARTICULARLY DISADVANTAGED AND BILINGUAL EDUCATION AND MANPOWER PROGRAMS MAY BE SEVERELY JEOPARDIZED.

AT THIS POINT, IT IS FAIR TO POINT OUT THAT DESPITE THE TREMENDOUS PUBLICITY GIVEN PROPOSITION 13

—MOST STATES HAVE HAD CONSIDERABLE EXPERIENCE WITH LIMITATIONS ON STATE AND LOCAL SPENDING

—STATES ARE ACUTELY AWARE OF THE FISCAL PROBLEMS OF PROPERTY VALUE INFLATION AND ARE MOVING ALMOST UNIVERSALLY TO DEVELOP PROPERTY ASSESSMENT AND RELIEF PROGRAMS THAT WILL REDUCE THE BURDEN OF RISING TAXES

—CONSIDERABLE UNREST WITH RISING STATE AND LOCAL TAXES, MUST IN PART, BE LAID AT THE DOOR OF THE FEDERAL GOVERNMENT WHICH HAS CONTRIBUTED TO THE EXPANSION OF THE STATE-LOCAL SECTOR THROUGH THE INCREASES IN FEDERAL AID, PARTICULARLY CATEGORICAL AID WHICH PROMOTES HIGHER STATE-LOCAL SPENDING.

III. FUTURE STATE RESPONSES TO PROPOSITION 13

IT IS CLEAR TO ME THAT PROPOSITION 13 IS USHERING IN AN ERA OF FISCAL RESTRAINT FOR STATE AND LOCAL GOVERNMENTS THROUGHOUT THE COUNTRY. THIS NEW ERA OF FISCAL PRUDENCE, I THINK, WILL PRODUCE SEVERAL MAJOR DEVELOPMENTS IN STATE FINANCE POLICY IN THE YEARS AHEAD.

FIRST, STATES WILL CONTINUE TO EXPERIMENT WITH SELF-IMPOSED LIMITS ON STATE AND LOCAL SPENDING RATHER THAN HAVE SUCH LIMITS IMPOSED THROUGH POPULAR INITIATIVE. TENNESSEE'S RECENT ENACTMENT OF A CONSTITUTIONAL LIMIT ON INCREASES IN STATE SPENDING AND THE VARIOUS SORTS OF FISCAL LIMITS THAT STATES HAVE IMPOSED ON LOCAL SCHOOL DISTRICTS IN THE COURSE OF SCHOOL FINANCE REFORM ARE AMPLE INDICATION THAT THE LEGISLATURE OFTEN NEEDS LITTLE PRODDING TO CURTAIL STATE AND LOCAL SPENDING, ESPECIALLY DURING THESE TIMES OF DOUBLE DIGIT INFLATION.

IN A RELATED VEIN, STATES ARE ALSO EXAMINING THEIR REVENUE STRUCTURES QUITE CLOSELY TO DETERMINE WAYS IN WHICH THEY CAN BE MADE MORE EQUITABLE DURING THESE TROUBLED TIMES. COLORADO, FOR EXAMPLE, HAS RECENTLY INDEXED ITS INCOME TAX TO PREVENT UNDUE FISCAL SURPLUSES DURING TIMES OF INFLATION. SEVERAL STATES CUT VARIOUS TAXES DURING THIS CURRENT YEAR (SEE TABLE 2). THE ARIZONA LEGISLATURE RECENTLY ENACTED A CONSTITUTIONAL AMENDMENT WHICH WILL BE SUBMITTED TO THE VOTERS WHICH WILL LIMIT TAX REVENUE TO 7 PERCENT OF INCOME. SIMILAR PROPOSALS ON LIMITING REVENUES HAVE RECENTLY BEEN ENACTED IN NEW JERSEY AND WILL BE CONSIDERED IN UPCOMING LEGISLATIVE SESSIONS IN SUCH DIVERSE STATES AS MAINE, FLORIDA, MINNESOTA, AND PENNSYLVANIA. TAX LIMITATION LEGISLATION WILL BE A MAJOR ITEM IN UPCOMING LEGISLATIVE SESSIONS.

IN THAT CONTEXT, LET ME ALSO REMIND THIS COMMITTEE THAT STATE GOVERNMENTS MOVED VIGOROUSLY IN THIS PAST SESSION OF THE LEGISLATURE TO MAKE MANY IMPORTANT CHANGES IN A VARIETY OF STATE-LOCAL FISCAL POLICIES. FOR EXAMPLE,

--17 STATES ADOPTED OR EXPANDED THEIR PROPERTY TAX CIRCUIT-BREAKER OR HOMESTEAD EXEMPTIONS

--10 STATES EITHER MADE MAJOR CUTS IN THEIR STATE TAXES OR ENACTED MAJOR EXEMPTIONS IN THEIR BROAD-GAUGED TAXES (SEE TABLE 2)

—A LARGE NUMBER OF STATES ARE CONDUCTING COMPREHENSIVE INTERIM STUDIES OF THEIR OVERALL STATE-LOCAL TAX STRUCTURE TO DEVELOP NEW POLICIES AIMED AT REDUCING STATE-LOCAL TAX BURDENS OR MAKING THEM MORE EQUITABLE FOR BUSINESSES AND INDIVIDUALS

FINALLY, STATES ARE INCREASINGLY ACTIVE IN SCRUTINIZING FEDERAL AID IN THEIR OWN BUDGETS. MORE AND MORE STATES ARE FOLLOWING PENNSYLVANIA'S LEAD IN REAPPROPRIATING FEDERAL AID IN THEIR OWN BUDGET. THIRTY-SEVEN STATES HAVE DEVELOPED REGULATION REVIEW CAPABILITIES THAT MAY ULTIMATELY BE APPLIED TO ANALYSIS OF FEDERAL REGULATIONS THAT INCREASE STATE AND LOCAL GOVERNMENTAL COSTS. IN THESE TWO AREAS AND MANY OTHERS, IT IS CLEAR THAT STATE GOVERNMENTS ARE GOING TO EXAMINE THE TERMS AND CONDITIONS OF THE FEDERAL AID DOLLAR MORE CLOSELY THAN EVER BEFORE TO PREVENT AGAINST DISTORTIONS OF STATE TAXING AND SPENDING POLICIES. IT MOST CERTAINLY MEANS THAT STATE LEGISLATURES THROUGHOUT THE COUNTRY WILL BE PROMOTING THE CONCEPT OF HAVING THE FEDERAL GOVERNMENT DELIVER MORE OF THEIR INTERGOVERNMENTAL AID THROUGH GENERAL

REVENUE-SHARING AND BLOCK GRANTS THAT GIVE BROAD STATE DISCRETION IN ALLOCATING FEDERAL AID.

IV. PROPOSITION 13: THE FEDERAL ROLE

AS I SAID EARLIER, CONGRESS MUST ASSUME CERTAIN RESPONSIBILITIES AS A RESULT OF THE TAXPAYER REVOLT. I DO NOT MAKE THIS STATEMENT LIGHTLY. I SINCERELY BELIEVE THAT MUCH OF THE ANGER BEHIND THE TAXPAYER REVOLT IS AIMED AT INFLATION AND THE FEDERAL SPENDING PRACTICES THAT ARE FUELING INFLATION.

MOST STATES OPERATE ON A BALANCED BUDGET. WE CANNOT PRINT ADDITIONAL MONEY OR OPERATE ON A DEFICIT. THIS IS WISE, AND CONGRESS WOULD DO WELL TO FOLLOW THE LEAD OF THE STATES IN THIS MATTER.

MY HOME STATE OF OREGON IS JUST ONE OF MANY STATES THAT HAVE PASSED A RESOLUTION CALLING FOR A CONSTITUTIONAL CONVENTION TO REQUIRE THE FEDERAL GOVERNMENT TO LIVE WITH A BALANCED BUDGET, EXCEPT IN TIMES OF WAR OR TRUE NATIONAL FISCAL EMERGENCIES. THE VOTERS VIEW YOUR CURRENT 51 BILLION DOLLAR DEFICIT AS ONE OF THE MAIN REASONS FOR TODAY'S SKYROCKETING COSTS — AND THEY ARE RIGHT.

BUT THE QUICK, ACROSS THE BOARD BUDGET CUTS NOW BEING CONSIDERED BY CONGRESS ARE NOT APPROPRIATE. THE HOUSE RECENTLY VOTED TO CUT 6.4 BILLION DOLLARS FROM VARIOUS APPROPRIATIONS BILLS. THIS MOVE TREMENDOUSLY INCREASED THE POWER OF THE EXECUTIVE BRANCH BY GIVING THE PRESIDENT THE FINAL RESPONSIBILITY TO DETERMINE WHICH PROGRAMS GET TRIMMED. IT IS CONGRESS' RESPONSIBILITY TO PRIORITIZE SPENDING AND DETERMINE WHERE CUTS ARE TO BE MADE —

AND TO DO OTHERWISE IS JUST PLAIN "CHICKEN."

CONGRESS WOULD DO WELL TO TAKE A LONG, HARD LOOK AT ALL EXISTING FEDERAL PROGRAMS. WHETHER THIS IS ACCOMPLISHED THROUGH A FORMAL "SUNSET" REVIEW OR A LESS FORMAL WAYS AND MEANS COMMITTEE REVIEW IS UP TO YOU. BUT CONGRESS HAD BETTER FIND SOME EFFECTIVE WAY TO CUT WASTE AND ELIMINATE OUTDATED PROGRAMS BEFORE THE VOTERS FIND A WAY TO DO IT THEMSELVES -- AS THEY DID IN CALIFORNIA.

I BELIEVE THE ISSUE OF FEDERAL PREEMPTION IS CENTRAL TO UNDERSTANDING THE ORIGINS OF THE TAXPAYER REVOLT. CONGRESS MUST TAKE A CLOSER LOOK AT THE MOUNTING ECONOMIC COSTS OF FEDERAL GOVERNMENT REGULATION.

ONE OF THE PRESIDENT'S INFLATION COUNSELORS, DR. BARRY BOSWORTH, HAS INDICATED TO THE NCSL THAT INCREASING FEDERAL REGULATIONS IN THE ENVIRONMENTAL AND OCCUPATIONAL HEALTH AREA MAY BE COSTING THIS COUNTRY AS MUCH AS $100 BILLION PER YEAR -- AN AMOUNT THAT MAY BE CONSIDERABLY IN EXCESS OF THE BENEFITS OF SUCH REGULATIONS. MOREOVER, THESE REGULATIONS MAY BE ADDING NEARLY A FULL PERCENT TO THE CURRENT INFLATION RATE.

IN THE SAME CONTEXT, THE FEDERAL GOVERNMENT MUST CONSIDER THE COST OF THE VARIOUS MANDATES AND PREEMPTIVE FEDERAL REGULATIONS THAT ARE INCREASINGLY BEING ISSUED FROM WASHINGTON. THE VOCATIONAL REHABILITATION ACT OF 1973, FOR EXAMPLE, MAY COST STATE AND LOCAL GOVERNMENTS AS MUCH AS $9 BILLION TO IMPLEMENT. NOT ONE CENT OF FEDERAL MONEY IS YET FORTHCOMING TO HELP MEET THIS MANDATE. MANDATING PROGRAMS WITHOUT THE PROMISE OF SOME FISCAL SUPPORT TO IMPLEMENT A PROGRAM IS AN OUTMODED NOTION. MORE AND MORE STATES, SUCH AS MY OWN STATE OF OREGON, ARE DEVELOPING POLICIES THAT WILL PROVIDE LOCAL GOVERNMENTS WITH ADEQUATE SUPPORT FOR ANY STATE MANDATED PROGRAM. THE FEDERAL GOVERNMENT SHOULD FOLLOW THE LEAD OF PROGRESSIVE STATES IN THIS FIELD.

CONGRESS SHOULD ALSO TAKE A CLOSE LOOK AT THE MANNER IN WHICH IT SENDS FUNDS TO THE STATES. LEGISLATURES ARE GOING TO NEED BUDGET FLEXIBILITY TO MEET THE WISHES OF THE VOTERS. GENERAL REVENUE SHARING DOLLARS ARE A MUST, AND I WOULD URGE THAT THE ADMINISTRATION AND CONGRESS EVEN NOW REAFFIRM ITS COMMITMENT TO EARLY PASSAGE OF GENERAL REVENUE SHARING IN THE 1980 SESSION OF CONGRESS.

UNCONDITIONAL GENERAL REVENUE SHARING REPRESENTS ONE OF THE MOST FUNDAMENTAL CHANGES IN THE OPERATION OF OUR FEDERAL FISCAL SYSTEM. WITH A MINIMUM OF STRINGS AND WITH DUE REGARD FOR THE BUDGET RESPONSIBILITIES OF STATE AND LOCAL GOVERNMENT, THE PROGRAM HAS PROVIDED WELCOME ASSISTANCE FOR STATE AND LOCAL GOVERNMENTS IN THE PAST SEVERAL YEARS. THIS PROGRAM SHOULD BE CONTINUED AND EXPANDED IN 1980. ANY CUTBACKS OR CONDITIONS PLACED ON THE PROGRAM WILL UNDOUBTEDLY BE OPPOSED BY STATE AND LOCAL GOVERNMENTS AND THEIR NATIONAL ORGANIZATIONS SUCH AS NCSL. THEREFORE, TO PRESERVE COMITY AMONG ALL LEVELS OF GOVERNMENT, WE WILL APPRECIATE YOUR EARLY SUPPORT IN REVENUE-SHARING RENEWAL.

V. <u>CONCLUSION</u>

IN CONCLUSION, LET ME STATE THAT PROPOSITION 13 HAS PROVIDED BOTH STATE AND FEDERAL GOVERNMENTS WITH A RARE OPPORTUNITY TO REASSESS THE STRUCTURE OF FISCAL FEDERALISM IN THIS COUNTRY.

BOTH STATE AND FEDERAL GOVERNMENTS WILL HAVE TO BETTER BALANCE THEIR REVENUE AND EXPENDITURE STRUCTURES. THE FEDERAL GOVERNMENT MOST CERTAINLY

WILL HAVE TO ADDRESS THE IMPACT OF CONTINUED FEDERAL DEFICITS AND THEIR IMPACT ON INFLATION; THEY WILL HAVE TO APPLY THE SAME SCRUTINY TO THE ECONOMIC IMPACT OF THEIR REGULATIONS AND OTHER PREEMPTIVE MEASURES THAT UNDULY RAISE THE COST OF GOVERNMENT.

STATES WILL BE REVISING THEIR REVENUE STRUCTURES TO CREATE MORE FISCAL EQUITY FOR THE BUSINESS AND INDIVIDUAL TAXPAYER. THEY WILL ALSO BE CONTINUALLY ANALYZING THEIR MANY LOCAL AID PROGRAMS TO PREVENT UNDUE DISRUPTIONS IN ESSENTIAL LOCAL PUBLIC SERVICES AND TO PREVENT OVERRELIANCE ON THE LOCAL PROPERTY TAX.

AS BOTH LEVELS OF GOVERNMENT BEGIN TO REVISE THEIR FISCAL POLICIES IN LIGHT OF PROPOSITION 13, WE MUST HAVE A MORE CONSTRUCTIVE AND FRUITFUL DIALOGUE BETWEEN STATE LEGISLATURES AND THE CONGRESS ON SUCH MATTERS AS FEDERAL TAX REFORM, WELFARE REVISIONS, GENERAL REVENUE SHARING, AND REGULATION REFORM. AS PRESIDENT OF THE OREGON SENATE AND THE PRESIDENT OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES (NCSL) YOU MAY BE ASSURED THAT STATE LEGISLATURES WILL HELP IN STEERING A COURSE OF FISCAL PRUDENCE FOR THIS NATION'S INTERGOVERNMENTAL FISCAL SYSTEM. I URGE MEMBERS OF THIS COMMITTEE AND YOUR OTHER COLLEAGUES TO DO LIKEWISE IN ORDER TO ASSURE THE AMERICAN PUBLIC THAT THEIR GOVERNMENT IS ONE THAT CAN RESPONSIBLY LIVE UP TO THE MANY CHALLENGES BROUGHT ABOUT BY PROPOSITION 13.

THANK YOU.

Table 1

State Limits on School District Operating Budgets, 1976

State	Limit in force	Limit imposed on: Millage	Expend/levy	Limit coverage: Universal	Classified	Partial	Referendum override possible
New England							
Connecticut							
Maine	x	x		x			
Massachusetts							
New Hampshire							
Rhode Island							
Vermont							
Mideast							
Delaware							
Maryland							
New Jersey	x	x				x	x
New York	x	x				x	x
Pennsylvania	x	x			x		
Southeast							
Alabama	x	x			x		x
Arkansas							
Florida	x	x		x			
Georgia	x				x		x
Kentucky	x		x	x			
Louisiana	x	x		x			
Mississippi	x	x			x		
North Carolina							
South Carolina							
Tennessee							
Virginia							
West Virginia	x	x		x			

33-595 O - 78 - 4

Table 1 (continued)

State Limits on School District Operating Budgets, 1976

State	Limit in force	Limit imposed on: Millage	Expend/Levy	Limit coverage: Universal	Classified	Partial	Referendum override possible
Great Lakes							
Illinois	x	x			x		
Indiana	x		x	x			
Michigan	x	x		x			
Ohio	x	x		x			x
Wisconsin	x		x	x			
Plains							
Iowa	x		x		x		x
Kansas	x		x		x		
Minnesota	x		x		x		x
Missouri	x	x		x			
Nebraska	x	x			x	x	x
North Dakota	x	x			x		x
South Dakota	x	x			x		
Southwest							
Arizona	x		x	x			
New Mexico	x	x		x			
Oklahoma	x	x		x			
Texas	x	x			x		

Table 1 (continued)

State Limits on School District Operating Budgets, 1976

State	Limit in force	Limit imposed on: Millage	Limit imposed on: Expend/Levy	Limit coverage: Universal	Limit coverage: Classified	Limit coverage: Partial	Referendum override possible
Rocky Mountains							
Colorado	x		x		x		x
Idaho	x	x		x			x
Montana	x	x		x			x
Utah	x	x			x		
Wyoming	x	x			x		
Far West							
Alaska	x	x				x	
California	x		x		x		x
Hawaii							
Nevada	x	x		x			
Oregon	x		x	x			x
Washington	x	x		x			x

Source: See Appendix A

TABLE)

SELECTED STATE TAX ACTIONS, 1978

STATE	STATE TAX CUTS/REVISIONS	STATE TAX EXEMPTIONS	STATE SPENDING LIMITS	CIRCUIT-BREAKER/ HOMESTEAD EXEMPTIONS
California			Proposition 13	X
Colorado	Indexation of state income tax			X
Connecticut	Elderly recipients of SSI can receive direct grant in refund of utility & rent bills paid			X
Idaho				X
Illinois				X
Indiana		Increased income limits on property tax exemptions for elderly		X
Iowa				X
Kansas				X
Maine	Reduced personal income tax rates			X
Maryland				X
Massachusetts		Extended income limits on income tax exemptions		
Michigan				X
Minnesota	Reduced state income tax rates			
Mississippi	Doubled standard deduction allowable			
Nebraska				X
New Jersey				X

TABLE 2 (CONTD.)

STATE	STATE TAX CUTS/REVISIONS	STATE TAX EXEMPTIONS	STATE SPENDING LIMITS	CIRCUIT-BREAKER/ HOMESTEAD EXEMPTIONS
New Mexico	Reduced state sales tax rate			
New York	Reduced state income tax rates, increased investment tax credit, increased amount standard deduction allowable			X
Rhode Island				X
South Dakota	Increased property and sales tax refunds for elderly and disabled			X
Tennessee			Limited state spending to the rate of economic growth in state	X
Vermont	Repealed state income surtax			

JASON BOE

PRESIDENT OF THE OREGON SENATE

Biographical Sketch

* Born in Los Angeles, California, on March 10, 1929
* Received Bachelor of Science degree from Pacific Lutheran University in 1951 and a Doctor of Optometry Degree from Pacific University in 1955.
* Now lives in Reedsport, Oregon, where he has practiced Optometry since 1955.
* Married to the former Kathryn Reule of Hillsboro, Oregon. Father of three sons: Eric, Peter and Brian.

During his 19 years of public service, Jason Boe has worked his way up from City Councilman to President of the Oregon Senate. Elected to the Reedsport City Council in 1958, Boe won a second term on the Council in 1962. He won election to the Oregon House of Representatives in 1964, and was re-elected in 1966 and 1968. Jason Boe was elected to fill a vacancy in the Oregon Senate in 1970. He was re-elected to the Senate in 1972 and again in 1976.

Jason Boe has held leadership positions in both House and Senate. He served as Minority Whip in 1967, and was elected House Minority Leader by his Democratic colleagues in 1969. After only one term in the Senate, Jason Boe was elected President by his fellow Senators in 1973. He was re-elected President in 1975, and in 1977 -- becoming the first person in Oregon's history to serve as Senate President in three consecutive terms.

As state Senator, Jason Boe is closely identified with issues relating to education and property tax relief. Jason Boe has played a major role in achieving Oregon's current high financial commitment to public education. He was also instrumental in the creation of the Oregon Homeowner and Renter Property Tax Relief Plan, and in a number of other programs aimed at reducing the property tax burden facing Oregon taxpayers.

As Senate President, Jason Boe is firmly committed to maintaining a strong and viable state government. His work to strenghten the role of state government resulted in his election in 1976 as Vice-President of the National Conference of State Legislatures, a national organization which serves as a voice for state government in Washington, D.C. In August of 1977, he was elected President-elect, and became President of NCSL in July of 1978.

Chairman REUSS. Thank you very much, Senator Boe.

Next, Stephen B. Farber, executive director of the National Governors' Association will present his statement.

STATEMENT OF STEPHEN B. FARBER, DIRECTOR, NATIONAL GOVERNORS' ASSOCIATION

Mr. FARBER. Chairman Reuss, Chairman Moorhead, members of the House Subcommittee on the City and the Joint Economic Committee, it is a great pleasure for me to appear before you today on behalf of the National Governors' Association, the policy instrument of the Nation's Governors.

Your hearings today are timely and important. The issues which you are examining require less heat and more light, and these hearings can help achieve this result.

My statement, which you have seen, addresses several questions that are of fundamental importance to the debate over tax and expenditure limitations. One key question is the extent to which State assistance to local governments has increased to enable those governments to restrict the growth of their local property taxes. Our analysis, at the National Governors' Association shows that State support of local governments now totals $73 billion and has virtually doubled in the last 12 years. Even after the impact of inflation is discounted, two-thirds of all State revenues go to support local governments. State discretionary grants to local governments have increased twice as fast as overall State aid. As a result, local property taxes have steadily declined, both as a percentage of total State and local revenues, and as a percentage of personal income.

During the past 12 years, State assistance to local governments in welfare has grown by 450 percent; in revenue sharing, by 409 percent; in education, by 240 percent; in highways by 103 percent; and in health and hospitals by 259 percent.

I would like to emphasize the growth in revenue sharing, 409 percent, because we strongly believe that the Federal Government would also be making more effective use of its funds through a continued and expanded use of mechanisms for revenue sharing.

Sometimes, in Washington, D.C., Mr. Chairman, the magnitude and the significance of State assistance to local governments are underestimated. But I can assure you that in the capitals, of all the 50 States, both State and local officials have a full appreciation of the meaning of the $73 billion figure that I have quoted, a figure that looms even larger in importance when tax and expenditure limitations are discussed or projected.

A second key question deals with actions States have taken, and and are taking, to limit taxes and expenditures. On the tax side, almost every State has acted in the past 3 years to limit State and/or local taxpayer liability through increased credits, deductions, or exemptions.

State circuit-breaker programs, for example, now operate in 30 States and, in 1977, returned $932 million to just over 5 million households for an average rebate of $184.

On the expenditure side, tax expenditure limits of different kinds have been set in Tennessee, New Jersey, Colorado, and Michigan, and they are pending in other States.

In short, Mr. Chairman, the past several years have seen extensive State actions to limit taxes and expenditures. The need now, as States consider new approaches in the wake of the passage of proposition 13, is for proposals that are well-considered and precisely targeted.

A third key question deals with the impact of tax limitation efforts on the State and national economies and on the delivery of services. You are familiar with the recently completed CBO analysis of the effects of proposition 13. That report is sobering in its conclusions. Whether or not one fully agrees with the report's conclusions, the message, it seems to me, is quite clear: We must all insist on knowing the full impact of the proposals to limit taxes and expenditures on the economy of the States and of the Nation and on the delivery of services, before and not after they are adopted.

The question to which my statement devotes the most substantial attention, Mr. Chairman, is the actual fiscal condition of the States. There has been widespread and, I believe, quite damaging error and confusion on this question. And these hearings can perform a great service by helping to set the record straight so that sound and well-informed public policy can be made.

The prevailing myth in some quarters is that there is a massive surplus in the States in the range of $30 billion. Chairman Moorhead alluded to these figures in his opening presentation, and I am glad that you did, Mr. Chairman, because it is time to nail hard, and nail precisely, what the facts are.

The reality, as opposed to the myth, of the State surplus—or, more accurately, the States' general fund operating balance—is quite different. The $30 billion figure often heard is actually a combination of what the Commerce Department calls social insurance funds and other funds for both State and local governments.

The social insurance, or pension funds, are not available to local governments to pay their operating costs, yet these funds currently represent nearly two-thirds of the so-called "surplus."

The aggregate State government general fund operating balance as of the first quarter of 1978 was projected at $6 billion by our best analysis, and that figure reflects sound budgeting practices. During the first quarter of 1978, local governments, as opposed to State governments, appeared to have an operating balance of approximately the same size as State governments. That is in the range of $6 billion.

These are data that we have compiled painstakingly with the excellent assistance of the National Association of the State Budget Officers. The aggregate State operating balance represents less than 6 percent of the operating budgets of all States.

Sound budgeting experience suggests that such a contingency fund is necessary to offset unexpected emergencies or financial difficulties, and in all of the States that you represent, Mr. Chairman and members of the committees, you know that these emergencies, whether floods or disasters of other kinds, or fiscal difficulties can do and do arise and must be budgeted for.

The bulk of the aggregate State operating balance is found in just a few States, and in those States such as California, where Governor Brown and the legislature have acted decisively to deal with the impact of proposition 13, the balances have already been largely committed.

The fact is that most States—such as New Jersey, Mrs. Fenwick, which has a $23 million surplus in a massive State budget—have a modest or marginal balance, at the very best.

In short, the reality of the State financial situation is significantly different from the myth. The "surplus," as Barron's magazine concluded in its May issue of this year, is "vanishing" and "phantom". The aggregate operating balance for State governments is about $6 billion, or one-fifth of the commonly cited $30 billion figure, and it is projected to be proportionately smaller, perhaps 30 percent smaller by the end of fiscal year 1979.

The balances in most States are small and represent sound financial management, and far from acting as a drain on the economy these balances will either be returned to citizens to reduce property taxes or reinvested in economic growth and development.

This morning's Wall Street Journal, on page 3, has this headline: "U.S. Finds State-Local Budget Surpluses Evaporating; Trims Third-Period Estimate." And I commend this excellent story to your attention.

The impact of this information on the tax limitation debate and on fiscal federalism cannot be overstated. Misinformation on the fiscal condition of the States could well confuse and even inflame, the tax limitation debate. And, as the night follows the day, inaccurate data will lead to unsound public policy.

It is, frankly, high time to consign the myth of massive State surplus to the oblivion it deserves. As Gov. William G. Millikan, chairman of the National Governors Association has said, "Anyone who claims there are massive State surpluses is not familiar with the facts."

As the administration and Congress consider the fiscally aided Federal budget, and as you examine longer term issues such as continued State participation in general revenue sharing, it is extremely important for options to be considered, and decisions made, on the basis of the reality, not the myth of the States' fiscal condition.

It is time to note with precision the tremendous growth in State assistance to local governments and the enormous size of that State assistance. And it is time to note, as well, and with equal precision, the facts and not the fiction about the States' fiscal condition.

Finally, Mr. Chairman, it seems to me that on this question, as on the others I have discussed, the stakes for responsible government and for fiscal federalism are extremely high.

The National Governors' Association will continue to address these questions as forthrightly as we can. We look forward to a continuing relationship with the administration and the Congress in this effort.

Thank you.

Chairman Reuss. Thank you very much, Mr. Farber.

[Mr. Farber's prepared statement appears in the appendix on p. 779.]

Chairman Reuss. We will now hear from Fred F. Cooper.

STATEMENT OF FRED F. COOPER, COUNTY SUPERVISOR, ALAMEDA COUNTY, CALIF.

Mr. COOPER. Thank you, Mr. Chairman.

I would like to, of course, refer to my prepared testimony, as well as I have submitted a resolution adopted by the National Association of Counties at their annual convention in Atlanta, 2 weeks ago today.

Chairman REUSS. Without objection, those will be inserted in the record.

Mr. COOPER. I, in my statement, have attempted to look at what I see as some of the reasons for the passage of proposition 13 in California.

I am a county supervisor in Alameda County, which has a population of 1,100,000 people. It is across the bay, east of San Francisco. It has 13 cities, running from the core urban cities of Berkeley and Oakland in the north, to the suburban cities of Fremont, Livermore, and Pleasanton in the south. So we have both the urban and the suburban problems, and are of course at the core of the problem of proposition 13's problems and solutions.

I think one of the key factors that I think has been overlooked in passage of proposition 13, and the reason why many voters seem to be angry with government, is that for 30 years, in the 1940's, 1950's, and 1960's, we had inflation, but we still had people's purchasing power increasing.

In the past 5 years, purchasing power has been eroded, and we are continuing to have inflation, but people's purchasing power does not keep up.

I think Congress needs to look at the impact of the actions of the Arab oil countries, and the impact of the environmental and consumer movements on purchasing power in this country. Those three things have all substantially increased the cost of goods and services in this country, without adding anything to the value of goods and services. I think this has resulted in the purchasing power of many people being eroded.

Inflation, of course, is a continuing factor; but as I have indicated, we have had inflation for a number of years without purchasing power being diminished. And when people see their purchasing power eroding, they look for somebody to blame. They tend to blame the unions, business, and they nowadays, following Watergate, tend to blame government.

And I think it is important to focus on the reasons for the erosion of purchasing power, and get people to understand better what is happening.

Obviously, when they get angry, they look for something to do something about—the property tax, with proposition 13. It gave them that opportunity to express their dissatisfaction and cut at least one major cost item that they could have impact on.

Another major factor is mandates to local government that are passed, without providing the funds, and those mandates come from the Congress; they come from the State legislature; they come from the courts.

And I have outlined in my prepared testimony some of the mandates from the courts, some of the mandates from the Congress, and some from the State legislatures that our county has to live with, that increase our costs, that require us to increase our property tax much faster than just the cost of living. And it seems to me that Congress needs to look at the impact of those mandates.

Some of them come from laws you pass that are implemented by regulation. And as I point out in my statement, the same newspapers and television stations and voters that are complaining about Alameda County increasing the property tax, 1½ years ago were all supporting the disabled people who were sitting in Senator Cranston's office in San Francisco and coming back to Washington, and asking that Secretary Califano adopt regulations.

Those regulations resulted in a cost of $10 billion to $20 billion to local governments in this country. They are based on a law you passed. They are based on the regulations that Secretary Califano signed. And everybody who was in favor of them 1½ years ago when nobody looked at the cost, and now we in local government are being blamed for the fact that to implement those regulations takes money.

We are being blamed for the fact that you have imposed those regulations on us, without giving us a dime to fund the costs. And I think you need to look at some way of requiring economic impact statements when you adopt regulations, and when you adopt legislation that has an impact on local governments.

Finally, in my statement I point out that California has rejected three similar propositions to proposition 13 over the past 15 years. This one was passed, even though three prior ones had been rejected.

I think there are two key factors that resulted in the passage of the fourth one, when the first three were rejected:

One, the substantial increase in the market value of single-family homes, which has partly to do with inflation and partly to do with the environmental and no-growth movements. That has resulted in the assessed valuation of the average home in California doubling over the past 5 years, and has resulted in a substantial shift of the property tax burden from commercial and industrial properties, to homeowners.

The second factor that did not exist when California rejected similar programs three times previously was the substantial State budget surplus which has hit—or which has passed $5 billion. And of course, a substantial amount of that budget surplus was accumulated by the State passing on costs to local government through regulations and through State legislation without providing the dollars. So at the same time the State legislature and the Governor have increased the property tax through mandates, they have been accumulating a substantial surplus. And their inability to keep their commitments—which they've been making for 2 years—to use the surplus to fund some property tax relief for the homeowners, also added to people's anger. And by the time they adopted a program under the threat of proposition 13, the voters had lost confidence in their sincerity.

So those two factors did exist this year in California. They do not necessarily exist throughout the rest of the country, but they do explain—to at least a great extent—the reason why proposition 13 passed when three prior measure failed.

I think Congress could assist the States by studying the question of the State surpluses, by studying the impacts of the environmental movement on increased costs of housing, by looking at what is happening to purchasing power in this country, and helping people understand that it isn't necessarily the property tax that is affecting their purchasing power, and by looking at the possibility of economic impact studies before you adopt regulations, before you adopt legislation, and looking at the possibility of requiring that whenever you insist through your laws or your regulations that we do something new or that we expand a program, that you send the money on to fund them.

Local government in California, through the passage of proposition 13, has become almost totally dependent upon the State and Federal Governments for the funds with which to operate.

This erosion of local control over local government is a dangerous thing, because it will result in the inability of local officials to adjust local programs to meet local needs. It will mean that only programs approved in Sacramento and Washington will be funded. And that means that the most vital decisions for local government will be made by State and Federal employees adopting and modifying regulations in Sacramento and Washington, rather than by people responsible to their local voters.

That is the real danger of proposition 13. And if that spreads throughout the country, local government throughout the country will become less and less responsive to the local voters.

Thank you.

[Mr. Cooper's prepared statement and a resolution adopted by the National Association of Counties on tax reform and responsible government follow:]

STATEMENT OF ALAMEDA COUNTY SUPERVISOR FRED F. COOPER
ON JULY 25, 1978 BEFORE THE
HOUSE SUBCOMMITTEE ON THE CITY

Members of the Subcommittee:

I appreciate this opportunity to appear and testify before you on what I see as some of the causes for the passage of Proposition 13 in California and several of the problems that led to its passage.

Perhaps the biggest single factor is the fact that the cost of local government, and county government in particular, is going up faster than the cost of living at the same time that individual taxpayers see their purchasing power eroded away through actions of the Arab oil countries, the consumer movement and the environmental movement. While we have had thirty years of inflation, throughout most of that period people's purchasing power has increased more rapidly than their expenses, but in the last five years that has not been the case. People see their purchasing power each year being reduced, they look for someone to blame, and the tendency is to blame labor unions and business for raising prices, and to complain about property tax going up rapidly since it is one thing where they have some control. I do not think adequate attention has been paid to the fact that a major portion of the erosion in purchasing power is due to actions of the Arab oil countries, the environmental movement, and the consumer movement since all three result in our having to pay higher prices for products without the products being improved or being made more valuable in any way. Perhaps your committee can focus on the erosion of purchasing power in this country and the basic causes, since inflation is often blamed, but inflation in the 1950's and 1960's did not result in lower purchasing power.

A more direct cause of voter dissatisfaction with the property tax is the fact that it goes up substantially faster than the cost of living. Partly this is due to the fact that the cost of some things that counties purchase go up faster than the cost of living, particularly utilities and gasoline due to the oil crisis. But of course higher oil prices are built into the cost of every item of goods and services purchased by counties, just as substantially higher medical costs are built into the price of every item of goods and services. Every time you go to a grocery store and buy a bag of potatoes you are contributing to the medical care of the grocer and his staff, the people who process and deliver the items, etc. Higher medical care costs should be added to my previous discussion of increased costs from Arab oil countries, and the consumer and environmental movements.

A major factor causing the county property tax to increase much faster than the cost of living is governmental mandates. These include the United States Congress, the California legislature, and both state and federal courts as follows:

1. The average length of a felony trial in Alameda County has tripled in the past fifteen years, from just over two days to over eight days. Mostly the increased length is due to decisions of the United States Supreme Court, and a substantial amount is due to decisions of the California Supreme Court, which require the courts to provide attorneys, provide time for hearings on a great many different things such as search and seizure, past records of police officers, discovery of evidence, etc. The increased length of trials requires more judges, more district attorneys, more public defenders, more clerks, more courtrooms, etc.

2. Mandates by the federal government increase local costs. Passage by Congress of unemployment insurance is increasing our costs, and even though the Fair Labor Standards Act application to local government was suspended by the Supreme Court, many jurisdictions including my own are continuing through labor negotiations to apply portions of that act to county operations at higher costs. The adoption by HEW of regulations for the disabled and handicapped a year and a half ago will eventually result in increased costs to local government, probably more than one-half in the schools, of $10 billion to $20 billion. In this area it is significant that the same taxpayers and newspapers that are criticizing local government in California for the high property tax were, a year and a half ago, quite sympathetic to the demonstrations by handicapped people in Senator Cranston's office in California and in Washington, when they were asking Secretary Califano to sign the regulations. The same people who urged that the regulations be signed are now complaining about having to pay the cost. It might be useful to require an "economic impact report" before Congress passes legislation affecting local government, and before federal agencies adopt regulations that require changes in the operations of local governments.

3. A large portion of the increased property tax for Alameda County has been due to mandates by the legislature of the State of California. We have been required to fund increasing amounts each year for Medi-Cal, AFDC, and adult welfare. State law and state regulations frequently require improvements and expansions in county programs, without supplying any funds. At the same time, when the State provides partial funding for local programs the State frequently provides no cost of living increase in their share of the program. For example, the state has been paying the same $95 per month for the care of juveniles in juvenile camps since 1953, leaving the county to pick up all increases in costs over the past 25 years.

I believe the above listed factors of reduced purchasing power and increased mandates by the courts and the state and federal governments apply fairly uniformly throughout the country, although I suspect that state mandates are less of a problem in states with low overall tax rates than they are in California.

I would urge the Congress to look at the erosion of purchasing power over the past several years associated with the oil crisis, and the consumer and environmental movements, and to consider some sort of economic impact report on local government whenever Congress, or state legislatures, or the courts, mandate new programs or mandate improvements in existing programs.

If we look specifically at California and Proposition 13 we need to recall that over the past fifteen years the voters in California have rejected three similar measures to Proposition 13 - two proposed by the former Assessor of Los Angeles County and one proposed by former Governor Ronald Reagan.

It is my feeling that three factors existed in 1978 that were not present when the voters rejected the three similar measures previously as follows:

1. The erosion of purchasing power on the part of most people has gotten most severe in the past two or three years, and results in frustration since inadequate attention has been paid to the problem and inadequate explanations given. People get frustrated when their purchasing power goes down, but the frustration is compounded by the fact that they are not sure who to blame, and is compounded further when they see their taxes increasing rapidly to provide additional services and benefits to people whom they feel are not carrying their full weight. So far, that frustration has not extended to dramatic increases in the Social Security tax to fund dramatically increased benefits to senior citizens, but unless there is better public understanding of what is happening I think we can anticipate in the next few years the same frustration directed at senior citizens as is presently directed at recipients of welfare.

2. The cost of housing, and particularly single family housing, has doubled in California in the past five years. This seems to be partly due to general inflation, and partly due to the environmental movement, which has kept the supply of housing down at the same time the demand has increased, thereby causing market values to sky-rocket. Since property tax assessments are based on market value, the assessment of the average home has doubled over five years and therefore even with the same tax rate the amount of tax being paid has doubled. Because single family homes increase in market value much faster than commercial and industrial property, this has resulted in a shift of part of the property taxes from commercial and industrial properties to homeowners. It should be noted that the opinion polls in California showed equal numbers of people against Proposition 13 as those in favor of it up through March of this year. When the increased assessments came out in April, public opinion shifted dramatically in favor of the Proposition.

3. The other major factor present this year in California that was not present previously was the fact that the State was sitting on a budget surplus of $3 to $4 billion at the same time that the State legislature and Governor were

unable to provide the property tax relief that they had been promising for more than a year. Voter frustration increased as the taxes went up, as dramatically higher assessment notices were sent out in April, and yet the legislature and Governor were unable to keep their promises to distribute the surplus to solve the problem, at least until some time after Proposition 13 qualified. The fact that the legislature finally passed an alternative measure some months after Proposition 13 qualified for the ballot made many voters feel that the legislature would not have done anything except under the threat of Proposition 13. It is, of course, significant that substantial portions of the State surplus were developed as a result of state mandates by both the legislature and administrative mandates from the Governor that increased the property tax. If, instead of accumulating a large surplus, the State had used that money to fund the many mandates to local government which increased property tax and to provide adequate funding for the State's share of partnership programs, the property tax would not have increased so dramatically and Proposition 13 might not have passed.

Congress could assist the states by studying state surpluses, by studying the impacts of the environmental movement on increased cost of housing, by attempting to help control inflation in housing costs, and by encouraging the use of state surpluses to fund state mandates, thereby reducing the need to increase local property taxes.

Local government in California, through the passage of Proposition 13, has become almost totally dependent upon the state and federal governments for the funds with which to operate. This erosion of local control over local government is a dangerous thing because it will result in the inability of local officials to adjust local programs to meet local needs, will mean that only programs approved in Sacramento and Washington will be funded, and that the most vital decisions for local government will be made by state and federal employees adopting and modifying regulations in Sacramento and Washington, rather than by people responsible to their local voters.

TAX REFORM AND RESPONSIBLE GOVERNMENT

Be it Resolved, upon the initiative cfPresident William O. Beach, that NACo adopts the following statement on tax reform and responsible government, to have the effect of a resolution:

The adoption of Proposition 13 in the state of California constitutes a confirmation from the voters of that state of which has been a NACo position of longstanding - that the property tax levels at the local level are often intolerable, and the property tax itself has been asked to carry far too many of our governmental burdens. In addition to the traditional property-related services, it also now often must pay for our expensive modern educational systems, health and social services, and many other programs. Too often this over-loading of the property tax is not the result of votes by local elected officials, but rather the mandates of Federal and state government. NACo has long held that the major burden of property taxes frequently arises from Federal and State policies mandating the conduct and financing of Federal and State programs from local resources principally, and in many cases exclusively, from the property tax.

NACo is acutely aware of the public concern and reaction to the crushing burdens of property taxes placed upon property owners not only in California, but elsewhere in the nation. We support the roll-back of property taxes if they reach confiscatory levels, and the adoption of property tax levels which accurately reflect the costs to local governments to provide essential local governmental services.

While the implementation of such roll-backs may, in many cases, cause initial severe economic and programmatic dislocations, a direct result of such implementation can be to put into clear public perspective the impact of Federal and state mandated programs and policies upon the local governments' principal source of revenue -- the property tax.

NACo calls upon the President, the Congress and each state's executive and legislative leaderships to recognize the clear and compelling principle of the need for equitable reallocation of cost burden sharing now placed upon the property tax used by many of our nation's counties and other local governments.

NACo further calls upon Federal and state governmental leadership to review, with sensitivity to the unacceptable tax burdens of all kinds upon the people of this nation, all aspects of governmental spending to reduce waste, duplication and unnecessary governmental spending - an objective which NACo and its individual members have long advocated, and to which we re-commit ourselves.

In order to more clearly re-state where NACo and its member counties stand, we hereby rededicate ourselves to the following long-held principles and objectives:

- delivery to the best of our abilities a wide variety of important and essential public services to our citizens, including vital human services to the poor, aged, disabled, mentally and physically ill and those otherwise disadvantaged who are least able to care for themselves;
- operation of the delivery of those services with the confines of a balanced budget that the taxpayers can afford;
- maintenance of a vigilant watch in order to maintain only essential positions in county government and otherwise to eliminate all unnecessary expenditures from our public budgets;
- continuing efforts to increase efficiency and productivity of both management and the rank and file of county employees; and
- fair and equitable administration of the property tax, together with all other local taxes.

We also, individually and as a national organization, pledge our best efforts, in cooperation with our state associations of counties and our fellow state, city and Federal officials, to encourage and work at all levels of government:

- to resist all state and Federal mandates to local government unless there is a provision for funding by the state of Federal government; and
- to control inflation, by vigorously urging the President and Congress to balance the Federal budget at the earliest possible date and we pledge to assume our share of that responsibility.

Finally, we pledge ourselves to the following specific actions and commitments:

Establish Priorities. In the interests of economy, we ask each of our twelve steering committees to establish priorities among their various functional areas. We ask the Board of Directors to establish priorities among those submitted by the committees. Finally, we as the policy-making membership pledge ourselves to the difficult but necessary task of developing each year an American County Platform which combines a balance of necessary programs and fiscal responsibility.

In establishing priorities, we ask each of our steering committees to give full consideration to actions in their respective subject areas which are calculated to increase economy and efficiency by such devices as caps on medical expenses, removing much of health and welfare costs from the property tax base, and bring Federal, State and local regulations to a minimum.

Maintain NACo's Tax Revolt Action Center. Provide factual information to public officials, media and the citizens in general, on the various methods and devices for tax reform and expenditure control. In particular, we will endeavor to better educate voters on the real problems concerning the property tax, the roll of mandated programs in driving the property taxes to often near confiscatory levels, and the need for basic tax and spending reforms at the state and Federal levels.

Strenghten NACo's New County Center. Top association priority should be given to the New County Center, which provides information to the public officials and citizens in general on ways and means of improving county administration, finance management, planning, organization, staffing, budgeting and public reporting. Special emphasis should be placed upon the following: consolidations or elimination of special authorities and districts; functional consolidations; joint governmental contracting; voluntary regional cooperation; increased management and labor productivity; and improved general public administration.

Provide Federal Budget Input. At the earliest date, the leadership of NACO should meet with the director of the Office of Management and Budget and the Congressional Budget Committees to determine a responsible county role in aiding the President and the Congress in determining Federal budget priorities and limits.

Improve Financial Management. NACo will continue to help county governments improve their financial management practices. Our Tax and Finance Conference in Los Angeles, September 18-20, 1978, will focus on tax reform activities and fiscal management.

Urge Tax and Welfare Reform. Funding of welfare and certain health costs from the property tax is a major concern to citizens and is strongly opposed by NACO. All efforts should be made to secure Federal action to remove these costly items from the property tax.

Chairman REUSS. Thank you, Mr. Cooper.

In order to conserve time, Representative Moorhead and I have suggested that the next witness panel—consisting of Prof. Edward M. Gramlich of the University of Michigan; Public Finance Director George E. Peterson of the Urban Institute; and Herrington Bryce of the Academy for Contemporary Problems—take their seats and give their papers, and that we then examine those seven witnesses, and then we would withhold the final panel until later.

And so, if you gentlemen would just remain at ease where you are, we will hear the next three witnesses.

Representative KELLY. Mr. Chairman, I have a brief statement that I would like to make at this time, if the Chair has no objection.

Chairman REUSS. Why, sure.

Representative KELLY. Mr. Chairman, proposition 13 represents "government by volunteers," where the people en masse have turned away from their duly elected officials—the constitutional Government—and have looked to volunteers to lead them, and to establish government that is satisfactory to the public.

Recently, a poll in my district showed that the Congress of the United States has a minus-51 job rating, which means that the rest of the people—49 percent—either did not have an opinion or thought Congress was doing all right.

A combination of these two considerations indicates the very serious significance of proposition 13.

Mr. Chairman, the threat that is being made by the elected officialdom is that if the people try any shenanigans like proposition 13, there are going to be reprisals, massive layoffs among the public employees; that a lot of people are going to get fired; and public services are going to be reduced. But nowhere does there seem to be any suggestion that government as a matter of economy might cut salaries, as a way of retaining the employment of everybody and also maintaining the level of public service.

And the other suggestion seems to be that we will just shift the burden of spending from local governments to the Federal Government, and in that way some miracle will be wrought.

Of course, that is just going to shift the burden on the taxpayers from one pocket to another, and not really accomplish anything.

So I see merit in two major areas—the idea of cutting salaries, and of trying to cause Government officials who are elected according to our constitutional processes to start functioning in the way that proposition 13 suggests that they should, rather than to run the risk of chaos in our Nation and a destruction of our constitutional form of Government, by forcing the people to turn to volunteers, rather than the established government.

Chairman REUSS. Representative Moorhead?

Representative MOORHEAD. Thank you, Mr. Chairman.

As the leadoff witness for panel No. 2 of the Joint Economic Committee and the Subcommittee on the City, we would first like to hear from Prof. Edward M. Gramlich.

STATEMENT OF PROF. EDWARD M. GRAMLICH, PROFESSOR OF ECONOMICS, UNIVERSITY OF MICHIGAN

Mr. GRAMLICH. Thank you, Mr. Chairman and committee members.

I have a statement of about five or six pages here which I will submit into the record. What I would like to do is just make five points that I make in the statement much more briefly than I do there. As Congressman Moorhead said, we are addressing in this panel the question of the high current-day national income account State and local budget surplus and what it means.

The first point is a factual point. Is the surplus really all that it is cracked up to be? There are a couple of reasons why it is not.

The first is that, as Mr. Farber, in particular, mentioned, one really must deal separately with a pension fund surplus. In the latest full-year numbers that I have available, the overall surplus is $29 billion, of which $15½ billion are pension funds, so that the appropriate Government surplus is more like $15 billion.

There are a lot of reasons why the pension fund surplus doesn't mean anything about even the financial health of the pension funds, and certainly it is true that that money is not available for general Government purposes and must be left out of these kinds of discussions.

Now, even the general Government surplus of $14 billion has increased $20 billion in the past 2 years. There has been a sharp turnaround even in that number. And so a second question that I deal with in my testimony is: What has caused that?

Basically, there are three causes: The first is, there has been a very sharp drop in State and local construction that accounts for one-third of the change in the surplus, and there are a number of fairly, at this point, mysterious reasons for that. I have some thoughts about that, but I did not go into them in my testimony.

In any case, the construction budget is again not part of the operating budget of most State and local governments, and so probably a better number to focus on is more like the $13 billion change in the operating surplus over the past two years.

Now, what has caused that? I think that you can attribute that mainly to two sources: The first is that the aggregate economy has recovered sharply from the recession of 1975. In the recession of 1975, State and local budgets were in a precarious budgetary situation. They have recovered now because the economy has recovered. That is a welcome improvement. We shouldn't regret it, and we probably shouldn't change our views about aiding State and local governments because that has happened.

The second thing is that there has been an increase in some Federal grants in the past 2 years, most particularly in CETA grants. Many people feel that there is a lot of so-called displacement with CETA, and if that is so, that could also explain at least some of the rise in the operating budget surplus in the last 2 years.

Now, the next point refers to the composition of the surplus. Is it held by State governments or is it held by local governments?

One thing that I should say this morning, and that is that anybody who talks about this is talking in a little bit of a factual vacuum, because, as a matter of fact, we don't have very good figures in the most recent period of which governments have the surplus. The Department of Commerce has just published a breakdown of the State and local accounts between State governments and local governments through 1976. These figures don't cover 1977, which is the year when a lot of the change and the surplus has taken place, so it is very hard to tell at this point whether the surplus is actually possessed by State governments or local governments.

But if you look at the 1976 numbers, what you find is that, indeed, the State governments have received a little bit more of the year-to-year change but State government budgets are always more cyclical than local government budgets. If you compare the budget position now within the sixties, in fact, local governments are doing slightly better now than they were in the sixties, and State governments are doing the same or a little bit worse.

So while it is true that State governments have received a little more of the latest rise in the surplus than local governments, local governments have received some, and local governments still are better off relative to the sixties. It is very hard to go beyond that and talk about individual governments.

Now, the next point is the relevance of the surpluses or overall macro policy. These surpluses are saving in the overall national accounts; they are revenues that are not met by expenditures. This does mean that, other things equal, it is going to be harder for the Federal Government to cut its own budget deficit without causing an increase in unemployment, and it may be, as some of the speakers have said this morning, it is a top priority for the Federal budget to come more into balance. But what is liable to happen is that either the State surpluses and the State and local surpluses will disappear more rapidly than they otherwise would have, or we will observe a worsening in unemployment, and I think that those risks in the Federal budget policy should be confronted directly.

The final point regards the relevance of these surpluses for the longer-term questions about Federal grant policy, aiding urban governments, or aiding various functions at the State and local level, and there I think the answer is that the relevance is not much; that is, that one can look at time series numbers and observe the surpluses bouncing about always, and there are good reasons for the rise in the surplus in recent times. The surplus probably has a very high transitory component—it always has—and that if you are considering more permanent things such as, let's say, aid to urban governments or supporting various social goods, such as maybe antipollution expenditures or roadbuilding or whatever, those decisions ought to be made on more permanent, longer-run grounds. You should not be observing State and local surplus, which bounces up and down according to short-term changes in income and also in Federal grant policy.

Thank you.

[Mr. Gramlich's prepared statement follows:]

July 25, 1978

STATE AND LOCAL BUDGET SURPLUSES AND FEDERAL GRANT POLICIES

Edward M. Gramlich
The University of Michigan

Thank you for inviting me to testify this morning. In my remarks I'd like to focus on an astounding fact that is lately affecting fiscal and grant policy decisions: the $29 billion budget surplus run by state and local governments in 1977. How can this number be true when we keep reading of urban fiscal crises? What will happen to it? What does it mean for federal fiscal policy and federal grant policy? Why should there be yet more aid from the biggest debtor government, the federal government, to those large creditor state and local governments?

Before getting into the substance, a brief look at the facts. The aggregate state and local surplus, the number that is causing all the commotion, is given in the left column of Table 1. There it can be seen that this surplus never exceeded $4 billion before 1972, took a brief rise in 1972-73, fell back down in 1974-75, and lately has soared back to $29.2 billion by 1977. What is going on?

A first thing that is going on is that this overall number, recorded in the national income accounts statistics of the Department of Commerce, includes the surpluses of employee's retirement funds. For macroeconomic purposes this saving is relevant, and does imply that the federal government must dissave more to maintain a high level of overall spending demand. But in trying to examine the financial health of state and local governments, it should be recognized that these pension

Table 1

State and Local Budget Surplus

National Income Accounts Basis
Billions Current Dollars

Calendar Year	Overall Surplus	Less: Pension Fund Surplus	Equals: General Govt. Surplus	Plus: Net Capital Items	Equals: Operating Budget Surplus
1960	0.1	2.3	-2.2	6.2	4.0
1961	-0.4	2.4	-2.8	6.9	4.1
1962	0.5	2.6	-2.1	7.0	4.9
1963	0.5	2.8	-2.4	7.4	5.0
1964	1.0	3.2	-2.2	7.7	5.5
1965	-	3.4	-3.4	9.2	5.8
1966	0.5	4.0	-3.5	10.5	7.0
1967	-1.1	4.8	-5.9	12.7	6.8
1968	0.3	5.3	-5.0	14.0	9.0
1969	2.1	5.9	-3.7	14.1	10.4
1970	2.8	6.8	-4.0	12.3	8.3
1971	3.7	7.5	-3.8	13.3	9.5
1972	13.7	8.1	5.6	13.3	18.9
1973	13.0	8.9	4.1	13.7	17.8
1974	7.6	10.5	-2.9	16.5	13.6
1975	5.9	12.1	-6.2	15.1	8.9
1976	18.4	14.5	3.9	10.4	14.3
1977	29.2	15.5	13.7	8.9	22.6

Source: Survey of Current Business, various July issues.

funds must run a surplus to pay for larger pensions for greater numbers of employees in future years. Whether the surplus is large enough to maintain the actuarial standing of the funds is still questionable -- many observors think not. But whether it is or is not, at least this component of the surplus is not available for normal governmental operations, must be deducted and leaves the smaller general government surplus in the third column. To be sure, it has still risen almost $20 billion in two years time, but $13.7 billion is less dramatic than $29.2 billion.

A second thing that is going on is that even the general government surplus does not measure the true operating budget for most states and localities because it includes capital expenditures. The fourth column in the Table gives the adjustments necessary to go from total budgets to current operating budgets -- construction expenditures are not considered expenditures and are added back, debt retirement (a better proxy for how much capital is "used up") is deducted, and grants for construction deducted. Since normally net capital expenditures as so defined are positive, the operating surplus in the fifth column is always more positive than the general government number. Perhaps more relevantly, however, we should focus on the <u>change</u> in this value, and there we see that the change is less dramatic than before because of a recent mysterious drop in construction that has caused at least part of the recent rise in the NIA surplus.

A last factual question is to inquire into the breakdown of this surplus or its change into that received by states and localities. Because certain necessary data are not yet published, we cannot do this for 1977, but we can for 1976, and there we find that states have received slightly more of the recent rise than localities. But not much more: localities have shared in the recent improvement too. Moreover, state budgets are recently more cyclical than localities, and their recent gains in surpluses merely restores losses in the recession of 1975. If we were to compare the average fiscal position in the seventies with that in the sixties, localities are the governments that are doing better.

The result of all these adjustments is then to take much of the pizzazz out of the recent changes in the state and local surplus. Not only is a realistic indication of the fiscal health of state and local governments not as high as the gross NIA number, but its recent change is also less dramatic -- only $13.7 from the low point in 1975 to the high point in 1977. This is a change, and perhaps a welcome indication that things are better for state and local governments, but certainly not as much to get excited about.

Since even the adjusted surplus shows a recent rise, we might inquire further about what it means. Basically the surplus records changes in the stock of buffer assets possessed by state and local governments, and as say income rises, in the short run governments are likely to put much of this change into their stocks and run a temporary surplus. As time goes on, this behavior makes less and less sense, because once stocks get built to a sufficient level, there is no point in further saving. So over the cycle the surplus will rise temporarily in an upswing, fall temporarily in a downswing, and average out to some normal level over time. A brief look at the numbers in either column three or column five indicates strong traces of this behavior over the seventies. The surplus was up in good years 1972, 73, 76, 77 and down in bad years 1974, 75. An ironic side effect of this is that if the recently passed Jarvis Amendment can be interpreted as forcing the State of California to get rid of its surplus, that is exactly what past relationships say the state would have done anyways (even as far as saying it would mainly result in tax reductions).

Economic fluctuations are only one of the causes of possible changes in the surplus, however: the other might be federal aid. Just as in the short run a rise in income might pad surpluses before there are inclinations or plans to spend the money, so might also be the case for federal aid. In some statistical work I have done on state and local budgets I have indeed found this to be the case. With general revenue sharing, I find that only one-third of the money is used for expenditure increases or tax reduction after one year and about sixty percent after two years -- broadly in agreement with some studies commissioned by the Treasury. If there is displacement of public service employment grants, the same will be true -- much of this money will not result in higher expenditures or lower taxes, but will simply be saved by local governments. Hence an additional reason for changes in the surplus is changes in federal aid policy, with big rises in the early years of general revenue sharing (1972-73) and CETA (1975-76).

It seems to me that the lessons that can be drawn from all this are as follows:

a) At least part of the level and change in the state and local surpluses are illustory, caused by pension fund surpluses and by a mysterious drop in construction.

b) In any case the surplus always moves about in an erratic manner in the short run, rising when income rises and aid is increased, and falling in the reverse situations. We should expect some abnormal surpluses right now, and we can also expect they will disappear in a year or so, even without Jarvis Amendments.

c) The high surpluses are relevant for macro policy. State and local governments are saving, and the federal government must dissave accordingly to maintain spending demands. This is one reason why it is now difficult to cut the federal deficit without generating unemployment.

d) The high surpluses may or may not be relevant for grant policy. If the aim of grant policy is to stimulate the overall economy in a recession, the surplus changes impede this aim because they imply that the grant money will not get spent. But if the aim of grant policy is a more permanent one of counteracting the economic decline of certain areas, transitory changes in the budget surplus are not very relevant and certainly not sufficient reason to limit the aid.

Representative MOORHEAD. Thank you, Mr. Gramlich.

The two committees would now like to hear from George E. Peterson, director of public finance, the Urban Institute of Washington, D.C.

Mr. Peterson?

STATEMENT OF GEORGE E. PETERSON, DIRECTOR, PUBLIC FINANCE PROGRAM, THE URBAN INSTITUTE

Mr. PETERSON. Thank you, Mr. Chairman.

I have been asked to concentrate on the current fiscal condition of large cities, especially those that have been viewed as fiscally distressed.

In my paper I have followed recent events in seven of those cities—Boston, Buffalo, Cleveland, Detroit, Newark, Philadelphia, Pittsburgh—which 2 or 3 years ago appeared to be in nearly as precarious a financial condition as New York City.

The financial recovery of these cities has been impressive. Although their long-term, tax-base prospects have not improved greatly, most have recovered from the immediate financial strain; this fact changes the character of the choices to be made about Federal aid policy.

I would like to emphasize five themes in my paper which I think relate most closely to the comments of your other panelists.

First, there is now under way a fundamental reversal of city spending, employment, and wage trends.

Until 1975 city government spending had increased steadily year in and year out relative to the gross national product, as illustrated by these charts on the right-hand side of the room. This trend has now come to a halt. Mr. Kelly mentioned public sector wages. Wages in the majority of large cities, in fact, have declined in real terms during the last 3 years, in some cities quite substantially.

In this sense, proposition 13 is a confirmation rather than a harbinger of a movement to restrain public spending.

Viewed a decade from now, the last 3 years may well stand out for halting the postwar trend of persistent growth in the share of national output spent by State and local governments.

This reversal, has been most visible in the older cities. During the decade preceding 1975 the Nation's older cities, those that were losing population and jobs and tax base, not only spent more per capita than other cities, had more public employees per 1,000 residents, and paid higher wages to those employees, but all of these costs of public sector operations were growing more rapidly than elsewhere and have been growing more rapidly for the past decade.

Table 1 of my paper shows how greatly things have changed since 1974. Since 1974 public sector wages in those cities losing population have grown at about half the rate of wages in other cities. Public employment actually has declined in these cities at a faster rate than population has been lost with a consequent decline in the number of workers per 1,000 residents, especially if you exclude Federal employment trainees.

These trends are in sharp contrast to those visible in the newer and more prosperous cities. In short, we are in the midst of a strong reversal of fiscal course. Budget difficulties have forced the large cities to cut back on their historic spending growth.

Second, I would like to call your attention to the nature of the cities' budget adjustments and the role of tax limitations in shaping those adjustments.

Table 2 of the paper shows how different have been the reactions of different cities to local fiscal pressure.

In Boston, Philadelphia, and Pittsburgh, the adjustments were made almost entirely through tax increases, and some of those have been very large, indeed. Philadelphia increased its property tax rate by 66 percent and its wage and income tax rate by 30 percent. Boston increased its property tax rate by 28 percent. Pittsburgh had to reinstate its wage and income tax. In Newark there was a very large municipal tax rate increase which, fortunately for the city, was offset by the State taking over a large share of school costs, making possible school tax reductions.

Detroit—the city with perhaps the greatest exposure to cyclical downturn—responded more quickly to the cyclical rebound in the local economy, which was translated through the cyclically sensitive income tax base into a strong recovery in local revenues.

I might add that Detroit was very greatly assisted by State countercyclical aid programs as well as Federal aid programs.

There are two other cities, Buffalo and Cleveland, which tried to balance their budgets almost solely through expenditure reductions, with virtually no tax increases, and little outside aid except for the standard Federal aid programs. I think it is interesting to look at the reasons for these differences of response.

Buffalo is subject to a strict limit on its rate of property taxation. It has been at or near the maximum of that tax ceiling for some time, and thus unable to increase local taxes. In fact the State courts recently ruled unconstitutional State legislation allowing property tax rates imposed for pension payments to be excepted from the statewide 2-percent tax rate limitation established by the New York State constitution. As a result the city has had to cut back severely on its rate of property taxation.

Cleveland has one of the most severe voting requirements for authorization of tax rate increases in the country. Cleveland has been unable to secure voter approval for property tax increases either for general city government or for its schools.

One point comes through clearly from these adjustments, and that is just how difficult it is for cities to balance their budgets solely by restraining expenditures.

Cleveland and Pittsburgh have made as great efforts at spending cutbacks as can reasonably be expected. Cleveland's public employment is down by 16 percent in the course of 3 years. Real wages also have declined. But these spending reductions have not been sufficient to balance local budgets.

One of the reasons for this I have illustrated in table 3 of my paper, which compares the costs of current service delivery with the fixed costs of a labor force that are unresponsive to reductions in current services.

You can see that over the 5 years, covered in the table, which were 5 years of very heavy inflation, Pittsburgh trimmed its labor force by 20 percent, more than 2,000 employees and was able to hold its total current service costs to an increase of 11 percent. Yet, its contributions to pension costs increased by over 120 percent. The city's cost of other fringe benefits increased by a total of 170 percent.

The point simply is that in these cities where population and tax base are declining rapidly, it is extraordinarily difficult to make commensurate reductions in public sector budgets because of the fixed nature of many of the costs of city government. Moreover, even reductions of 20 and 25 percent in the labor force may not suffice to balance the local budget.

Local tax rate increases have been a central ingredient of the fiscal adjustment of financially distressed cities where these adjustments have been successful. A prohibition against tax rate increases through imposition of new tax limitations, I think, would be very traumatic to these cities, as it would remove the most disciplined option for restoring budget balance.

I might add that in fact where these limitations have been in effect, such as in Buffalo and Cleveland, one response has been to go deeper into debt as the cities have borrowed to cover their fixed costs.

Third, let me comment on the surplus situation. These cities, too, have had substantial surpluses in fiscal 1977, and 1978. But I think it is important to see how current annual surpluses take on a quite different meaning in the context of recent budgetary history.

You can see from table 4 and table 5 in the text that each of these cities went very deeply into the red in 1975 and 1976: Philadelphia to the tune of $78 million in 1 year; Detroit, $35 million; Boston, $60 million. In fact each of these cities went so far into deficit during the 1975 and 1976 fiscal years that they entirely depleted their balances on accumulated account, creating cumulative deficits as well, which had to be covered by the issuance of short-term debt instruments. State constitutions require that the cities generate surpluses in subsequent years to restore their cumulative budget position.

Concentrating solely on the surpluses generated in 1977 and 1978 without comparing these with the deficit positions which the cities have inherited and which they are now liquidating is, I believe, to misread the message of the surpluses. It is one thing to compile a surplus on top of a sound fiscal position, it is something quite different to generate a current account surplus that permits repayment of debt issued to cover previous operating deficits.

The restoration of cash liquidity was just as important to the cities in normalizing their budgetary circumstances as the restoration of liquidity was to the private corporate sector, which was also recovering from the recession and where the first priority for almost all corporations was to liquidate the massive debt increases incurred during the recession in order to restore a sound financial basis.

Let me also mention two uncertainties that lie ahead and that complicate further the surplus interpretation. It was noted that many of these surpluses are being held in pension funds. Despite that fact, almost all large city pension funds are seriously underfunded at this time, relative to the obligations that the future carries.

Two of the cities in this sample are on a virtual pay-as-you-go basis of pension funding. It has been estimated by auditors that Pittsburgh and Boston would have to approximately triple their current pension fund contributions to fully fund their outstanding pension obligations over a 40-year period. As the cities move toward fuller funding of their pensions, we can count on incurring larger surpluses on cash account in pension funds. It will become a matter of severe public policy how those funds should be invested, and how the cash surpluses should be interpreted.

The final point I wanted to mention is related to the downturn in capital construction. One thing that has been happening in addition to the change in cash surplus is underinvestment in the existing capital stock of several of these older cities, which has had the effect of depreciating the assets the cities have accumulated in the past. The drop in maintenance and repair expenditures in several of the older cities has been on the order of 30 and 40 percent. In fact, what appears to be a cash surplus may be an indirect conversion of physical capital to cash, by letting that capital run down in order to save on maintenance, repairs, and replacement costs.

Thank you.

[Mr. Peterson's prepared statement follows:]

FISCALLY DISTRESSED CITIES: WHAT IS HAPPENING TO THEM?

Prepared Statement of

George E. Peterson
Director, Public Finance Program
The Urban Institute

Submitted to Hearings of
Joint Economic Committee
and
Subcommittee on the City

July 25, 1978

33-595 O - 78 - 6

The fiscal condition of cities has been a major source of federal policy concern for the last three years. New York City's financial distress reawakened public officials to the risks involved in managing cities during national recession and local economic decline. Much of recent federal domestic legislation, adopted or proposed, has aimed at strengthening the fiscal capacity of cities or at lessening their fiscal exposure to weak local economic conditions.

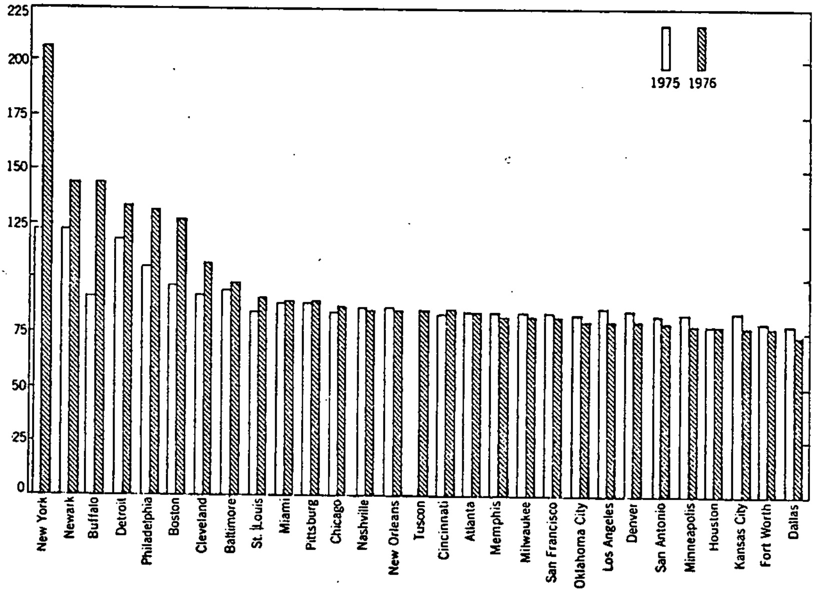
This paper tracks recent fiscal events in seven of the nation's most fiscally distressed cities: Boston, Buffalo, Cleveland, Detroit, Newark, Philadelphia, and Pittsburgh. The fiscal strain on these cities is reflected in Figure 1, which shows the interest costs paid for municipal borrowing relative to Moody's AAA bond index. With New York, these cities possessed the highest perceived risk and interest rate premiums during the capital market disruptions of 1975-76.

The rank ordering of presently perceived fiscal distress has changed substantially from that shown in Figure 1. Detroit, which in 1975 was regarded by the bond market as financially troubled in the same degree as New York City, has largely recovered its equilibrium. Cleveland, which appeared in relatively sound fiscal condition in 1975, now faces the greatest financial disarray. The events that produced these divergent paths reveal a good deal about the signs of fiscal health in urban governments.

In general, American cities have experienced a strong fiscal recovery since 1975, assisted by recovery of their local tax bases, federal aid programs, and local expenditure restraint. Many cities continue to face long term prospects of tax base stagnation, but immediate financial difficulties

Figure 1

YIELD ON 1984 GENERAL OBLIGATION BONDS OF DIFFERENT CITIES RELATIVE TO THE MOODY'S Aaa MUNICIPAL BOND INDEX, 1975 AND 1976



Source: L. Browne and R. Syron, "Big City Bonds after New York," New England Economic Review (1976), Chart 2, p. 8.

are limited to a handful of cities, such as Cleveland, which have failed to take vigorous measures to close their budgetary gaps.

• Expenditure Cutbacks and Tax Rate Increases

In a long term perspective, the cities' fiscal problems emerged largely because the cities were slow to cut back expenditure commitments in line with population losses and local tax base declines. Budgetary difficulties have given a powerful impetus to spending restraint. For the quarter century ending in 1975, local public spending rose year in and year out relative to national product, but during the present economic recovery city expenditures have grown at a much slower rate than national output. Cities suffering economic and population decline have taken the lead in restraining expenditures. In this sense Proposition 13 seems a confirmation rather than a harbinger of a new attitude in the state-local sector. Viewed a decade from now, the last three years may well stand out for halting the post-war trend of persistent growth in the share of national output spent by state and local governments.

Table 1 shows the convergence that is now occurring within city government finances. In 1973-74, the per capita public expenditures of the nation's older cities--those losing population and jobs--were far higher than other cities', as were the number of city government employees per resident and public sector wages. The expenditure gaps between "declining" and "growing" cities had been widening steadily for the past decade. Since 1974 this trend has reversed. Comparable Census data are available only through fiscal year 1976, but local financial reports show that the trends toward convergence of spending, employment and wages have persisted, even

Table 1

Spending, Employment and Wage Trends
Large Cities (1974-76)

Item	Large Cities Gaining a/ Population	Large Cities Growing in Population in 1960-70, Now Declining b/	Large Cities Losing c/ Population
Growth in Per Capita Spending d/	+37%	+31%	+24%
Growth in Non-Educational City Employment, per 1,000 Residents	+ 8%	+ 3 %	- 1%
Growth in Average Monthly Wage, Non-Educational Employees	+30%	+20%	+15%

Source: Bureau of the Census, City Finances and City Employment, Selected Years.

a/ Honolulu, Houston, Jacksonville, Memphis, Phoenix, San Antonio, and San Diego

b/ Columbus, Dallas, Denver, Indianapolis, Kansas City, and Los Angeles

c/ Baltimore, Boston, Buffalo, Chicago, Cincinnati, Cleveland, Detroit, Milwaukee, New Orleans, New York, Philadelphia, Pittsburgh, St. Louis, San Francisco, and Seattle

d/ Excludes education and welfare, functions not provided by many of the cities.

strengthened, in the last two years. As might be expected, the budgetary pressure on older cities has proved to be an effective spending limitation.

Local tax rate increases also have played an important role in restoring financial solvency to the fiscally troubled cities. Table 2 shows the tax rate and revenue adjustments made by the seven cities reviewed in this paper. As is clear from the table, different cities have relied to different degree on local revenue increases to restore budgetary balance. Philadelphia, Boston, and Pittsburgh have depended heavily on tax hikes. Newark, New Jersey, also has financed its municipal revenue needs through steep tax increases, though it was able to substitute municipal millage rates for school millage rates as the result of the school tax relief enacted under New Jersey's new school finance arrangments. Detroit was greatly aided during the recession by the adoption of new state aid programs. Since 1976, Detroit's economic base has rebounded vigourously. Indeed, Detroit's fiscal troubles, more clearly than those of any other city, were largely cyclical in nature. The exposure of the city's automotive industry to recession was compounded by Detroit's heavy use of the cyclically sensitive municipal income tax. In fiscal 1975, income tax revenues fell some $14 million, or 13 percent, short of projected levels. Fortunately for the city, the income tax base responded with equal alacrity to the economic upturn. In fiscal 1977 and 1978, the city underestimated income tax receipts by a total of almost $22 million. The countercyclical assistance programs of both the federal government and the State of Michigan were able to smoothe out these violent fluctuations.

Cleveland and Buffalo present a different picture. Both have attempted to react to budgetary pressure almost solely through expenditure reductions, in part because of limitations on their ability to raise taxes.

Table 2

Changes in Local Tax Rates and Local Revenue Collections
(Fiscal 1975-Fiscal 1977)

City Government	Property Tax Rate	Wage & Income Tax Rate	Total Locally Collected Revenues
Boston	+28%	No Tax	+19%
Buffalo	+ 5% a/	No Tax	+ 5%
Cleveland	0	0	+ 5%
Detroit	+23%	0	+ 6%
Newark	+101% b/	0	+51% b/
Philadelphia	+66%	+30%	+41%
Pittsburgh	0	Newly Installed	+26%

a/ Property tax rate decreased by 12 percent in fiscal 1978
b/ Largely offset by reductions in school tax financed by State of New Jersey

Source: Local Financial Reports

• Are Further Tax or Expenditure Limitations on Distressed Cities Desirable?

Further tax or expenditure limitations are desirable only if it is thought the adjustments of distressed cities to their long run budget constraints are occurring too slowly. To impose a new set of tax or spending ceilings would, in many cases, require more rapid reversals of policy than the cities can handle. Without accumulated balances to cushion their adjustments, cities would have to translate such limitations into immediate layoffs or (what is more likely) new borrowing to cover their revenue losses.

An examination of the record of tax and spending restraints in cities laboring under fiscal strain shows some of the undesirable effects these can have. The New York State courts recently ruled unconstitutional state legislation allowing property tax rates imposed for pension payments to be excepted from the statewide 2 percent tax rate limitation on true property values. As a result, Buffalo was forced to cut its property tax millage from 87.03 in FY 1977-78 to 75.60 in FY 1978-79. In order to balance its budget on a cash basis, the city borrowed $11.5 million from the state. However, the city is hoping the state eventually will treat this sum as an advance aid payment. Should the loan terms be enforced, Buffalo will find itself in severe financial trouble as it is forced to make back payments plus finance continuing pension obligations from a severely limited taxing authority. Buffalo faces this financial predicament despite the fact that twice in the last three years the New York State retirement systems, to which Buffalo belongs, have sharply reduced pension benefits for new public employees. Constitutional restrictions prevent the city or state from reducing benefits for existing employees. Hence, the possibilities for effecting economies are sharply circumscribed.

Cleveland is another city which finds itself in financial difficulty, in part because the city is prevented from balancing its budget through tax rate increases without voter approval. Between 1973 and 1976

Cleveland cut its city labor force by 16 percent, the largest reduction of any big city in the country. It has reduced real wages for public sector workers. And it has substituted federally supported CETA workers for locally paid workers, at one time using almost all of its CETA slots for police and sanitation personnel. Nonetheless, the city's expenditure reductions have not been sufficient to balance its budget. Without the ability to raise taxes, Cleveland has gone deeper and deeper into debt. It now faces probably the most difficult fiscal circumstances of any American city. The city is under court order to pay some $16 million for past acquisition of electricity for resale through its municipal utility, but cannot secure voter approval for a new tax levy or court authorization to raise the funds through a bond issue. The city has added to its short term debt to finance its other cash requirements, much as New York City did prior to its financial crisis, but now the banks and other public bondholders have refused to purchase further debt. The city has temporarily staved off financial crisis by arranging for its water system to buy the city's short term debt issues. Cleveland's school system also has been accumulating short term debt, finally forcing the state to take over operation of Cleveland's schools after voters refused to authorize the tax hikes necessary for repayment.

In short, tax rate increases have been an essential ingredient of the fiscal adjustments of recently distressed cities, where these have been undertaken successfully. The fiscal problems of these cities have been so great that it is impracticable to expect them to restore sound financial condition through expenditure reductions alone.

- <u>Fixed Costs</u>

The difficulties that cities face in reducing budgetary outlays are illustrated by the experience of Pittsburgh. Pittsburgh was perhaps the

Table 3

Expenditure Growth for Wages and Benefits,
Pittsburgh, 1970-75
(Thousands)

Item	Year		Growth
	1970	1975	
Current Service Costs			
Public Safety	$32,641.6	$34,044.8	
Public Works	16,607.9	16,537.7	
Parks & Recreation	5,947.7	6,156.9	
Library	1,976.5	2,443.5	
Land & Buildings	2,315.8	2,404.3	
Supplies	271.8	4,490.0	
Total	$59,781.4	$66,472.2	+ 11.2%
Benefits			
City Contribution to Pension Funds	3,151.0	7,144.0	+126.7%
Other Fringe Benefits (Workman's compensation, Hospitalization, Group Insurance & Severance Pay)	2,074.8	7,305.5	
Total	5,225.8	14,449.5	+176.5%

Source: Annual Financial Statements for Pittsburgh, Pa., 1970, 1975.

in accord with legal requirements. Indeed, the necessity of counter-balancing past operating deficits with current year surpluses is a large measure of the fiscal discipline imposed by the budgetary process. Tables 4-6 show the annual and accumulated balance positions of the several cities. Tables 4 and 6 present local operating results as reported by the cities themselves; Table 5 converts local accounts to a uniform pro forma basis, which recognizes only recurring revenues and restates revenues and expenditures on a consistent basis. EAch of the cities can be seen to have gone into the red at some point during the recession, and most faced negative accumulated balances at the end of 1975 or 1976, which were subsequently offset by oeprating surpluses. Restated on a pro forma basis, Cleveland's accounts show it to be the only city with a steadily worsening financial position throughout this period. The city's operating deficits were hidden from public view by extraordinary revenues realized from asset sales and by transfers from the cash balances of enterprise accounts.

With the single exception of Pittsburgh, the cities also entered fiscal 1977 with unrestricted cash deficits. The value of short term debt outstanding exceeded local cash reserves held in other than restricted pension fund or bond fund accounts. These cash deficits reached as high as 50 percent of annual general expenditures in Cleveland. Their presence made it imperative for cities to roll over their short term debt, yet made access to the bond market difficult. The restoration of liquidity therefore was as immediate a financial priority to these cities, and as important to their future fiscal prospects, as was the restoration of liquidity to the private corporate sector during the recovery from the recession. All of the cities except Buffalo (and Cleveland on a pro forma basis) have now eliminated their accumulated deficit balances. The oniy city which failed to make progress on its accumulated balances through current account surpluses--Cleveland--now finds itself in a perilous financial predicament.

Table 4

General Fund Operating Surpluses (Deficits) as Reported
by Six Cities (Millions of Dollars)

City	Fiscal Years Ending 12/30/74 to 6/30/75	12/30/75 to 6/30/76	12/30/76 to 6/30/77	12/30/77 to 6/30/78
Detroit	(35.6)	(22.7)	51.5	3.5 a/
Newark	9.7	(5.6)	6.2	(0.1) a/
Philadelphia	(27.6)	(77.8)	64.3	NA
Boston	0.7	(12.6)	24.8	NA
Buffalo	(5.8)	0.6		NA
Cleveland	0.2	0.1	0.3	0.0 b/

a/ Estimated
b/ Budgeted

Source: Local Financial Reports and Bond Prospectuses

Table 5

Pro Forma General Fund Operating Results (Millions of Dollars)

City	Fiscal Years Ending 12/30/74 to 6/30/75	12/30/75 to 6/30/76	12/30/76 to 6/30/77	12/30/77 to 6/30/78
Detroit	(35.6)	(22.7)	51.5	3.5
Newark	(4.7)	(6.6)	8.2	1.1*
Philadelphia	(27.6)	(77.8)	(64.4)	NA
Boston	(9.1)	(60.2)	24.8	NA
Buffalo	(12.6)	1.4		
Cleveland	0.02	(3.4)	(8.8)	(16.8)**

* Estimated
** Budgeted

Table 6

Accumulated General Fund Balances (Deficits)
End of Fiscal 1975 or 1976, as Reported

City	Fund Balance	Year
Detroit	(36.9)	1976
Newark	(19.3)	1975
Philadelphia	(87.8)	1976
Boston	NA	
Buffalo	(20.5)	1976
Cleveland	0.1	1976

• Future Uncertainties

Although the prospects for city finances are generally encouraging, several major uncertainties cloud the horizon.

Pension Funding

Several cities have failed to fund their future pension liabilities. Boston and Pittsburgh, for example, operate virtually total pay-as-you-go pension systems. These carry the necessity of sharply increasing future pension contributions, as well as the possibility for sudden and drastic jumps in contribution levels should state courts or state legislatures make full funding mandatory. Pittsburgh's auditors have estimated that full funding of currently incurred pension obligations plus amortization over forty years of past service liabilities would require the city to triple its current pension contributions, increasing total city expenditures by more than 10 percent. Boston's recent pension contributions have been growing at more than 20 percent per year, but a report of the Massachusetts Retirement Law Commission estimates that full funding of current obligations plus amortization of past service costs would jump the necessary city funding level from 11.7 percent of payroll to 27.2 percent.

Capital Investment

Capital spending, particularly spending on repair and maintenance of existing capital facilities, has borne the brunt of fiscal adjustment in a number of financially hard pressed cities. Several of the older cities operating under fiscal pressure have had spectacular reductions in their capital spending--Buffalo trimmed its capital budget by one-thrid in 1976 and more in 1977. New York reduced total city capital spending by more than half, some $800 million; while Pittsburgh cut back capital outlays by almost 20 percent. Hardest hit in each case were general improvements to the city infrastructure systems. In several instances, cities were shut out of the municipal capital market for an extended period of time, causing their bond fund reserves to dwindle and impairing their ability to finance capital improvements.

Because of the difficulties they have encountered in raising local revenues or issuing general obligation bonds, many of the older cities have become deeply dependent upon federal aid programs to pay for their capital budgets, especially that portion devoted to general improvements. No less than 80 percent of Newark's capital budget in 1978 will be financed by federal emergency local public works funds, as well as 65 percent of the capital budget of Pittsburgh, 30 percent of the public construction contracts issued by New York City and 43 percent of St. Louis' total capital spending.

It is difficult to get a firm grasp on the postponed maintenance, repair and capital spending of cities. The last several months also have brought sharp recovery to capital expenditures. But the danger persists that in bringing their budgets into balance cities will try to squeeze savings from their capital stock.

- Implications for Federal Aid Programs

In many respects the greatest risk attending city finances at present is the fate of the temporary federal aid programs that have helped cities resist fiscal pressure. The enabling legislation for both CETA and anti-recession fiscal assistance expires on September 30, 1978. The local public works program already has terminated, though a sizable proportion of the funds remain to be spent by local recipients. All three programs have successor legislation currently pending before Congress.

Our review suggests the following conclusions for future federal assistance toward large, "distressed" cities.

- From the standpoint of financial condition, relatively few cities need extra help at this juncture. City finances have strengthened considerably in the last 24 months; those cities that remain in weak financial shape find themselves in that predicament largely because of local management decisions. It would be undesirable to remove the pressure on city budgets althogether through external assistance, since this pressure has been primarily responsible for promoting the spending restraint that seems in the ciites' own best long term interests.

- The simultaneous elimination of CETA, countercyclical revenue sharing, and Local Public Works aid undoubtedly would disrupt city budgets. The first two programs in 1977 accounted for approximately 16 percent of the general operating budgets of the cities in our sample. Although CETA funds now are used largely to support district employment programs, rather than to pay for ordinary municipal services personnel, loss of these funds would require large scale adjustments in local service delivery and tax rates. Elimination of local public works assistance would, with some delay, depress city capital spending.

- In choosing the right mix of urban aid for the future, the federal government would do well to look beyond financial difficulties to the long run tax base deterioration of the cities. The most important studies in tax base equalization have been taken by state governments, through school aid formulas and urban aid packages which compensate cities for their special costs of service provisions. The cities' recovery from the financial pressure of 1974-76 is now nearly complete. Some of the temporary federal aid programs adopted to cope with this pressure can begin to be eliminated. In devising long term fiscal assistance for the cities, Congress should look to a fresh partnership with the states, so that federal aid is used to encourage permanent state initiatives at sustaining the tax capacity of urban areas.

33-595 O - 78 - 7

Representative MOORHEAD. Thank you very much, Mr. Peterson.
The committee would now like to hear from Herrington Bryce, vice president of the Academy for Contemporary Problems.

STATEMENT OF HERRINGTON BRYCE, VICE PRESIDENT, ACADEMY FOR CONTEMPORARY PROBLEMS

Mr. BRYCE. Thank you, Mr. Chairman and members of the committees. I have a prepared statement which deals with the problems of—the fiscal problems of small cities, as requested by the committee; and that written testimony also attempts to distinguish between some of the fiscal trends in growing and declining small cities, and in metropolitan and nonmetropolitan small cities.

I would prefer, however, not to read the testimony and to give just a brief statement which highlights at least two points made in the written version.

I think, first of all, it is rather important that we appreciate the fact that small cities account for a very significant part of the general expenditures of all cities, and also for the capital spending of all cities. Small cities, depending upon how they are defined, account for anywhere from a third to 40 percent of the general expenditures of all cities. Consequently, they have an important impact on resource allocation among cities in general. And the truth is, they have a very significant impact upon our ability to deal with cyclical crises and resource allocation.

In addition to their relative importance in the spending of cities in general, I think the most important feature of current trends is the significant rise in dependency of small cities on the Federal Government. I have looked particularly at the very short period 1969 through 1976, which, of course, embraces two recessions. And during that period of time the small cities which I have looked at increased their dependency on the Federal Government by over 800 percent. This was almost twice as much as cities in general.

Now, John Shannon, from whom I think you will hear later, has looked at some annual rates of increases in small cities during the period 1965 through 1972. And I think his figures show that among small cities that rate of increase in dependency was even higher than it was for most large cities, with the exception of the six or so cities with over a million population.

But I wish to underline my particular finding that looks at it in a short period, which shows an increase over 800 percent. Now, there are any number of ways in which one might look at that figure. First of all, I think that it does imply some serious kinds of problems concerning local initiatives.

I think, however, that if the trends continue with respect to how citizens embrace the possibilities of putting a cap on local government expenditures or local government revenues, we can expect that that dependency would rise and probably rise rather sharply in the near future. That rise will occur as well if we accept, which I do, the position of our previous speakers, which indicates that the State surplus is No. 1, probably overestimated, and No. 2, transitory.

The dependency, however, is not all that bad. First of all, I wish to call your attention to the fact that in a sense part of the dependency reflects an attempt on the part of the Federal Government to finance some of its mandated costs which arise when the Federal Government requires local action by way of regulations, for example, EPA. Part of the dependency is reflected in the transfer of funds from the Federal Government to local governments which permit the local governments—small cities in this particular case—to meet those requirements.

Second, part of the dependency reflects an attempt on the part of the Federal Government to deal with these cyclical crises. Clearly, that is the case with some programs; clearly that is the case in CETA and other such programs. Now, that is not bad, because what it does, it reduces the fiscal strain that smaller cities would experience had it not been that those transfers were available.

The third part of the dependency must be viewed as a voluntary act on the part of local government. There are many programs, for example the community development block grant program, in which a local government has the option of participating. My own figures have shown that among the small cities I have looked at, over 84 percent of them applied to participate in the community development block grant program.

The point is that dependency reflects in this sense an expression on the part of many local governments to participate in these programs, even though the price that the Federal Government might impose is not, to them, a very comfortable one.

It is widely acknowledged that many of the small cities find it very difficult to deal with some of these specific regulations and specific requirements of the Federal programs. The point is, however, that should the Federal Government transfers to these cities decrease, given the trends to put a cap on local government revenues, we can expect a significant fiscal crisis, I believe, in many small cities.

I wish to stop here, Mr. Chairman, and refer back to my testimony.

[Mr. Bryce's prepared statement follows:]

The Academy for Contemporary Problems

1501 NEIL AVENUE / COLUMBUS, OHIO 43201 / (614) 421-7700

Washington Office
444 NORTH CAPITOL STREET NW, SUITE 349/WASHINGTON, D.C. 20001

OPERATED BY:
Council of State Governments
International City Management Association
National Association of Counties
National Conference of State Legislatures
National Governors' Conference
National League of Cities
U.S. Conference of Mayors

CURRENT TRENDS IN FINANCING SMALLER CITIES

Herrington J. Bryce*

Testimony prepared for the

Midyear Hearings of

The Joint Economic Committee

and the

Subcommittee on the City,

Committee on Banking, Finance and Urban Affairs

House of Representatives

*The author is Vice President, the Academy for Contemporary Problems.

This testimony does not necessarily reflect the views of the Academy for Contemporary Problems, the Charles F. Kettering Foundation (the National Urban Policy Roundtable) or its sponsors.

This testimony is drawn from a study on small cities which this author is conducting for the Joint Center for Political Studies. The study is funded in part by National Science Foundation grant ERS74-21286 and assistance from the Charles F. Kettering Foundation (National Urban Policy Roundtable which is coordinated by the Academy for Contemporary Problems). I am grateful for the assistance of Barbara Buhl, Avra Rapton and Shirley Lee. The views expressed in this paper are strictly those of the author and do not necessarily reflect the views of any of the organizations mentioned or their sponsors.

CURRENT TRENDS IN FINANCING SMALLER CITIES

Herrington J. Bryce
July 25, 1978

This testimony looks at the recent fiscal trends in small cities -- generally those ranging in size from 25 to 50 thousand, although in particular circumstances it also considers cities 50 to 100 thousand. It looks at various types of expenditures and revenue sources and compares the experiences of growing and declining cities and of metropolitan and nonmetropolitan cities, as was requested by this Committee.

The period of comparison is relatively short, 1969-1970 through 1975-1976, a period which embraces two recessions and during which the Consumer Price Index and Producers Prices rose by approximately 55.6 percent. A problem of looking at any jurisdictional group over time by size class is that over very long periods of time some cities enter and others leave the group so that the composition of the group is not constant. The period being used in this testimony is sufficiently short such that we do not have major changes in the composition of what we refer to as small cities.

General Expenditures

By 1975-76 general expenditures in cities 25 to 50 thousand (small cities as defined in this testimony) exceeded $13.4 billion or 25 percent of the total general expenditures of all cities combined. Thus, while small, these cities have a significant impact on the demand for goods and services among jurisdictions.

The three major expenditure categories among small cities are in police, sewerage and sanitation and highways. Each takes roughly 14 percent of their general expenditures. The lower proportion of the municipal budget going to education in smaller cities as compared to all cities combined is not to be misconstrued. The latter figure contains the effects of those few large cities which conduct their own educational systems. Education in other cities is frequently the responsibility of independent school districts.

Table 1 also shows that a much larger proportion of the budgets in small cities goes to highways. This, too, is not to be misconstrued. The total mileage which falls within the local government system in rural areas alone, for example, is nearly three and a half times as great as the mileage in cities.[1]

Over the period, two of the functions in which expenditures have risen fastest among small cities are police and park and recreation. In both cases, the rise is greater than explainable simply in terms of inflation.

The crime rate among cities 25,000 to 50,000 grew six times as fast between 1975 and 1976 as it did in all cities taken as a whole and much faster than all big cities except the six cities which have over a million people. In fact, many of the middle-sized cities (those 250,000 to 1 million in population) had a a decline in crime during this period. The crime rate rose especially fast among the nonsuburban cities (25 to 50 thousand in population) It was two and a half times as fast among those cities as it was among suburban cities.[2]

The rapid rise in spending on park and recreational services is to be viewed more than as a measure to provide amenities for present residents. Among many small cities the major attraction to visitors as well as prospective newcomers is in the area of park and recreational facilities.

Capital Expenditures

Capital expenditures increased among small cities by a greater amount than among cities as a whole. In 1975-76, capital expenditures among these small jurisdictions amounted to $3.0 billion -- roughly a third of the capital outlays of all cities. This is a significant portion of the capital programs of municipal governments.

Just under 50 percent of the capital outlays in small cities go to two functions -- highways (23.1 percent) and sewerage and sanitation (24.2 percent). These two areas are also the two most emphasized in the capital improvement programs in cities in general. It should be noted, however, that while among cities as a whole there has been a dramatic shift in capital formation in housing and urban renewal to sewerage, such has not been the case in small cities. Housing and urban renewal remain small proportions of the latter's budget and the proportion going to sewerage has remained reasonably stable between 1970-1976.

Table 2 shows that although hospital and public buildings together account for less than 10 percent of the total capital spending by small cities, they are the two fastest growing areas of such spending.

The expenditure on sewerage is particularly important in pointing to a theme (fiscal dependency) which will be discussed in this testimony in a later section. The relative importance of sewerage is related to the fact that this is one of the most common functions discharged directly by small city governments.[3] Waste disposal is also an important tool for controlling and managing growth. But a signficant part of the allocation of resources to this function relates to the imposition of federal requirements as well as the availability of federal dollars obtained through HUD's Community Development Block Grant, the Farmers Home Administration, the Environmental Protection Agency, and to some extent, the Department of Commerce.

Borrowing

Among small cities, the financing of a capital project might occur through a variety of means such as the use of reserves, special assessments, grants, loans and borrowing.

Given the rapid rate of growth of population in small cities, capital expenditures are important in providing new or improved infrastructure. Thus, we find in Table 3 that growing small cities (those 50 to 100 thousand in population) spend a larger percentage of their budgets on capital items than do declining cities. Forty-one percent of the growing compared to 23 percent of the declining small cities allocate at least a fourth of their annual expenditures to capital programs. Further, as Table 4 shows, growing cities are more likely to have a larger debt outstanding than declining cities. Nearly one half (48 percent) of the growing compared to only 30 percent of the declining cities have a gross outstanding debt of at least $25 million.

It is frequently more common that declining small cities guarantee their debt instruments with the full faith, credit and taxing powers of the jurisdiction. Sixty percent of growing cities as compared to only 49 percent of declining cities had 25 percent or more of their outstanding debt not guaranteed. See Table 5. Heavy dependence on guaranteed debt implies greater exposure to voter referenda. It is also troublesome since the tax base which secures the loan is by implication either declining or growing more slowly in declining cities.

Partly reflecting this fact, the Moody rating of the general obligation bonds of declining cities is slightly less favorable than it is for growing cities. Ratings are shown in Tables 6 and 7. Some 81 percent of the growing cities had bond ratings of A or better compared to 72 percent of the declining cities. What is most striking, however, is that declining cities are not significantly more likely to be unrated than growing cities. Roughly 18 percent of the declining cities and 13 percent of the growing are unrated. Admittedly, rating is only one factor which affects the marketability of a debt instrument.[4]

Among small cities there is also a difference between the capital programs of metropolitan as contrasted with nonmetropolitan cities. Some 44 percent of nonmetropolitan small cities allocated at least 25 percent of their annual expenditures to capital programs as compared to 30 percent of metropolitan cities. This reflects the fact that nonmetropolitan cities are more likely than their suburban counterparts to be directly responsible for the provision of basic services.[5] Table 8.

Accordingly, small cities in the metropolitan areas tend to have a smaller debt outstanding than do their nonmetropolitan counterparts. Only 35 percent of metropolitan cities, but 55 percent of nonmetropolitan cities had an outstanding debt of $10 million or more. But nonmetropolitan cities were <u>less</u> likely to back their debt with the full faith and credit of the municipality. Thus, 61 percent of nonmetropolitan cities had at least 25 percent of their outstanding debt nonguaranteed. Tables 9 and 10.

As shown in Table 6 , it is not clear (at least among cities ranging in size of 25 to 50 thousand) that bond ratings are decisively lower among nonmetropolitan cities.

Revenues and Dependency

Looking at the revenue patterns in Tables 11 and 12 reveals the declining importance of the property tax as a source of revenues among small cities. Nevertheless, this tax remains the major source of all general revenues derived by these cities.

On the other hand, intergovernmental transfers have increased. Like all cities, small cities still get proportionately more of their intergovernmental aid from the state government. But the increase in the flow of funds from the federal government to small cities is spectacular. This aid has increased by over 800 percent (twice the rate of increase of all cities taken together) in the short period ranging from 1970 to 1976. Table 13.

Table 14 helps us to look at this dependency as it relates to growing and declining cities and as it relates to those cities in metropolitan as opposed to those in nonmetropolitan areas. It also shows that dependency is greater among nonmetropolitan cities. Just over half of the metropolitan cities (52 percent) obtained 75 percent or more of their general revenues from their own source compared to 31 percent of nonmetropolitan cities.

The data do show as well that growing cities rely more heavily on their own source of revenues than declining cities do. Forty-three percent of the growing cities compared to 32 percent of declining cities obtain 75 percent or more of their revenues from their own source.

The heavy reliance on outside sources while making the local government less vulnerable to the displeasure of local taxpayers does reduce local initiatives.[6]

Another consequence of this increase in dependency is the heavy administrative burden which has been placed on these small cities. It is reported by many of them, for example, that the most difficult task they have in discharging the responsibilities of the Community Development Block Grant is in completing the financial and administrative paperwork.[7] Partly as a consequence of the federal demands on the administrative and financial components of these governments, their expenditures on financial administration more than doubled between 1969 and 1976. Admittedly, part of this increase is financed by the federal government which permits the use of some fraction of program funds for administrative costs.

Conclusions

We make a serious error in not giving adequate attention to the role of small cities in determining the overall economic behavior of cities in general. Small cities account for a significant part of the expenditures of city governments. Consequently, as a group, they have a significant impact on resource allocation. But size is not an exclusive determinant of the economic behavior of cities; therefore, we have shown in this testimony some significant differences between small cities depending upon their metropolitan or growth status.

Perhaps the most outstanding feature of the recent fiscal trend in small cities is their growing dependence on the federal government. This trend is not all negative. To some extent it represents partial federal financing of expenditures mandated by the federal government. In some respects, as is true of the various countercyclical measures, it represents federal intervention to relieve fiscal and economic pressures on small cities. Hence, my own study has shown that 75 percent of small cities have relied on CETA to offset the employment impact of the recession. It is also true that part of the fiscal dependency reflects a voluntary action on the part of local governments to participate in federal programs which are optional. My own study shows that over 85 percent of small cities applied for participation in the Community Development Block Grant Program.[8] The implication is that in spite of the "price" that the federal government extracts for participation by small cities in programs and in spite of the negative side effects of this intervention, the overwhelming majority of small cities would be fiscally hurt by the termination of these programs.

FOOTNOTES

1. United States Department of Transportation, Highway Statistics: Summary to 1975 (Washington, D.C., United States Government Printing Office, 1976) p. 211.

2. Federal Bureau of Investigation, Uniformed Crime Report (Washington, D.C., United States Government Printing Office, 1976) pp. 146-149.

3. Herrington J. Bryce, Planning Smaller Cities (Lexington Books: forthcoming 1978), Chapter IV.

4. For a discussion of the marketability of debt instruments of small cities, See John E. Petersen, "The Borrowing Costs of Small Cities" in Herrington J. Bryce (ed.) Small Cities in Transition: The Dynamics of Growth and Decline (Cambridge, Massachusetts, Ballinger, 1977), pp. 365-368.

5. Herrington J. Bryce, op. cit.

6. For an additional view of the dependency phenomenon among small cities, see John Shannon and John Ross, "Cities: Their Increasing Dependence on State and Federal Aid," in Herrington J. Bryce (ed.) Small Cities, pp. 189-208.

7. The Department of Housing and Urban Development, Community Development Block Grant Programs, Second Annual Report, (Washington, D.C., United States Government Printing Office) p. 10. Approximately 10 percent of county program costs in CDBG were federal paperwork, and 5 percent of municipal program costs resulted from federal paperwork requirements. See Timothy D. Mead, Impact of Federal Paperwork on State And Local Governments: An Assessment. Report to the Commission on Federal Paperwork, July 15, 1977, pp. 48-53, 69-72.

8. See Herrington J. Bryce, Planning Smaller Cities, op. cit. Chapters VII and VIII.

Table 1

General Expenditures of Cities, by City Size and Type of Expenditure, Percent Distribution, 1975-76

	All Cities	With Population 25,000 to 49,999	All Cities	With Population 25,000 to 49,999
	Millions of Dollars		Percent	
GENERAL EXPENDITURE	54,425	13,465	100.0	100.0
Capital outlay	9,312	3,040	17.1	22.6
Other general expenditure	45,113	10,426	82.9	77.4
GENERAL EXPENDITURE				
Education	7,610	1,246	14.0	9.3
Highways	4,245	1,886	7.8	14.0
Public Welfare	4,544	69	8.3	0.5
Hospitals & Health	3,462	690	6.4	5.1
Police	6,015	1,827	11.1	13.6
Fire	3,257	953	6.0	7.1
Sewerage and Sanitation	5,557	2,009	10.2	14.9
Parks and Recreation	2,558	766	4.7	5.7
Housing and urban Renewal	1,525	160	2.8	1.2
Libraries	684	196	1.3	1.5
Financial Adminis.	912	321	1.7	2.4
General Control	1,611	597	3.0	4.4
General Public Bldgs.	934	329	1.7	2.4
Interest on Debt	2,683	573	4.9	4.3
Other	8,828	1,842	16.2	13.7

Prepared by Academy for Contemporary Problems Staff from data in:

U.S. Department of Commerce: City Government Finances in 1975-76, (Washington, D.C.: U.S. Government Printing Office, 1977) p. 7.

Table 2

Capital Outlays for Selected Items, by City Size,
Percent Distribution and Percent Change
1975-76

Selected Items	Dollars (Millions)		Percent Distrib.		Percent Change	
	All Cities	25,000 49,999	All Cities	25,000 49,999	All Cities	25,000 49,999
1975-1976						
Total Capital Outlay For General Expenditure	9,312	3,040	100.0	100.0	66.6	85.4
Selected Items						
Education	669	134	7.2	4.4	21.9	94.2
Highways	1,801	702	19.3	23.1	61.1	87.7
Hospitals	207	111	2.2	3.7	88.2	270.0
Sewerage	2,296	737	24.7	24.2	160.6	100.8
Housing and Urban Renewal	633	85	6.8	2.8	-9.2	25.0
Public Buildings	374	157	4.0	5.2	129.4	157.4

Prepared by the Academy for Contempoary Problems Staff from data in:

U.S. Department of Commerce: City Government Finances in 1975-76, (Washington, D.C.: U.S. Government Printing Office, 1977)p. 7

Table 3

Percent of General Expenditure Allocated to Capital Outlay
for Cities with 1970 Population of 50,000 to 100,000
Fiscal Year 1975-76 (by Declining or Increasing Population, 1970-75)

	All Cities	Percent for Capital Outlay			
		Under 25	25 - 49	50 - 74	75 - 100
			Number		
TOTAL	230	157	65	8	0
Declining	118	91	22	5	0
Stable or Increasing	112	66	43	3	0
			Percent		
TOTAL	100.0	68.3	28.3	3.5	0.0
Declining	100.0	77.1	18.6	4.2	0.0
Stable or Increasing	100.0	58.9	38.4	2.7	0.0
			Percent		
TOTAL	100.0	100.0	100.0	100.0	100.0
Declining	51.3	58.0	33.8	62.5	-
Stable or Increasing	48.7	42.0	66.2	37.5	-

Prepared by Academy for Contemporary Problems Staff from data in:

Barbara H. Grouby and Mary A. Schellinger, "Profiles of Individual Cities." in The Municipal Year Book 1978 (Washington, D.C.: International City Management Association, 1978), pp. 3-44.

Table 4

Bond Ratings of Cities with 1970 Population of 50,000 to 100,000
by Declining or Increasing Population, 1970-75

	All Cities Number	BOND RATING - PERCENT OF CITIES						
		Aaa	Aa	Al	A	Baal	Baa	NA
TOTAL	230	3.5	26.1	24.8	22.2	4.3	3.5	15.7
Declining	118	4.2	25.4	22.0	20.3	5.1	5.1	17.8
Stable or Increasing	112	2.7	26.8	27.7	24.1	3.6	1.8	13.4

Prepared by Academy for Contemporary Problems Staff from data in:

Barbara H. Grouby and Mary A. Schellinger, "Profiles of Individual Cities." in The Municipal Year Book 1978 (Washington, D.C.: International City Management Association, 1978) pp. 3-44.

Table 5

Percent of Gross Outstanding Debt Which Is Nonguaranteed
for Cities with 1970 Population of 50,000 to 100,000
Fiscal Year 1975-76 (by Declining or Increasing Population, 1970-75)

	All Cities	Percent Nonguaranteed				
		Under 25	25 - 49	50 - 74	75 - 100	NA
		Number				
TOTAL	230	41	54	37	34	64
Declining	118	18	25	18	15	42
Stable or Increasing	112	23	29	19	19	22
		Percent				
TOTAL	100.0	17.8	23.5	16.1	14.8	27.8
Declining	100.0	15.3	21.2	15.3	12.7	35.6
Stable or Increasing	100.0	20.5	25.9	17.0	17.0	19.6

Prepared by Academy for Contemporary Problems Staff from data in:

Barbara H. Grouby and Mary A. Schellinger, "Profiles of Individual Cities." in The Municipal Year Book 1978 (Washington, D.C.: International City Management Association, 1978), pp. 3-44.

Table 6

Bond Ratings of Cities with 1970 Population
of 25,000 to 50,000, by Metropolitan-Nonmetropolitan Stuatus

	All Cities	Bond Ratings							
		Aaa	Aa	A1	A	Baa1	Baa	Ba	NA
					Number				
TOTAL	452	5	93	92	114	16	30	1	101
Metropolitan	279	1	56	57	70	8	16	1	70
Nonmetropolitan	173	4	38	35	44	8	14	0	30
					Percent				
TOTAL	100.0	1.1	20.6	20.4	25.2	3.5	6.6	0.2	22.3
Metropolitan	100.0	0.4	20.1	20.4	25.1	2.9	5.7	0.4	25.1
Nonmetropolitan	100.0	2.3	22.0	20.2	25.4	4.6	8.1	0.0	17.3

Prepared by Academy for Contemporary Problems Staff from data in:

Barbara H. Grouby and Mary A. Schellinger, "Profiles of Individual Cities." in The Municipal Year Book 1978 (Washington, D.C.: International City Management Association, 1978), pp. 3-44.

Gross Outstanding Debt for Cities with 1970 Population of
50,000 to 100,000, Fiscal Year 1975-76
(by Declining or Increasing Population, 1970-75)

	All Cities	Gross Outstanding Debt ($000)								
		Under 100	100-999	1,000-9,999	10,000-24,999	25,000-49,999	50,000-99,999	100,000-149,999	150,000-199,999	200,000-& over
					Number					
TOTAL	230	5	5	46	84	60	24	4	1	1
Declining	118	5	3	25	49	25	10	1	0	0
Stable or Increasing	112	0	2	21	35	35	14	3	1	1
					Percent					
TOTAL	100.0	2.2	2.2	20.0	36.5	26.1	10.4	1.7	0.4	0.4
Declining	100.0	4.2	2.5	21.2	41.5	21.2	8.5	0.8	0.0	0.0
Stable or Increasing	100.0	0.0	1.8	18.8	31.2	31.2	12.5	2.7	0.9	0.9

Prepared by Academy for Contemporary Problems Staff from data in:

Barbara H. Grouby and Mary A. Schellinger, "Profiles of Individual Cities," in The Municipal Year Book 1978 (Washington, D.C.: International City Management Association, 1978), pp. 3-44.

Table 8

Percent of General Expenditures Allocated to Capital Projects,
for Cities with 1970 Population of 25,000 to 50,000,
Fiscal Year 1975-76 (by Metropolitan Status)

	All Cities	Percent for Capital Projects				
		Under 25	25 - 49	50 - 74	75 - 100	NA
				Number		
TOTAL	452	284	121	25	15	7
Metropolitan	279	188	57	14	14	6
Nonmetropolitan	173	96	64	11	1	1
				Percent		
TOTAL	100.0	62.8	26.8	5.5	3.3	1.5
Metropolitan	100.0	67.4	20.4	5.0	5.0	2.2
Nonmetropolitan	100.0	55.5	37.0	6.4	0.6	0.6

Prepared by Academy for Contemporary Problems Staff from data in:

Barbara H. Grouby and Mary A. Schellinger, "Profiles of Individual Cities." in The Municipal Year Book 1978 (Washington, D.C.: International City Management Association, 1978), pp. 3-44.

Table 9

Gross Outstanding Debt for Cities with 1970 Population of 25,000 to 50,000
Fiscal Year 1975-76 (by Metropolitan-Nonmetropolitan Status)

	All Cities	GROSS OUTSTANDING DEBT ($000)									
		Under 100	100-999	1,000 9,999	10,000 24,999	25,000 49,999	50,000 99,999	100,000 149,999	150,000 199,999	200,000 and over	NA
					Number						
TOTAL	452	4	30	210	148	36	7	2	0	0	15
Metropolitan	279	4	29	135	75	16	6	1	0	0	13
Nonmetropolitan	173	0	1	76	73	20	1	1	0	0	1
					Percent						
TOTAL	100.0	0.9	6.6	46.5	32.7	8.0	1.5	0.4	-	-	3.3
Metropolitan	100.0	1.4	10.4	48.4	26.9	5.7	2.2	0.4	-	-	4.7
Nonmetropolitan	100.0	0.0	0.6	43.9	42.2	11.6	0.6	0.6	-	-	0.6

Prepared by Academy for Contemporary Problems Staff from data in:

Barbara H. Grouby and Mary A. Schellinger, "Profiles of Individual Cities," in The Municipal Year Book, 1978 (Washington, D.C.: International City Management Association, 1978) pp. 3-44.

Table 10

Percent of Gross Outstanding Debt Which Is Nonguaranteed for Cities with 1970 Population of 25,000 to 50,000, Fiscal Year 1975-76 (by Metropolitan and Nonmetropolitan Status)

	All Cities	Percent Nonguaranteed				
		Under 25	25 - 49	50 - 74	75 - 100	NA
			Number			
TOTAL	452	95	77	65	94	121
Metropolitan	279	61	46	36	48	88
Nonmetropolitan	173	34	31	29	46	33
			Percent			
TOTAL	100.0	21.0	17.0	14.4	20.8	26.8
Metropolitan	100.0	21.9	16.5	12.9	17.2	31.5
Nonmetropolitan	100.0	19.7	17.9	16.8	26.6	19.1

Prepared by Academy for Contemporary Problems Staff from data in:

Barbara H. Grouby and Mary A. Schellinger, "Profiles of Individual Cities." in <u>The Municipal Year Book 1978</u> (Washington, D.C.: International City Management Association, 1978), pp. 3-44.

Table 11

General Revenue of Cities, by City Size, and Type of Revenue
and Percent Distribution, 1969-70

	All Cities	Cities with Populations of 25,000 to 49,999	All Cities	Cities with Populations 25,000 to 49,999
	Millions of Dollars		Percent	
GENERAL REVENUE	26,621	6,270	100.0	100.0
From Government Sources	7,906	1,356	29.7	21.6
State	6,173	1,066	23.2	17.0
Federal	1,337	180	5.0	2.9
Local	396	109	1.5	1.7
From Own Sources	18,715	2,011	70.3	78.4
Taxes	13,647	3,193	51.3	50.9
Property	9,127	2,346	34.3	37.4
Sales	2,422	214	9.1	7.9
Other	2,098	352	7.9	5.6
Current Charges	3,113	1,010	11.7	16.1
Miscellaneous	1,955	712	7.3	11.4

Prepared by the Academy for Contemporary Problems Staff from data in:

U.S. Department of Commerce: City Finances in 1969-70 (Washington, D.C.; U.S. Government Printing Office, 1977) p. 7.

Table 12

General Revenue of Cities, by City Size, and Type of Revenue
and Percent Distribution, 1975-76

	All Cities	Cities with Population of 25,000 to 49,999	All Cities	Cities With Population of 25,000 to 49,999
	Millions of Dollars		Percent	
GENERAL REVENUE	55,341	13,839	100.0	100.0
From Government Sources	22,234	4,635	40.2	33.5
State	13,772	2,595	24.9	18.8
Federal	7,442	1,656	13.4	12.0
Local	1,021	383	1.8	2.8
From Own Sources	33,107	9,205	59.8	66.5
Taxes	23,336	5,850	42.2	42.3
Property	14,165	3,912	25.6	28.3
Sales	5,109	1,262	9.2	9.1
Other	4,063	677	7.3	4.9
Current Charges	6,161	2,086	11.1	15.1
Miscellaneous	3,611	1,269	6.5	9.2

Prepared by Academy for Contemporary Problems Staff from data in:

U.S. Department of Commerce: City Government Finances in 1975-76, (Washington, D.C.: U.S. Government Printing Office, 1977), p. 7.

Table 13

General Revenue of Cities, by City Size and Type of Revenue, Percent Change, 1975-76.

	All Cities	City Populations 25,000 to 49,999
GENERAL REVENUE	107.9	110.7
For Government Sources	181.2	241.8
State	123.1	143.4
Federal	456.6	820.0
Local	157.8	251.4
From Own Sources	76.9	87.3
Taxes	71.0	83.2
Property	55.2	66.8
Sales	110.9	155.5
Other	93.7	92.3
Current Charges	97.9	106.5
Miscellaneous	84.7	78.2
UTILITY REVENUE		
Water Supply	56.9	59.9
Other Utility	112.6	118.4

Prepared by Academy for Contemporary Problems Staff from data in:

U.S. Department of Commerce: City Government Finances in 1975-76, (Washington, D.C.: U.S. Government Printing Office, 1977) p.7.

Table 14

Percent of General Revenue From Own Sources
for Cities with 1970 Population of 25,000 to 50,000
Fiscal Year 1975-76 (by Metropolitan Status)

	All Cities	Percent From Own Sources				
		Under 25	25 - 49	50 - 74	75 - 100	NA
		Number				
TOTAL	452	1	38	211	198	4
Metropolitan	279	1	15	116	144	3
Nonmetropolitan	173	0	23	95	54	1
		Percent				
TOTAL	100.0	0.2	8.4	46.7	43.8	0.9
Metropolitan	100.0	0.4	5.4	41.6	51.6	1.1
Nonmetropolitan	100.0	0.0	13.3	54.9	31.2	0.6

Prepared by Academy for Contemporary Problems Staff from data in:

Barbara H. Grouby and Mary A. Schellinger, "Profiles of Individual Cities." in The Municipal Year Book 1978 (Washington, D.C.: International City Management Association, 1978), pp. 3-44.

Table 15

Percent of General Revenue From Own Sources
for Cities with 1970 Population of 50,000 to 100,000,
Fiscal Year 1975-76 (by Declining or
Increasing Population, 1970-75)

	All Cities	Percent from own Sources			
		Under 25	25 - 49	50 - 74	75 - 100
			Number		
TOTAL	230	2	13	129	86
Declining	118	1	8	71	38
Stable or Increasing	112	1	5	58	48
			Percent		
TOTAL	100.0	0.9	5.7	56.1	37.4
Declining	100.0	0.8	6.8	60.2	32.2
Stable or Increasing	100.0	0.9	4.5	51.8	42.9
			Percent		
TOTAL	100.0	100.0	100.0	100.0	100.0
Declining	51.3	50.0	61.5	55.0	44.2
Stable or Increasing	48.7	50.0	38.5	45.0	55.8

Prepared by Academy for Contemporary Problems Staff from data in:

Barbara H. Grouby and Mary A. Schellinger, "Profiles of Individual Cities." in <u>The Municipal Year Book 1978</u> (Washington, D.C.: International City Management Association, 1978), pp. 3-44.

Representative MOORHEAD. Thank you.

Without objection, the entire statements of all of the members of panel No. 2 will be made a part of the record.

Mr. Chairman?

Chairman REUSS. I think, Representative Moorhead, it would be expeditious and fair, if it is all right with every member of the committees, if we now withheld the third panel of three sterling witnesses. and if the eight of us members here at the table, under the 5-minute rule, proceeded to examine the seven witnesses who we have before us. We then will hear from the second panel in 30 minutes, and start in the questioning on the part of the members of the committee where we left off.

Is there any objection to that procedure?

[No response.]

Chairman REUSS. If not, let me start out.

Mr. Jacoby, yours, like the others, was a fascinating paper. One is struck by the fact that here the Federal Government has been giving $2 billion or more a year in generalized revenue sharing to the States. California somehow or another ends up with $5 billion of do-re-mi which, mythological or not, seems to be of a nature that can be returned now to localities and some of the taxpayers.

Tax assessments and tax rates on homes did go up frightfully in your State, as who knows better than you?

How did this all come about? Could not some light be thrown on this by the action of the smallish community of Petaluma, where the city fathers said: "Look, we are tired of taxing existing homeowners to provide free or subsidized streets, highways, sewer extensions, water extensions, utilities to new subdivisions whose speculator-develepers are then able to sell for less than would be the case had they paid the full price, which results in a tax burden being loaded on the poor souls who got there first, for which they get no visible benefit?

I am not suggesting that is the whole story but there is this tremendous population boom you had in California, and with your climate and fine country, I can understand why you had it. Couldn't that be part of this ghastly problem which Jarvis-Gann finally made contact with?

Mr. JACOBY. Well, Chairman Reuss, I think the answer is yes. It certainly had a great deal to do with it. I believe that in interpreting the proposition 13 episode in California, one must bear in mind that California had been backward in reforming its State and local revenue system to reduce reliance on property taxation. The State was increasingly relying on property taxes to finance not only so-called property-related services—street maintenance, lighting, sewers, water, police, and fire protection—but also the increasingly expensive people-related services of recreation, welfare, health, and education.

Just to give you a figure, in 1977 the best estimate I have been able to make of the cost of property-related services in California was $3.9 billion. But the State and local governments were collecting $11 billion from property owners, and this figure was simply skyrocketing as inflation and speculation was driving up the prices of homes and other real estate. So that the pinch on the local property owner, who was unfairly bearing a burden that ought to be shared more generally, combined with the buildup of the State surplus to create a political problem that apparently the California Legislature was unable to solve.

For 3 years, the surplus built up, while the legislature struggled with various formulae for reducing property taxes that everybody agreed were excessive and were threatening the continued tenure of people in their homes. With a 3-percent average State property tax rate and homes that had been selling for $40,000 a few years ago now selling for $125,000, you can see how the burden was simply unbearable for the elderly and for the poor.

So that the State was faced with this political problem of utilizing the surplus to cut property taxes. And it brought forth a number of formulae that were unsatisfactory, and after 3 years, it appeared to the people that the legislative pocess had broken down.

Here I would like to comment on the question raised by Mr. Kelly. He asked quite properly whether California Government was not taken over by volunteers. Well, yes. But this is true whenever the initiative and referendum is utilized. And I think more than half the States provide for the initiative and referendum in cases where the legislative process has failed to produce a solution. So the people in this case produced their own solution, some 5 million people who voted for proposition 13.

I don't see this as a flaw in our democracy. I think it is unfortunate that the legislative process did not produce a solution. But I think it is fortunate that we do have a safety valve in the referendum and initiative where legislative action fails, as it did in California.

But that is now part of past history. Another question raised by Representative Kelly was whether cuts in salaries of Government employees, instead of firing them, might not serve to make an adjustment that is desirable. Well, as I pointed out in my paper, one of the adjustments to proposition 13 in California was a moratorium on all State and local hiring and on pay increases. No local government could get any State subvention unless it followed the rule of the State. The State was the fiscal disciplinarian for the local governments. So we have had a freeze and will have a freeze this year on local government pay increases, benefit increases, and hiring, which will go a very long way toward reducing the cost of government in California by the 10 percent that I referred to in my paper.

Chairman REUSS. Thank you very much, Mr. Jacoby. My time has expired.

Representative Moorhead?

Representative MOORHEAD. Thank you, Mr. Chairman.

I am well aware that there has been some criticism of the national income account figures. Isn't it the situation, however, that the figures are correct, but it is the use of them for purposes for which they were not intended that causes the difficulty? Professor Gramlich?

Mr. GRAMLICH. That is exactly right. The Department of Commerce gets the national accounts budgets by just adding up the accounts of various sectors of the economy in conventional ways. Those surpluses really are there. But you are exactly right in saying that the interperetation is what is the question. In my statement I tried to distinguish between the interpretation for macroeconomic purposes, where it really is saving, from an interpretation in Federal aid policy, which should be determined on a longer run basis and where the surplus is not particularly relevant.

Representative MOORHEAD. Mr. Peterson, you have painted a rather positive picture of the fiscal recovery of our cities. Isn't there a distinction, however, between what I would call the basic economic recovery, recovery of the tax base through job and population increases?

Mr. PETERSON. Yes. I would like to draw three distinctions, in fact. One is the strict financial condition of the cities, whether they are in significant jeopardy of a financial crisis. I think the answer to that question, with the exception of one or two cities, most conspicuously, Cleveland, is no; the finances are in rather sound shape now and they recovered well.

The second question involves the longer term fiscal condition of the cities, which I would measure primarily by their tax bases and their ability to raise funds from their own tax bases. On that account you cannot be very sanguine. Most of these cities have had stagnating tax bases; some of them have had declining tax bases in the face of very rapid inflation. Their ability to provide for themselves, through their own taxable resources is slight and deteriorating, which makes a case for some kind of permanent assistance, I think, from other levels of government. This assistance should be designed, however, to equalize tax capacity, to enhance their ability to purchase services themselves, not to stimulate additional local spending.

The third level of consideration is the economic base of the cities. This is partially related to their fiscal capacity over the long run, but also an independent concern.

On that score, we have greatly varying trends at this point. Some cities have shown signs of more than cyclical recovery. Others have not.

The Federal Government quite properly is directing much of its attention to stimulating investment in those cities that have not been able to recover economically.

Representative MOORHEAD. There is an interesting difference between Mr. Bryce's report and yours, Mr. Peterson. Mr. Peterson, you report that capital spending, referring mostly to the larger cities, and on repair and maintenance, has borne the brunt of the fiscal adjustment.

On the other hand, Mr. Bryce, you report that the smaller cities have actually increased their capital expenditures.

Can you gentlemen give me a reason why the smaller cities go one way and the larger cities go the other way?

Mr. BRYCE. Yes. first of all, I would like to point out that many of the smaller cities did begin to experience the effects of the recession much later than some of the larger cities. I think my figures in one of the reports I have done show something like 60 percent of the smaller cities having to postpone some amount of their capital programs.

I think that there are a couple of things. One is that to some extent Mr. Peterson's figures, I believe, might take into account some of the effects of increases in prices. My figures do as well, and to some extent some of the differences might just be an adjustment of the figure.

I think, however, I do not want to give the impression, as I said in the first part of the statement, that smaller cities were not also affected. Around 60 percent of them did reduce capital expenditures. To some extent, also, increases in capital expenditures were also aided by some of the intergovernmental transfers. Take the community development block grant, for example, in one particular function, sewer and sanitation, those small cities which use discretionary funds, a large portion of them use those discretionary funds for sewer and sanitation expenses.

Again, to underline the point, increases in capital expenditures by many of these cities during this particular period of time was enabled in part by Federal Government transfers.

Mr. PETERSON. Let me just make one comment.

In the broad picture over the last decade, capital spending by State and local governments, in real terms, has been down quite sharply and has been down very severely in the last 2 years up until the most recent few months when it has recovered in part because of local public works programs that percolate through the economy.

One particular handicap that these fiscally distressed, large cities faced was that they were unable to gain access to the bond market during 1975 and 1976. That inability to borrow had consequences in the succeeding years as they drew down their capital funds and had no cash with which to invest in their capital stock. Certainly for individual cities, that has been of primary importance.

Representative MOORHEAD. My time has expired.

Chairman REUSS. The time of the gentleman has expired.

Mr. Kelly?

Representative KELLY. Thank you, Mr. Chairman.

Mr. Jacoby, I would like to ask you, are the property taxes in New York about the same, more or less, than they are in California?

Mr. JACOBY. I really lack information to answer that. I can say that the overall average property tax in California before the proposition 13 was 2.8 percent of market value.

Representative KELLY. Does anyone on the panel know are the property taxes higher or lower in New York?

Mr. PETERSON. They have been moderately lower, sir.

Massachusetts and New Jersey lead the country.

Representative FENWICK. What was that?

Mr. PETERSON. Massachusetts and New Jersey have had the highest rates, followed at some distance by California.

Representative KELLY. Then the situation seems to be that we then play a sort of cynical game in this whole business of Government as it is presently being operated. New York City pays the highest taxes in the United States of America, when everything is considered. California does not pay taxes that are as high; yet they revolted. So the game is for the political establishment, the Government as it now exists, to milk the public and the economy in a way that it doesn't sting so that the public's attention won't be called to it. And if they can milk the public a great deal and sting them a little, then that is successful Government under the present-day criteria.

So in New York the politicians are just more successful at this game of milking without stinging, because they get more and create less discomfort among the public.

Is that a fair description of what we are about?

Mr. JACOBY. May I comment, sir?

Mr. COOPER. No; it is not.

Mr. JACOBY. I am not intimately familiar with the New York fiscal situation, but I would like to comment on California's.

I think it is important to recognize that California has relied far more heavily on property taxation for its total to finance State and local services than has the average State.

It is also important to recognize that we are a relatively high-taxed State. A recent study shows that the overall tax burden in California ranks only after Alaska and New York, and the margin behind New York is not very large.

We also have relied very heavily on property taxes.

Representative KELLY. Well, that is the point I was making. The mistake there was not how much you milk the cow but that you were not careful about it, and you just pulled the wrong thing.

Mr. JACOBY. I think we pulled the right plug, sir.

Mr. COOPER. Speaking as someone who has to deal with the voters at the local level, I disagree with your comment about milking the public. The public wants the service but does not want to pay for it. When we closed our libraries temporarily, the public came in and said, "We voted for 13, but we did not mean for libraries to be closed. We want you to close welfare, because we are not getting welfare benefits."

Everybody wants—everybody sees their service as the bone and somebody else's service as the fat.

Representative KELLY. Let me ask you this, then. In New York City, in order to accomplish some economy, they reduced the number of people that were working by over 25 percent, but yet reduced the cost of maintaining the services by only 1 percent, and I think the public is really getting flimflammed in this whole operation.

Mr. COOPER. The public wants to be flimflammed.

Representative KELLY. One person came into the library and said that, but the whole public did not come into the library and say that and probably does not share any such view.

But let me ask you this: Isn't it a truth that there are an awful lot of things that the Government itself is doing that increase the cost of doing business for all local governments, like the Davis-Bacon Act? Isn't that just an arbitrary imposition of inefficiency and excessive costs on local government?

Mr. COOPER. Congressman, I continually go to Sacramento and Washington and face the same problem with the legislation, fair labor standards or unemployment insurance, or something else comes up, and I say, "Look, we don't need this. We have put unemployment insurance into our labor agreement," for example. Alameda County does not need this legislation. But you can point to a thousand counties in this country that are not doing a competent job. And so you get horrible examples.

You are going to have the same thing on pensions. We are 80 percent funded and we are going toward 100 percent, but you can dig up a lot of local jurisdictions in this country that are probably zero percent funded.

On the other hand, General Motors is $10 billion underfunded. It is hardly unique to the public sector to be underfunded in pensions, and there are other solutions to that.

Representative KELLY. Mr. Chairman, I would like to ask unanimous consent that I be permitted to revise and extend the remarks that I made in the record earlier.

Chairman REUSS. Is there objection?

[No response.]

Chairman REUSS. Hearing none, so ordered.

Mr. COOPER. Could I comment on one thing Mr. Kelly commented on earlier, because I am directly involved in this.

My county has laid off more public employees since proposition 13 than any other county in California, because we are concerned if we don't lay them off, if we don't lay off 10 percent this year, we will have to lay off 20 percent next year, which will be impossible. Ten percent is difficult, after you have spent 10 years trying to be more efficient, but when you talk about cutting salaries, it is true, we have a salary freeze for 1 year. But if you do that for 2 years, no pay increases, you are going to—or if you start cutting salaries, you are going to lose the competent people. They are going to go to private industry where they can get decent salaries.

The same people that come in to me and say, "Cut those salaries, those management salaries," are the same ones that bitch about the way I administer the programs. And yet you want to cut the salaries, get rid of the competent people, have them go to private industry and have a higher percentage of incompetent people on your staff managing programs under civil service, and then they are going to have the justification to say, "This is impossible. Close the whole thing down."

You cannot cut salaries. You know, we are generally 10 to 20 percent below the Federal Government. A fair number of our people can get comparable jobs in the Federal Government. Now, if you want to cut your salaries and say we should also, I would be happy to go along with that. Then, at least, I can have a chance of keeping some of those competent people on my staff. But how do you maintain—keep competent people and not pay comparable salaries?

Chairman REUSS. The time of the gentleman has expired.

Representative KELLY. Pay less welfare.

Chairman REUSS. The Chair will point out that Senator Boe must leave within the next 10 or 15 minutes. Therefore, if there are any questions addressable to him, I would serve notice to the committee.

Mr. Pattison?

Representative PATTISON. Mr. Jacoby, you point out the systemic bias toward Government overspending due to both unbalanced collective bargaining and pressure politics. I do not think we could disagree with that.

Isn't there also a corresponding bias, a systemic bias when you are actually cutting your budget or keeping your budget from going up at the local level, a bias against maintenance and against capital expenditures, because they are the easiest things to cut. For instance, not fixing your sewer or not fixing your water system, because it is very hard to go out to the public and say, "Look what I have done. I have spent so much money maintaining the water system," or maintaining the sewer. As long as the water keeps coming out, and the toilets keep flushing, nobody really cares.

Consequently, you defer maintenance, as with the railroad experience. Because of the pressure group politics you keep some of the more visible things that people demand, and you ultimately get yourself in the position where your bridges fall down, your sewers collapse, your water system fails. Then you have an enormously expensive capital project which you cannot fund, and you then come to the next level of Government, or two levels up, and end up with that kind of situation.

With a spending limitation such as proposition 13, don't we similarly run that risk of what you might call irresponsible government, or government that doesn't feel the same about market disciplines that you might feel in a business?

Mr. JACOBY. Well, I don't feel that that is a very great risk. My observation has been that where the people feel the need of some capital asset or some maintenance expenditure, they will vote for it.

Representative PATTISON. If, in fact, you should spend, let us say, 10 percent of the value of your sewer on maintaining it so that you do it a little bit every year, people really don't feel the need for that very much. No one has ever come to me and said, "We have really got to maintain these bridges." It is when they fall down that the people feel this need.

Mr. JACOBY. Well, they usually have to be impressed with the need by some untoward event, I agree, but where there is a felt need by the public, the public will spend the money.

For example, in my own city of Los Angeles the public has turned down bond issues for new schools for some years. They don't believe they are needed. And I think the figures show that many of our schools are only half used; they are not needed. On the other hand, the people voted for a $30 million communications network for the police because they believe—they felt the need for better law enforcement.

I think that we can trust the people to make wise decisions as to how to allocate their incomes, as between public goods and private goods. But don't overestimate their information. If you give them the information, you will get a rational judgment from them.

Representative PATTISON. It seems to me that what you are saying is, that you can trust the people in the area of maintenance and capital, but that you can't trust the people through their representatives, and I assume you are still talking through representatives for maintenance and capital. You can't trust them to resist the special interest local pressure group politics or the collective bargaining pressures.

Where can I decide to trust the people?

Mr. JACOBY. We are talking about the vulnerability of the representative in a democratic government to the blandishments of special pressure groups. I am not saying he's a bad man—he's just as good as the rest of us—but his interest is in being reelected, and he finds that his strategy is more successful if he caters to the interest of the special pressure groups rather than the general public interest.

Representative PATTISON. I understand those pressures; I feel them all the time. Each group wants their pieces of pie, and they want to take it out of somebody else's piece of the pie. We understand that.

What I'm trying to point out is the flip side of that, and apparently you don't agree with it, that as to the same lack of pressures, when it comes to doing the difficult things that are invisible, the long-term things—fixing the jail, for instance, is not something that too many people go out and campaign on. I haven't heard anybody campaign on that basis, or very rarely. So that fixing the jail, fixing sewers, fixing water systems that seem to be working well is also the sort of flip side of that lack of pressure, and then you make the same kind of irresponsible decision.

Mr. JACOBY. Well, as I say, if the public is informed of the need for maintenance of public facilities, I believe they will vote for them.

There is no evidence that our public facilities overall are undermaintained, that I am aware of.

Chairman REUSS. The time of the gentleman has expired.

Senator McGovern?

Senator McGOVERN. Mr. Jacoby, I wonder if you would turn to page 8 of your prepared statement.

Near the top of that page, the first paragraph on page 8, you say, "Senator George McGovern insulted two-thirds of California voters by describing their action as 'degrading hedonism' which was 'motivated by racism' and which would impose heavy burdens on the poor."

In all due respect, Mr. Jacoby, I never made any such statement.

Now, I notice you have footnoted your remarks to the July 2d issue of the Los Angeles Times, is that correct?

Mr. JACOBY. That is correct.

Senator McGOVERN. I would like to read just two or three paragraphs from that article in the Los Angeles Times of July 2, which I authorized:

> The roots of the California tax revolt expressed in the passage of proposition 13 began growing long ago in the soil of an inflation fertilized by the escalation of the Vietnam War and irrigated by the continuing arms race with the Soviet Union. The media have placed too much emphasis on a recent remark I made suggesting that while the tax revolt articulated a profound and legitimate anger, it also had undertones of racism. Certainly, blacks and other minorities will suffer disproportionately from the cutbacks imposed on California by the passage of proposition 13, but I do not believe that the majority of voters was expressing racial resentment. As inflated property valuations and the increasing cost of living on all fronts leaped out of control, property owners finally saw an opportunity to react against taxes, inflation, and ineffective government all at once, but it seems to me that there are far better ways than proposition 13 to make taxes lower and fairer for everyone. Two-thirds of the proposition's tax relief will go to commercial property, much of it owned by out-of-State interests, rather than to California homeowners.

Mr. Chairman, I ask unanimous consent that the full text of this article from the July 2 issue of the Los Angeles Times be printed in the record.

Chairman REUSS. Without objection.

[The article referred to follows:]

[From the Los Angeles Times, July 2, 1978]

FEDERAL TAX REFORM AND DEFENSE CUTS ARE THE ONLY ANSWERS

(By George McGovern)[1]

The roots of the California tax revolt expressed in the passage of Proposition 13 began growing long ago in the soil of an inflation fertilized by the escalation of the Vietnam War and irrigated by the continuing arms race with the Soviet Union.

[1] George McGovern, a Democrat, is the senior Senator from South Dakota. He was his party's 1972 presidential standard-bearer.

The media have placed too much emphasis on a recent remark I made suggesting that while the tax revolt articulated a profound and legitimate anger, it also had undertones of racism. Certainly, blacks and other minorities will suffer disproportionately from the cutbacks imposed on California by the passage of Proposition 13. But I do not believe that the majority of voters were expressing racial resentment.

As inflated property valuations and the increasing cost of living on all fronts leaped out of control, property owners finally saw an opportunity to react against taxes, inflation and ineffective government—all at once.

But it seems to me that there are far better ways than Proposition 13 to make taxes lower and fairer for everyone.

The trouble is that Proposition 13 offers relief to the majority by reducing services vital to the minority and by creating new tax advantages for corporate landowners. Two-thirds of the proposition's tax relief will go to commercial property, much of it owned by out-of-state interests, rather than to California homeowners.

Beyond this, the tax cut is so sweeping that once the temporary state surplus provided by inflation is exhausted, public services of all kinds—police and fire protection, education and recreation, sanitation and medical care, family assistance and mental health—may have to be slashed sharply. The Jarvis formula may turn out to be the fiscal equivalent of the neutron bomb—a device that preserves property while destroying people.

Californians voted for Proposition 13 because they had no better choice that could both reduce unfair taxes and preserve essential services. But in view of the underlying causes that contributed to that action, I suggest the alternative steps of lowering federal spending on defense and eliminating both national and state tax loopholes currently available to corporations. These steps could lighten the tax burden on our citizenry and slow the ravages of inflation—not only in California, but also throughout the nation.

Much of the inflation and rising governmental costs that have driven up property valuations and taxes of all kinds originated with the cost of the Vietnam War. That war accelerated rapidly after 1965 with no tax increase to pay for it and no effective price and wage restraints to limit inflation.

The ultimate cost of the war to the American taxpayer, including veterans' benefits and debt-carrying charges, will approximate $500 billion. That is a war tax of $10,000 on each American household over approximately 10 years.

Nor is the Vietnam War the only factor still with us. Since the end of that struggle, the arms race has been speeding up rather than slowing down. Annual U.S. arms outlays have now skyrocketed to a current annual level of $126 billion.

In recent years we have squandered $51 billion on a useless, antiballistic missile complex in North Dakota, now abandoned; we spent nearly $5 billion on the B-1 bomber before abandoning that project as unneeded. We have spent tens of billions of dollars on the MIRV (multiple independently targeted re-entry vehicles) missile system, which the Russians are now matching. This would not be happening if a prohibition against MIRVs had been included in the first SALT treaty, signed in 1972.

Now a summit round of Strategic Arms Limitation Talks is pending with the Soviet Union. Should they fail or be substantially postponed, we will continue to pile another $75 billion in extra arms spending onto the backs of American taxpayers during the next five years.

Congress is about to force a $2.5 billion nuclear aircraft carrier on an Administration which insists that the carrier is unnecessary for national security. Although the Soviet Union and the United States both have enough nuclear fire power to pulverize each other many times over—no matter which side strikes first—we are pushing ahead on plans for a costly new mobile missile system on railroad tracks, plus a vast array of cruise missiles. The Soviets will doubtless follow suit.

Former Defense Department official Townsend Hoopes and former Deputy CIA Director Herbert Scoville have contended that the United States could save $30 billion over the next four years in non-nuclear military forces—without reducing our military effectiveness or our power to deter conventional war. Add to that the $75 billion which a successful SALT II agreement could save over the next five years, and it becomes clear that such savings could not only reduce government expenditures, deficits and taxes, but in doing so, could also dampen the fires of inflation.

Beyond all this, there are ways to make taxes fairer for everyone—ways I first proposed in 1972. At that time I urged that some of the loopholes in our federal tax laws be closed, estimating the consequent savings at $28 billion. It was my suggestion that these savings be returned to the states and earmarked for property-tax relief—a proposal that would have cut California's property taxes in half.

On March 21, 1972, I told the Senate: "The American people are angry with a tax system which has become increasingly unjust and which places an enormous burden on property owners. It is no exaggeration to say that we face a full-fledged tax revolt. While the President and the Congress would have to decide on the use of revenues resulting from tax reform, I believe that we must place a high priority on their allocation for the purpose of reducing the property tax."

Six years later, after Proposition 13, it is even more urgent to eliminate loopholes in the federal tax code and pass the savings on in the form of tax relief and strengthened public services.

Economist Arthur Okun of the Brookings Institution has suggested a further measure which would use federal tax reduction to fight inflation rather than aggravating it. Instead of offering President Carter's suggested broad tax cut of $20 billion to corporations and individuals, he favors making a major part of this reduction available to those businesses and their employees who agree to hold down prices and wages.

Economist Robert Eisner of Northwestern University has suggested other helpful tax revisions. He advocates a phaseout of the present 10% investment tax credit for corporations, which would save the U.S. treasury $15 billion annually—savings that could help finance either a tax credit or subsidy to employers for 50% of the cost of hiring and training Americans now without jobs. Second, Eisner supports ending all payroll taxes for workers under age 20.

If Proposition 13 was indeed a cry for help, then that help must be constructive and swift, as well as targeted directly at those whose pain is greatest. The combination of prudent savings in our swollen arms budget, plus federal tax reform based on common sense and designed to make our wiliest tax-avoiders bear their share of the load, would serve us well.

Senator McGOVERN. Even on the basis of what I have read, Mr. Jacoby, I wonder how you draw the conclusions you did about my analysis of proposition 13. Those phrases that you used don't appear at all in the July 2 issue of the Los Angeles Times.

Mr. JACOBY. I believe the article you have quoted was a second speech you made which succeeded your initial speech in which these comments that I quoted were made, sir.

Senator McGOVERN. It's the only one that appeared in the July 2 issue.

Mr. JACOBY. Well, I will get the other citation.

Senator McGOVERN. Well, let me read you the other citation. It comes from a speech delivered here on June 17, in which I addressed at considerable length a much larger problem than proposition 13, that is, the whole question of the priorities of the Nation and the fairness of our tax system as a whole.

Now, this is the only place in that 8-page, single-spaced speech where any reference to racism is made. It is all in about three sentences, and this is what I said:

And in conscience, some final words must be said. While the tax revolt expresses profound and legitimate anger, it also has undertones of racism. A news weekly quoted one California voter, and I quote: "It is those social services that annoy me, social services for the colored, the Mexican, and so forth." Sixty percent of the employees, maybe, laid off in Los Angeles, are members of minority groups.

Now, frankly, Mr. Jacoby, I regret even raising, in a very minor way, that there was an element of racism involved especially in the results of proposition 13. The reason I regret putting it in is not that it isn't true, but the fact that you and some of the news media have seen fit to lift that out of context and to use it as the interpretation of what I was trying to say about the essential unfairness of much of our total tax structure in this country.

Mr. JACOBY. Well, if I may say a word in reply, Senator McGovern, it was not my purpose to pillory you but rather to criticize a rather widely expressed view among the so-called liberal establishment of the country that the excessive burdens of property taxes in California and the very high cost of the inefficient government we are running which led to proposition 13 should be explained by an effort to place burdens on the poor or on racial minorities. This is not the case.

Senator McGOVERN. I just repeat again that I agree with you, that is not a fair statement, and I never made any such statement.

Mr. Chairman, since my time is up, I ask unanimous consent that the full text of the earlier speech of June 17 also be made a part of the record.

Chairman REUSS. Without objection, so ordered.

[The text of the speech referred to by Senator McGovern follows:]

A VISION OF POSITIVE GOVERNMENT

Remarks by Senator George McGovern (D.-S.D.)
Americans for Democratic Action Annual Convention
Washington, D. C.
Saturday, June 17, 1978

We meet in a month when liberals are supposed to be in hiding. California has voted overwhelmingly to approve Proposition 13. In New Jersey a rightwing extremist has taken a Senate nomination by pledging to cut taxes and to gut government. In Ohio a general rejection of bond issues may close down schools in Columbus and Cleveland. Across the country politicians are chasing and fanning the popular whirlwind. They are seeking a mandate to govern by running against government itself.

So first of all let me affirm that I continue to be a liberal — a believer in dynamic government unafraid to set important goals and to persist in their achievement. I still believe that social justice and peace among nations are the defining endeavors of our democracy. I do not concede that the New Deal and the United Nations are out of date. I do not intend, in the words of Edmund Burke, "to take up or lay down a great political system for the convenience of the hour."

Expedient politicians have reversed Burke's standard of integrity: apparently they are not in office "to support (their) opinion of the public good"; but they "form (their) opinion in order to get into (office), or to continue in it." Candidates who sowed the wind with anti-government slogans are reaping the whirlwind. It should come as no surprise that citizens who hear government denounced as feckless will decide that the futility is not worth their tax dollars. If Franklin Roosevelt had assailed the needy and the old as shiftless and thriftless, could he have passed unemployment compensation, rural electrification and social security?

Today politics is being malpracticed as tactics, not leadership. Timid officials are repeating and reinforcing a despair of democracy. Last January the President himself announced that the state of the union was one of powerlessness — that "government cannot solve our problems... define our vision... eliminate poverty... or reduce inflation...."

In the past, in success and in adversity, the Democratic Party has stood proudly for the possibilities of progress. Woodrow Wilson sought a New Freedom at home and peace through law abroad; Franklin Roosevelt brought a New Deal; Harry Truman fought for a Fair Deal; John and Robert Kennedy opened a New Frontier; Lyndon Johnson and Hubert Humphrey dreamed of a Great Society; and even in the crushing defeat of 1972, we tried to call America home to its founding ideals. We have not come this far to settle now for no deal. We are not Americans for Democratic inaction.

Let us insist that government can, and must, solve problems — that it can, and must, eliminate poverty and reduce inflation — that it can, and must set goals and define a vision for the nation. For it is as true now as it was when Franklin Roosevelt quoted it in his inaugural address that "where there is no vision, the people perish." The danger is not the immediate death of the system, but a steady decline of its capacity and credibility. And people literally do perish in the process. Bad diets, bad housing, and bad health care do take human lives. Abused children and battered wives do suffer and die. Dangerous poorly policed neighborhoods do kill people. Blacks and other minorities on average do die four years sooner than whites; thousands of senior citizens do lose the will to live out a neglected old age. And there is a death of hope among Americans of every race and age who must live out lesser lives in a lesser land. Beyond all of this may be the death of our planet if we do not soon curb the arms madness.

A clear vision of a better country cannot offer mere abstractions and disconnected echoes of the latest opinion polls. It asks not just for efficient government; it asks efficient at what. It depends not just on preaching love, compassion and competence — but on achieving results. For faith without works is empty.

But the conventional cynicism replies that the liberal faith will not work — that we should not try to move forward because the Great Society failed. I am tired of hearing that myth from the politicians and officials who urged the war that diminished the Great Society. They were not skeptical of government then. They believed the American government could work its will — in an Asian jungle. They were wrong. The final price of their error will total $400 billion for the fighting and its aftermath. It was the greatest single instance of government waste in any nation's history. That is when the taxpayers should have revolted. Three weeks of the Vietnam war at its height cost more than the highest budget of the war on poverty for an entire year.

Because all the firepower finally proved to be powerless, because it could not destroy enough villages in order to "save" Vietnam, does not mean that we are helpless to save our own cities by saving them, or to prevent needless malnutrition and illness, or to correct unemployment through job opportunities, or to reduce poverty through welfare reform, or to harness the sun and convert waste matter to energy. Government can do what is possible domestically — but not if it pursues a wasteful, self-defeating military globalism.

There is a fatal inconsistency in the nihilism of the new right that government is only good for tax write-offs and costly new weapons. Their Senate nominee in New Jersey emphasizes two issues — a 30 percent reduction in federal taxes and an American withdrawal from the SALT talks. He scorns the "free-spending" of government, but he would spend freely for tens of billions of dollars of extra megatons. How would the bill be paid? What programs would be slashed?

It is time to challenge the simplistic hypocrisies of the new right.

If government has the money to bail out Lockheed and Penn Central, why is it powerless to help older people, neglected children and average Americans — including those with black skin?

If government has billions for nuclear power plants, why does it lack the resources to develop solar power instead?

If government can find billions to dig 13-mile underground tracks for intercontinental missiles, why can't it restore railways and city transit instead?

In 1976 we were pledged a decrease of five billion to seven billion dollars in military waste; since then, we have had an increase of twenty billion. And recently we have been invited to the brink of a new cold war. We have heard no convincing rationale that current events in Africa outweigh the fundamental, mutual interest of America and Russia in ending the arms race before it ends all of us. But we have heard bombastic implications that who backed the Katanga rebels is a more urgent concern than SALT. Rather than proving that our leaders are tough enough, official overreaction to such minor events may convince the public that any SALT agreement that can be negotiated will be a bad one. How senseless it would be to hazard Armageddon for Shaba Province.

The real spendthrifts are the hardline hawks whose "worst case" nightmares are burdening the taxpayer, inflating our economy and jeopardizing the peace. The signing of SALT I in 1972 has saved us $15 billion in a needless ABM. The loss of SALT II would cost us $75 billion over the next five years — ten times the total property tax cut in California under Proposition 13. The arms race fuels the fires of inflation and the tax revolt. To be anti-waste is to be anti-war. In 1972, I urged military economies and tax reform to finance property tax relief. We were six years ahead of Howard Jarvis — and we explained how to pay the bill fairly. Today the fault for the heavy burden of unfair taxes rests not on liberal programs, but on needless war, a reckless arms race and an unjust tax system designed and continued by selfish special interests.

Instead voters are offered a degrading hedonism that tells them to ask what they can take from the needy — and conceals the fact that in effect they also will take necessities from themselves. Television commercials reassured Californians that local governments could lose revenues without losing essential services. Voters in surveys believed that enough frills could be eliminated. Now it turns out that the frills include police and firefighters; that entire school systems may be shut down; that even if they open, class sizes will soar as high as 170 pupils; and that 225,000 employees probably will be laid off — which will raise state spending for unemployment compensation and welfare. Tax dollars will be shifted: they will pay employees less to do nothing rather than enough to provide services.

Ironically, two-thirds of the tax relief will enrich corporations and corporate landowners — many of them absentee owners thousands of miles from California. The homeowners knew it; but they believed that to get a fair break for themselves, they had to give that boon to the corporations. Property taxes in California were fifty percent above the national average. State officials had piled up a five billion dollar surplus. They were proud of it: they cited it as evidence that they could cut government down to size. And they fought over it: they delayed even minor property tax reform. So people who literally were being taxed out of their homes were so frustrated that they followed a pied piper — a paid lobbyist for the real estate industry.

Politicians looking to ride or ride out the whirlwind of Proposition 13 cannot see or shape a vision of tax justice. They have become instant economizers and flailing taxcutters in the storm. The panic is non-partisan. In New York, a Democratic official has suggested an arbitrary ceiling on the number of state employees that would force tens of thousands out of work; he did not say what services would be slashed. In the same state the Republican candidate for Governor proposed a constitutional amendment to limit local taxes; according to an aide, he left it deliberately vague.

Here in Washington, officeholders have been busy compounding the deeper causes and the worst inequities of the tax revolt. The President resurrected his promise of a balanced budget by 1981, while simultaneously calling for a tax cut and an even bigger Pentagon budget. That combination will bring economic trouble if he really means it and disillusion if he does not. A Congress that has spurned even meager reform of federal taxes has rushed to cut the budget at least a little. Intent on not offending the powerful, the House of Representatives attacked the weak. It voted down $225 million to remove architectural barriers to the handicapped. What a spectacle the majority made of themselves: after raising the Pentagon's billions, they pinched a relative pittance for the halt, the lame, and the blind.

Was this one of those wasteful programs which will not work? Are we short of the materials and designs to build ramps? Nothing could more vividly expose the character of the assault on domestic government. A convenient arrogance of powerlessness comforts the comfortable: they would give less for what others need.

But even the comfortable would be in trouble if the whirlwind reached too far. John Kennedy's warning is still true that if we cannot help the many who are poor we cannot save the few who are rich.

It took Vietnam to teach the hard lesson that the American government in arms is not all-powerful. Will it take the domestic equivalent of that defeat to show the government in fiscal chains and our society in bondage? The new right figures that they can follow the tax revolt all the way into the White House. And in this illiberal hour, the rest of us are advised to trim our sails, tame our conscience, borrow the passing rhetoric, and gratefully accept a leadership of style over substance.

How can we continue to advocate government as the employer of last resort when the voters are making it the unemployer of immediate resort? We do so because it is right. We do so because we still believe in the decency of the American people. We believe that they prefer a government that is both efficient and compassionate. But if they do not have that alternative, then they, like the citizens of California, may pick a government whose only virtue is that it has been cheapened — not merely in finance, but in principle. The new right can exploit frustration; timid candidates may be swept along in the tide. But liberals can offer a steady vision of taxes that are lower for the majority and fairer for everyone. We can offer the vision of a society committed to a fuller justice for all citizens. We can and we must demand an end to the arms race as the condition of our prosperity and our survival.

First, we can provide tax relief through tax reform and the reduction of military waste. Billions of dollars are lost in unjustified tax loopholes; there are billions of dollars to be saved in completing the SALT talks.

Second, we can offer additional tax relief that simultaneously controls inflation. Rather than cutting corporate taxes willy-nilly as now proposed we should, as Arthur Okun recommends, offer tax rebates to businesses and their employees who practice price and wage restraints.

By contrast, present anti-inflation policy saps the economy of $100 billion of output. The policy raises unemployment and the costs of welfare and unemployment compensation. Economists are now warning of an imminent recession. To invite it in order to control inflation, to make unemployment a secondary concern, is Republican economics that did not work before. It is failing again as inflation soars into double digits.

As Roosevelt once said: "We are poor indeed if this nation cannot afford to lift from every recess of American life the dread fear of the unemployed that they are not needed in this world." Are we so poor now that 6 or 7 percent unemployment has become the moral equivalent of full employment? Fifteen years ago a 4 percent rate was just a temporary goal. Is a level far higher now to become a permanent condition?

Third, we can offer financial relief by enacting programs instead of dismantling government. A common sense program of nutrition education and preventive health care could cut the nation's medical bill by one-fourth and probably more.

Similarly government intervention in energy could prevent excessive price increases. The Administration apparently will welcome any energy program now, including deregulation of natural gas. Government is not working when the average family's gas bill will rise $2,000 over the next seven years. Government is not working when the moral equivalent of war becomes the functional equivalent of surrender to the oil monopoly. Instead of an energy policy that seeks conservation through higher prices and higher oil taxes, we should be pressing hard for alternative, renewable sources of energy and more economical transportation.

How ironic it is to see the new rightists piously protesting every public endeavor that costs anything, then eagerly advocating natural gas legislation that will transfer $60 billion from people's pockets to private boardrooms. In truth the tax revolt is an accident that happened to their ideology. They are not against waste; they are anti-government, good or bad, except when it is paying for B-1 bombers or neutron bombs. Their loyalty is not to hard-pressed taxpayers, but to the ideology of McKinley, Harding and Hoover.

I know that it is not politic to oppose that ideology now — that Proposition 13 in California has stirred a panic even more serious than the Cubans in Africa. But the redeeming purpose of politics is to explain, to educate, to take risks for a conviction — in short, to lead. I also know that no matter who leads us, the political journey from the vision to the reality will not be an easy one.

I believe that Jimmy Carter is a dedicated, conscientious man who longs to be a good President. I well know that the problems that now afflict the nation are not the results of a single presidency and no single President will end this time of troubles. Wilson and Roosevelt lost their share of congressional and judicial struggles. But what counted was that they fought another day, and then another, for their conceptions of how government could and should work. And they held a vision of greatness constantly before the American people. A President reaps disapproval not because he is set back in a cause that is right, but when he is lukewarm in a course that is confused.

We elect leaders to set goals and solve problems, not to plead that they are insoluble. And in the final analysis, their leadership must be a moral one. I do not mean the moralism of insubstantial pieties or dreary self-righteousness. Moral leadership does not tell us how good we are, but how we can do better. It touches conscience as well as self-interest.

And in conscience, some final words must be said. While the tax revolt expresses profound and legitimate anger, it also has undertones of racism. Crime was, and is, a legitimate issue; but in the last decade, law and order became a code word. So it could be with tax relief. A news weekly quoted one California voter: "It's those social services that annoy... me — social services for the colored, the Mexican, and so forth." Sixty percent of the employees who may be laid off in Los Angeles are members of minority groups.

It is unfashionable now to worry about the poor and minorities and to defend the idea that they, too, deserve an opportunity. Perhaps property taxpayers ought to remember, if only for a moment, how many of them would never have owned a home without a government loan and a mortgage tax write-off. To give up on government now, to turn our backs on those who have been left behind, to decide that all we can do is keep our own share, is to give up on our own best instincts. It is un-American; it is unacceptable.

At stake is whether America will become a parcel of geography drained of ideals, a collection of selfish, competing economic persons whose highest purpose is the bottom line. We worry about defending our nation as a physical entity; we must also defend it as a source of justice and mercy. National security includes the condition of our national spirit as much as the size of our nuclear arsenal. The gravest threat today is not a foreign adversary, but an enemy within. That enemy is not a conspiracy or a fifth column; it is inside ourselves and among our leaders. It is the sense of futility. It is the dulled conscience. It is the lost vision.

Those of us who have seen the liberal vision have an obligation to nurture it.

We must insist that this latest revolution against taxation need not overthrow the first, best traditions of that earlier revolution for "the unalienable rights" of all people.

We must speak for those who have no voice.

We must stand for those who have no lobby.

We must be strong for those who are weak.

We must demand fairness for those to whom life has been unfair.

We must take the road that leads to peace.

We must not be ashamed to care or afraid to be liberal. For in this month when we are supposed to be hiding, a month that comes 10 years after Robert Kennedy's death, we still refuse to see things as they are and assume that they have to be; we continue to dream things that never were — and to say "why not."

###

Chairman REUSS. That will also take care, I believe, of Mr. Jacoby's request, because that second McGovern speech is the one you at least partially referred to. Is that not so?

Mr. JACOBY. Well, I think the first comment is also relevant. I should have cited that, as well, and I am sorry I omitted that reference. But I believe it is true that the expressions of "racial overtones" and "degrading hedonism" were used by you.

Senator MCGOVERN. They were minor, trace elements. It was not the central thrust of my remarks, at all. And I am not suggesting you are trying to be unfair, but I have made a real effort—including the article that I wrote for the Los Angeles Times of July 2—to clarify what I thought was an unfortunate distortion of my position.

And what does puzzle me slightly is that you quoted that clarification, but used the language from the initial statement.

Mr. JACOBY. Well, I appreciate your effort to clean it up, and I certainly wish to say that there are not hard feelings on my part, sir.

Senator MCGOVERN. Well, I feel the same way.

Representative REUSS. Thank you both very much. Senator Boe has to leave. Mrs. Fenwick has a question to ask him. I recognize the gentlelady from New Jersey.

Representative FENWICK. I wonder if you would comment on the feeling, or expression of opinion of Mr. Gramlich about unemployment as a result of this proposition 13?

I would like to say that I don't think that feeling of impatience or "rage" against government, and what it imposes upon people, is found only in California. It is found all over the Nation, and I think it is increasing.

But could you comment on the unemployment aspect?

Mr. BOE. I believe that there is no question in my mind that the ultimate effect of proposition 13 will be decreased employment—particularly in schools. We are talking about property taxes—we are talking about education.

In the State of Oregon—and we are not too far different from most of the rest of your States—75 cents of every property tax dollar goes to the support of education, K through 12, or K through community college education. That is what we are talking about, where I think the stringent unemployment aspects are going to happen.

Representative FENWICK. What do you mean "unemployment aspects"? Do you mean, fewer teachers are going to be employed?

Mr. BOE. Of your average school budget, 80 percent is salaries. So if there are going to be cuts in funding, there are going to be cuts in education and your pupil/teacher ratio is going to increase from 1 to 25 kids to 1 to 40 kids. It is the only way that the budget can be balanced.

Representative FENWICK. But isn't it also true that some of the education budget is spent for programs like the summer lunch program? According to Congresswoman Holtzman, this produced a handsome profit in 10 weeks of $1 million in her district.

There are elements which have nothing to do with education and are extremely burdensome and expensive. Maybe those could be eliminated which would not result in unemployment, but merely the denial to that enterprising gentleman of his $1 million profit.

Mr. BOE. Well, this is perhaps correct, and goodness knows, we, in the State legislatures, are faced with the same problems, on a smaller scale, that you are. You can go through the Federal budget. Senator Proxmire does it regularly, and points out some of the interesting things that the Congress budgets for throughout the Federal budget. But I think that—and I do have to leave, and I want to leave this with you, if I can.

I think that the voters—the most dangerous thing about this is the fact that there is going to be a backlash—a voter backlash, somewhere between 4 and 8 years down the track, if this goes on, as is the way I see it. The reason for that is this: Your property taxes, under this, are rolled back to 1975, 1976, with a 2-percent incremental increase. But if the property sells, then the assessor comes and assesses at the new true cash value.

Statistics tell us, nationally, that homes sell three times in 20 years. That means, every 6-plus years, homes turn. They will then be reassessed at true cash value.

Senator McGovern mentioned that two-thirds of the property taxes are paid now by income-producing property, so we have two-thirds here, and one-third for the homes.

As those homes sell—because Southern Pacific does not sell its railroads, utilities don't sell their utilities, and apartment owners don't often sell their apartments—the relationship of two-thirds, one-third, within 6 to 8 years, is going to be this way. Homes are going to be picking up two-thirds, and income-producing property is down to about a third.

Now we, in the States, really only have one way to tap income from business, and that is through the property tax. Oregon's corporate excise tax is 7 percent. We can't get more because the Feds have already preempted us with 49 percent or 48 percent, or whatever the rate is now. The States simply have to keep that corporate excise tax down to a reasonable level for competitive reasons, as well as others.

And so, the property tax is really the only way that we have a chance of business supporting local public services.

When the homeowners begin to realize what has happened in this shift, then I am prepared to predict that there will be a voter reaction that will make Jarvis-Gann look like a picnic, and the brunt is going to be felt by the business community.

And they can wave their checks and say, "Look, we contributed against Jarvis-Gann," like they did in the California Manufacturers Association meeting, and the public is going to say, "To heck with that; we are going to get you, now."

And I think that is one of the greatest dangers that we have of this now, and so far I have heard no answers to that from my colleagues here.

Representative FENWICK. I would tell you one answer, but my time has expired.

We are addicted to spending down here. That is the truth. There was an effort made to reduce the increase in the budget from 11 to 9 percent, and it was turned down by the House of Representatives.

Just that, alone, explains what is happening to the deficit, to the people's rage. They can't seem to control it. We are addicted to spending. It is work. We are all here.

Representative REUSS. I must call the gentlelady's attention to the four excellent charts which show that our addiction, while considerable, is of a Quaalude nature, compared with other levels of government.

Representative FENWICK. Well, we must also consider the public service employees and CETA. Look at the revenue, as a percentage of the level of government. Look at the blue column in all of these expenditures—that is Federal [indicating]. As a percentage of GNP, look at the Federal spending [indicating] over there.

Representative REUSS. Senator Boe, thank you for giving us your time. We are most grateful to you. Now I think, under the rule, we will start right out in the questioning after the next panel, with Representatives Cavanaugh and McKinney, who have not yet been heard from.

We would like to hear from the final panel. David Greytak, would you lead off? Of course, the other witnesses will stay, if you would, for further questions.

STATEMENT OF DR. DAVID GREYTAK, THE CENTER FOR METROPOLITAN PLANNING AND RESEARCH, JOHNS HOPKINS UNIVERSITY

Dr. GREYTAK. Mr. Chairman, and members of the committees, I have a prepared statement which I would like to submit for the record, which I would like to partially summarize at this point.

Let me begin by noting that expenditures of State and local governments increased at annual average rates of less than 10 percent before 1974. They have increased at rates in excess of 14 percent after 1974.

Over the last 10 years, per capita State and local governments expenditures increased fully 250 percent—a sizable increase, by any measure.

Three types of explanation can be given for this growth.

First, there is the demand-side explanation. Here, the argument goes that a large and growing population, with growing income, demands more public services, and therefore larger levels of public expenditures.

The second is the cost-side explanation. Here, the argument is simply that public employee bargaining and inflation have increased the cost of providing any level of public services.

The third argument is the inefficiency argument. It states that, because of mismanagement and/or low productivity, the public sector has become increasingly costly. Actually, it is likely that elements of all three of these explanations have been operative.

However, an understanding of the relative importance of the three is essential, for they hold forth different prospects for future growth in expenditures, and therefore have different implications for public policy. If mismanagement is the root of the problem, then reorganization, new technology, and innovative procedures hold forth promise for expenditure control. If the explanation lies in growing demand, then the decline in school-age populations, and the decline in dependent populations which will accompany economic recovery, hold forth some promise for future relief.

If cost pressures are the result principally of public employee unionization and inflation, a continuation of both of these imply that there is little relief in sight.

With regard to the demand-side argument, the data would seem to indicate that growing service needs cannot account for much of the State and local government growth in expenditures. In fact, although expenditures have grown at accelerated rates recently, population, and schoolage populations, more particularly, have not. More to the point, the reins on the employment growth at all levels of government—at the State level, and all levels of local government as well—have been drawn increasingly tight since 1973. This is particularly the case for employment in education, and employment by municipalities. In fact, municipal employment in 1976 stood at a level below that of 1973. As a result of the wide differences in expenditure and employment growth rates, per capita State and local government expenditures have increased at 5 to 7 times the rate of per capita State and local government employment in recent years. This reading of the data implies that little State and local government growth can be attributed to increasing demands and growing service levels.

The situation is quite different in the case of the cost side. Although State and local governments have been able to put the brakes on employment growth, the record is much different in the case of employee compensation.

Average wage and salary compensation of State and local government employees has continually increased, but, since 1972, it has increased at rates somewhat greater than in the previous decade. Fringe benefits and other supplemental expenditures per employee also have increased at rapid rates—12 to 15 percent during the last 5 years—and, in 1976, the average fringe benefit cost per State and local government employee stood at a level of about $1,850.

As high as this figure is, it is probably an understatement of the true cost of wage and salary supplements. For there is strong reason to believe that at least many of the State and local government pension funds are underfunded, and full funding would inflate that figure even more. Even if the full cost of pension programs were included, the true cost of fringe packages still would be understated, for employees receive substantial benefits in the form of paid vacations, holidays, sick leave, and the like. When the cost of these is included, the ratio of fringe benefits to pay-for-hours-worked jumps quite sharply. For uniformed services in local government, for example, the ratio is in the range of 46 to 47 percent. For other local governmental employees, the range is slightly lower, but still at about 40 percent. As high as these costs are, there are reasons to believe that they will continue to increase as the full effects of the recent social security legislation and the movement toward full funding of State and local government pension plans materialize.

Inflation is another important factor, and one that has been mentioned by many. Although it affects all sectors of the economy, its impact on State and local governments is difficult to determine, as none of the generally available price indices is appropriate for application to the public sector. Under the sponsorship of the National Science Foundation, the metropolitan studies program of Syracuse

University has developed a set of indexes for State and local governments which measure inflation's impact on their expenditures and their tax bases. These indexes clearly reveal the susceptibility of governments to inflation. They indicate that if State and local governments had simply absorbed price increases of goods and services they purchased from the private sector, while compensating employees and transfer payments for only the increases in the cost of living, their expenditures would have increased by about 22 percent during the 5-year period 1967 to 1972—a period of moderate price increases. During the 2-year period of double-digit inflation—1972 to 1974—inflation pressure on State and local government expenditures exceeded that of the previous 5 years, as a whole. That is, inflation may have increased the cost of State and local governments by as much as 25 percent in just 2 years. The decline in the rate of inflation after 1974 is reflected in the lower rate of cost increases for State and local governments—roughly 12 percent between 1974 and 1976.

An analysis based on these data is reported in my prepared statement. The data indicate that fully two-thirds of the growth of local government expenditures between 1972 and 1976 can likely be attributed to inflation alone. Alternatively, only about 21 percent of local government expenditures can be attributed to the increase in the number of local government employees.

Clearly, local governmnets have had little, if any room, to increase the amount of goods and services they purchase from the private sector, or to increase the real incomes of their employees.

It is also possible, to estimate the impact of inflation on tax bases. And to be fair, this must be done. These calculations indicate that inflation has led to an increase in the nominal values of many tax bases. However, between 1967 and 1974, the inflation-induced increases in cost were substantially greater than the inflation-induced increases in nominal values of tax bases.

Between 1974 and 1976, inflation hit the land and housing markets, and local governments' tax bases inflated much more rapidly than their costs. Indeed, between 1974 and 1976, the purchasing power of the tax bases of many local governments was reestablished at 1972 levels.

Still, there remains the question of whether local governments were able to capture the inflation-induced increases in the nominal values of their tax bases. For some taxes, such as those on retail sales and incomes, changes in tax bases are immediately translated into revenues. For others, particularly the property tax, these changes must be measured before they can be realized. In those jurisdictions where reassessments are prompt and accurate, the effects of inflation on property tax revenues will be captured quite quickly. California is one State where reassessments are regular and accurate.

The implication is that, for 7 years, inflation increased expenditures more than tax revenues. Then, between 1974 and 1976, a reversal occurred. It does not take much of an imagination to envision the plight of local officials. Conditioned by the experience of the previous 7 years, any budgetary slack which occurred after 1974 was a surprise. Uncertainty as to the permanence of newly found sources of revenues no doubt precluded the sharing with taxpayers what might be just a one-time shot of relief from the pressures of inflation on public budgets. Such circumstances lead to tax burden increases unaccompanied by service level expansion, and this obviously is the fuel for tax revolt.

The implication of this analysis—and I will summarize quite quickly—is that increasing cost due primarily to inflation rather than growing demands is largely responsible for the recent increases in State and local government expenditures. This being the case, the inevitable conclusion is that the fight against inflation must be the single most important element in any program to restrain increases in State and local government expenditures and tax burdens. There are other possibilities for restraining growth in expenditures and tax burdens of State and local governments. The implications of each of these must be examined separately, and many of these I have reviewed in my prepared statement.

In particular, care must be taken not to follow a course which simply shifts the burdens of local government operations from local taxpayers to State taxpayers with no reduction in combined State and local government tax burdens. This, I fear, may be a likely outcome of such policies as the imposition of property tax limits, State assumption of the financial responsibility for what had been local functions, and increases in State aid to local governments.

It has been mentioned by earlier witnesses here that there also are serious local control and equity issues related to the above mentioned, and other policy alternatives. Many of these are discussed in my submitted statement. In the interest of time, I will not pursue them at this point.

Thank you.

[Dr. Greytak's prepared statement follows:]

The Increasing Costs of Local Governments:

Underlying Causes and Policy Considerations

by

David Greytak
The Center for Metropolitan Planning and Research
The Johns Hopkins University
and
The Maxwell School of Public Affairs
Syracuse University (on leave)

Prepared for presentation to the U.S. House of Representatives, Subcommittee on the City, Committee on Banking, Finance, and Urban Affairs, of the Ninety-fifth Congress hearings, "How Cities can Respond to the Taxpayers Revolt." 25-26 July 1978.

INTRODUCTION

The development of serious policies for effective control of local government expenditure growth requires not only a knowledge of the factors underlying the growth in the cost of local government, but equally an understanding of the consequences of the available policy options. These topics have been of increasing concern to public policy analysts and researchers. Still, a consensus has yet to be achieved as to the exact nature of the problem, let alone the appropriate policy response. The purpose here is to examine in a general way a number of the factors related to the growth in the local public sector and to consider some of the problems associated with some of the more popular policy alternatives. It should be emphasized at the outset that the available evidence about the cost and expenditures of local governments is sufficient to support only those conclusions which are of a general nature. More explicit statements would require detailed analysis of local government fiscal documents. Given the limitations of the generally available information about the operations and costs of local governments, any conclusions, including those stated herein, must be considered as tentative.

PART I

GROWTH IN EXPENDITURES

Expenditures of state and local governments, both in total and those in support of current operations, have grown at a substantial pace during the last decade (Table 1). The rate of growth in these expenditures, however, has been higher in the 1973-76 period than in the previous five years, 1967-1972. The increase in the rates of expenditure growth is quite sharp, as both total expenditures and current operating expenditures have grown at annual rates in excess of fourteen percent since 1974, while prior to that date their growth rate was generally less than ten percent. This rapid growth in expenditures, in combination with fairly slow growth in population, has resulted in an increase in per capita expenditures from $539 in 1967 to $1422 in 1976, an increase in excess of 250 percent. As was the case with total expenditures, the annual average rates of increase in per capita expenditures indicate that their growth has accelerated during recent years.

A number of possible explanations of the growth in expenditures exist. On the one hand, it may be argued that expenditure increases are largely due to expansion of service levels; that is, as total population, the number of school-aged children and the number of dependent poor increase, the need for public sector activity also grows. Alternatively, there is the cost side argument. Simply stated, the success of public employees at the bargaining table, coupled with inflation, has driven up the cost of providing any given level of service. Finally, there is the efficiency argument; that is, because of mismanagement and low productivity, the bureaucracy has become increasingly costly.

Most likely, some combination of the elements of all three explanations has been operative. However, some idea of the relative importance of the three is essential, for they hold very different prospects for future growth in expenditures.

Table 1

Growth in State and Local Government Expenditures and Growth in
Per Capita State and Local Government Expenditures,
Selected Years, 1967-1976

	State and Local Government Direct Expenditures			Employees per 10,000 Population
	General		Current Operation	
	Total*	Per Capita	Total*	
1967	$ 106,675	$ 539.14	$ 68,248	378
1972	188,825	906.80	125,630	444
1973	205,195	977.81	138,974	456
1974	226,032	1,069.27	154,810	466
1975	266,483	1,250.38	180,976	478
1976	305,268	1,422.11	204,976	475
	Average Annual Growth Rates			
67-72	10.0%	9.1%	10.17%	2.7%
72-73	8.7	7.8	10.5	2.7
74	10.1	9.1	11.6	2.2
74-75	17.9	16.9	16.5	2.5
75-76	14.6	13.7	12.9	-.01

SOURCE: U.S. Bureau of the Census, Governmental Finances, Selected years, 1967-76, U.S. Government Printing Office, Washington, D.C.; and U.S. Bureau of the Census, Public Employment in 1976, Series GE 76-No. 1, U.S. Government Printing Office, Washington, D.C., 1977.

*illions of dollars

If the problem is one of mismanagement, then reorganization and/or the adoption of new technology and innovative procedures would imply the possibility of expenditure control. If growing service explanations are appropriate, then the anticipated decline in school-age population and any decline in the size of the dependent population which accompanies growth in the economy should provide some relief. Alternatively, if cost pressures are the principal cause of growth, then the outlook is for continued expenditure growth.

Demand Considerations

An obvious question to be posed when confronted with such rapid growth in expenditures is whether it has been a response to increased service needs. As is well known, the search for the answer to such a question is a maze of pitfalls, arising out of the difficulties and complications associated with the measurement of public output and service levels.[1] However, the extent to which service level increases have accompanied expenditure growth can be evaluated in ways that are rough and crude, but which can be taken as indicative.[2]

Despite the fact that the pace of growth in state and local government expenditures has stepped up during the last few years, rates of public employment growth have continually declined during this decade (Table 2). Since 1973, the reins appear to have been drawn increasingly tight on educational employment by all levels of government, and on total employment by municipalities. In the latter case, employment reductions in 1976 offset the growth of the two previous

---

[1] These problems have been discussed in the context of case study evaluations of local government productivity and performance in David Greytak, Donald Phares, and Elaine Morley, Municipal Output and Performance in New York City (Lexington Books, 1975).

[2] For a detailed case study account of the relation between expenditure, service levels, and productivity, see Jesse Burkhead and John P. Ross, Productivity in the Local Government Sector (Lexington: D.C. Heath and Company, 1974).

Table 2

Employment (Full Time Equivalent) of State and Local Government, 1962-1976
(in thousands)

	State & Local	State	Local	Municipalities	Education
1962	5958	1478	4480	1486	2730
1972	9237	2487	6750	2029	4585
1973	9578	2547	7031	2109	4751
1974	9852	2653	7199	2127	4901
1975	10098	2744	7354	2142	4952
1976	10206	2799	7407	2107	5003
			Average Annual Growth Rates		
1962-72	4.5%	5.3%	4.2%	3.2%	9.1%
1972-73	3.7	2.4	4.2	3.9	3.6
1973-74	2.9	4.2	2.4	0.9	3.2
1974-75	2.5	3.4	2.2	0.7	0.1
1975-76	1.1	2.0	0.7	-1.7	0.1

SOURCE: U.S. Bureau of the Census, Public Employment in 1976, Table 2.

years and, in 1976, the municipal full-time equivalent employment level was below that of 1973.

It could be argued that the recent decline in municipal employment reflects just the substantial employment rollback which has occurred in New York City. However, the record for large cities shows that employment reductions have occurred in a number of cities during recent years. In 1976, half of the twenty largest cities reportedly cut back the number of employees on their payrolls.[3] The case is similar with total state and local government employment. Although state and local government employment has continually increased, the rate of growth in per capita employment has been at a much lower rate, in the neighborhood of two to three percent, than that in expenditures. In fact, per capita employment declined in 1976 despite the increase in expenditures. In addition, expenditures for current operations have increased more slowly than total expenditures since 1974, whereas in previous years the reverse was the case. The implication is that state and local government expenditures for labor and other services directly related to the provision of public services account for a smaller share of total expenditures than had been the case in the recent past. To the extent that service levels are closely related to employment and expenditures for current operations, these differences in rates of increase can be taken as an indication that factors other than expansion of current service levels account for an increasing share of the growth in state and local government expenditures.[4] Whether this trend can be related to the growing importance of state

---

[3]Roy Bahl et al., The Outlook for City Fiscal Performance in Declining Regions (Syracuse, N.Y.: Metropolitan Studies Program, Syracuse University, 5 April 1978).

[4]Other than current operation expenditures, total direct expenditures includes capital outlays, interest on debt, insurance benefits and repayments, and assistance and subsidies. Of these, changes in the latter are likely to be closely related to changes in service levels, i.e., welfare payments. However, the share of state and local direct expenditures which assistance and subsidies accounts for has declined since 1971.

governments, whose share of total state and local expenditures increased from 37.2 percent in 1967 to 40.8 percent in 1976, is an interesting, but at this point unanswerable, question.

Of course, it could be that, because of increased productivity, public sector employment growth understates the increase in service levels. However, it is doubtful that the technology and efficiency of governmental operations have changed sufficiently to allow a service level increase commensurate with growth in per capita expenditures. Given the contrast between the patterns of growth in state and local government expenditures and employment, the association between increasing expenditures and employment additions seems weak at best. Moreover, the implication that government expenditures and costs of operation have increased more rapidly than levels of service seems inescapable.[5] As will be discussed later, state and local government employment additions themselves can be held accountable for a relatively small part of expenditure growth.

Cost Considerations

Although state and local governments apparently have been able to put the brake on employment growth, the record is much different when it comes to employee compensation. Indeed, the average wage rates of state and local government employees have increased regularly since 1967 (Table 3); and, since 1972, they have increased at rates which exceed the rate for the previous ten years. This would seem to lend credibility to the many accusations about excessive pay rates for state and local government employees. In fact, state and local government wage rates have been above the average private industry wage level for some time. However, since 1973, the

---

[5] Similar conclusions have been drawn from case studies of city and state governments. See Roy W. Bahl, The Long Term Fiscal Outlook for New York State (Syracuse, N.Y.: Metropolitan Studies Program, Syracuse University, mimeo, n.d.); and David Greytak, Status and Prospects for Maryland's Public and Private Sectors (Baltimore, Md.: Center for Metropolitan Planning and Research, The Johns Hopkins University, Occasional Paper, February 1978).

Table 3

Average Annual Wages and Salaries Per Full Time Equivalent Equivalent Employee by Industry, 1972-76[1]

	Private Industry	Federal Civilian	State & Local Government
1962	$ 5082	$ 6239	$ 5017
1972	8590	12679	8916
1973	9106	13497	9505
1974	9832	14112	10063
1975	10690	15195	10862
1976	11486	16201	11572
	Average Annual Growth Rates		
1962-72	5.4%	7.4%	5.9%
1972-73	6.0	6.5	6.6
1973-74	8.0	4.6	5.9
1974-75	8.7	7.7	7.9
1975-76	7.4	6.6	6.5

SOURCE: U.S. Department of Commerce, Office of Business Economics, The National Income and Product Accounts of the United States, 1929-1965, Tables 6.2 and 6.4.

[1] Calendar years.

difference has been continually eroded as private sector wage rates increased at a greater rate than those in the state and local government sector. Alternatively, the gap between federal civilian and state and local government wage rates has narrowed since 1972. Thus, while the case for excessive state and local government pay rate increases is questioned by comparison with private sector pay rates, it garners strength in a comparison with federal civilian pay rate increases.

Wages and salaries are not the only components of employee compensation. Indeed, they are not even the fastest growing component. Fringe benefits and supplements such as pensions, health and hospital insurance, and social security coverage add considerably to employee costs (Table 4). Since 1971, these costs have grown quite rapidly in the private and federal civilian sectors (about 66 and 87 percent, respectively), as well as in the state and local government sector (66 percent). Although wage and salary supplements in the federal sector have been and continue to be quite large, the advantage of private over state and local government employees has declined slightly since 1972. Still, in 1976, the cost of supplements averaged about $1848 per employee in the state and local government sector. This is a significant amount, i.e., about 16 percent of average earnings.

There is serious question as to whether levels of pension expenditures reflect the true cost of these programs. Indeed, the pension systems to which a number of state and local government employees belong are funded on a pay-as-you-go basis.[6] A more appropriate means of financing pension plans is through full funding. In this case, the employer sets aside funds which, when invested, are sufficient to cover the claim on future benefits that employees accumulate during their working

[6]For example, Pittsburgh, Seattle, Indianapolis, and Washington, D.C., are among the major cities which use pay-as-you-go financing.

Table 4

Average Annual Supplements to Wages and Salaries Per Full Time Equivalent Employee by Industry, 1962-1976[1]

	Private Industry	Federal Civilian	State and Local Government
1962	$ 482	N/A	$ 431
1972	1,150	$1,497	1,110
1973	1,331	1,689	1,248
1974	1,485	2,006	1,437
1975	1,706	2,442	1,619
1976	1,904	2,809	1,848
	Average Annual Growth Rates		
1962-1972	9.1%	N/A	9.9%
1972-1973	15.7	12.8%	12.4
1973-1974	11.6	18.8	15.1
1974-1975	14.9	21.7	12.1
1975-1976	11.6	15.0	14.1

SOURCE: U.S. Department of Commerce, Office of Business Economics, The National Income and Product Accounts of the United States, 1929-1965, Tables 6.4 and 6.7.

N/A - Data are not available

[1]Calendar years

33-595 O - 78 - 11

lives. Indeed, most pension plans in the public sector claim to be of the fully funded rather than of the pay-as-you-go variety. Still, there are strong reasons to believe that even these are under funded.[7] If indeed this is the case, state and local expenditures have not increased sufficiently to cover their full obligations. Moreover, those governments which have underfunded pension plans will be faced, at some later date, with sharply increased employee pension costs, even with no increases in employment, pay rates, or benefit packages.

Be that as it may, even if the cost of fully funded pension plans were to be included in the figures for supplements, the true cost of fringe benefits would be understated. In all sectors of the economy, employees receive substantial fringe benefits in the form of paid vacations, holidays, sick leave, and the like. When the cost of these is added to that of wage and salary supplements, fringe benefit cost relative to pay for actual hours worked jumps dramatically (Table 5). The ratio of fringe cost to pay for hours worked is particularly high for police, 46.8 percent, and fire, 47.2 percent. The ratio for sanitation, 43.3 percent, is a good bit lower, but still 10 percent above that for other general municipal employees, 39.37 percent, which aligns closely with the private sectors of the economy.

Whether there is an appropriate relation between the full cost of fringe and supplements and pay for hours worked is not at issue here, nor is the question of whether these costs should be equated within the public sector or between the public and private sectors. Rather, for present purposes, the point is that fringes and supplements account for a substantial share of government expenditures. Moreover, that share appears to be increasing even faster than average salaries.

The fact that pensions and fringe benefits have been growing more rapidly than total payroll outlays implies that governments have been more willing to provide

---

[7] Labor-Management Relations Service of the National League of Cities, U.S. Conference of Mayors, National Association of Counties, First National Survey of Employee Benefits for Full Time Personnel of U.S. Municipalities, Special Report: A Spotlight on City Employee Benefits (Washington, D.C.: Labor Management Relations Service, n.d.); Thomas P. Bleakney, Retirement Systems for Public Employees (Homewood, Ill.: Richard D. Irwin, Inc., 1972); and Advisory Commission on Intergovernmental

Table 5

Annual Pay for Hours Worked and Employer Cost for Fringe Benefits, Employees of Selected Municipalities and All Private Industry, 1973 and 1975

	Annual Pay for Hours Worked			Employer Cost of Fringe Benefits			Fringe Benefit Cost as a Percentage of Pay for Hours Worked	
	Amount		Percentage Change	Amount		Percentage Change	1973	1975
	1973	1975	1973-1975	1973	1975	1973-1975		
Police	$9170	$10699	16.7%	$3878	$5002	29.0%	42.3%	46.8%
Fire	8973	10194	13.6	3969	4812	30.2	41.2	47.2
Sanitation	6868	8232	19.9	2737	3567	30.3	39.9	43.3
Other General Municipal Employees	7409	8182	10.4	2730	3215	17.8	36.8	39.3
All Private Industry	8167	9318	14.1	3007	3713	23.5	36.8	39.8
All Manufacturing Industry	8092	9126	12.8	2907	3651	25.6	35.9	40.0
All Non-Manufacturing Industry	8238	9571	16.2	3151	3799	2016	38.2	39.7

SOURCE: Edward H. Friend and Albert Pike, III, 1975 National Survey of Employee Benefits for Full-Time Personnel of U.S. Municipalities, Washington, D.C.: Labor Management Relations Service of the National League of Cities, 1977, pp. 48 and 49.

increases in supplement and fringe packages than they have been to grant wage and salary increases. Or it could be that employees have bargained more actively for fringe benefits than for wage and salary increments. Whichever the case may be, the data are consistent with the hypothesis that, rather than grant highly visible and immediately payable wage increments, state and local governments have provided compensation increases which have low public visibility and whose full cost may not appear on the public ledger for some time.

The social security element of the fringe package is deserving of special note. Currently, about 70 percent of state and local government employees work for jurisdictions which participate in social security. As a result of recent legislation, the social security tax rate and the level of earnings subject to the tax are being increased in a stepwise fashion over a number of years. There can be no doubt that this, too, will increase the employee compensation costs of state and local governments.

Inflation

Although widely recognized as a factor underlying cost increases in all sectors of the economy, the impact of inflation on state and local governments is difficult to calculate from generally available price indexes. Under the sponsorship of the National Science Foundation, the Metropolitan Studies Program at the Maxwell School of Syracuse University has developed a set of inflation indexes which measures inflation's impact on both expenditures and revenues.[8] These indexes have been calculated for the periods 1967-72, 1972-74, and 1974-76 (Table 6). Examination of these indexes reveals the susceptibility of government expenditures to inflationary pressure. For example, during the 1967-72 period, the rates of price increases were

---

[8] David Greytak and Bernard Jump, "Inflation and Local Government Expenditures and Revenues: Method and Case Studies," Public Finance Quarterly 5, No. 3 (July 1977); and The Effects of Inflation on State and Local Government Finances, 1976-1974 (Syracuse, N.Y.: Metropolitan Studies Program, Syracuse University, Occasional Paper No. 25, 1975).

Table 6

Inflation Indexes for State and Local Government Expenditures
and Tax Bases by Type of Government,
Selected Periods, 1967-1972

	Expenditure Indexes			Revenue Indexes		
	1967-72	1972-74	1974-76	1967-72	1972-74	1974-76
States	122.6	125.4	112.2	115.2	116.6	110.0
Counties	122.7	125.4	112.0	127.7	116.7	114.2
Municipalities	122.8	125.4	112.1	123.7	115.4	113.3
Townships	122.1	125.6	112.6	130.0	114.8	113.9
School Districts	123.7	125.0	110.7	132.2	119.2	116.4
Special Districts	121.8	125.7	113.4	114.8	113.3	109.6
All State & Local	123.0	125.2	112.0	121.2	116.9	110.9

SOURCE: Inflation indexes computed using methods and data sources noted in David Greytak and Bernard Jump, The Effects of Inflation on State and Local Government Finances, 1967-1974, Syracuse, N.Y.: Metropolitan Studies Program, Syracuse University, 1975); and Roy Bahl et al., The Outlook for City Fiscal Performance, Syracuse, N.Y.: Metropolitan Studies Program, Syracuse University, 1978.

relatively modest, but sufficient to increase the costs of the goods and services purchased by state and local governments by slightly more than five percent per year, or roughly by 22 to 23 percent over the five-year period. During the 1972-74 period, inflation hit the double digit level, and resulted in a two-year increase in prices paid by state and local governments of 25 percent. The decline in the rate of inflation between 1974 and 1976 is reflected by a lower rate of increase in the prices paid by government. Still, over the two-year period, the indexes indicate that inflation boosted prices paid by governments by 12 percent.

Over the whole ten-year span, the prices of the goods and services purchased by local governments increased by a full seventy-five percent. That is to say that, if state and local governments did no more than absorb price and cost of living increases while holding service levels constant, the cost of the services provided in 1967 would be seventy-five percent greater in 1976. Note, however, the major part of these cost increases has occurred in the post-1972 period.

As indicated in Table 7, over the period 1972-76, the prices of goods and services purchased by state and local governments increased by roughly forty percent. That is to say that, if state and local governments had done no more than absorb the price increases on the goods and services they purchase from the private sector, while maintaining the real value of the compensation paid to their employees and transfer recipients, their cost would have increased by about forty percent between 1972 and 1976. Under such conditions, a large proportion of expenditure increases, fully two-thirds for local governments and 43 percent for state governments, could be attributed to inflation.[9] Still, the data in Table 7 indicate that only a

[9]The share of expenditure increases not associated with inflation or employment growth can be attributed to increased purchases of goods and services from the private market, changes in the real value of employee and transfer recipient compensation, and increased numbers of transfer recipients. With the data at hand, it is not possible to determine whether state and local government employees and/or transfer recipients compensation increased sufficient to offset cost of living increases. However, the available evidence indicates that, while it is unlikely that the real compensation of public employees increased, any decreases which might have occurred would not significantly alter the conclusions stated in the text.

Table 7

Selected Data Related to the Growth in State and Local Government Expenditures by Source, 1972-1976

	State	Local	State and Local
Total Expenditure Growth (millions)[a]	$ 28,385	$ 50,379	$ 78,757
Growth Index	152.30	150.57	151.05
Inflation Index	140.80	139.87	140.18
Percent of Expenditure Growth due to Inflation	42.81%	67.94%	64.09%
Percent of Expenditure Growth due to Employment Increase	15.89%	21.23%	19.30%

[a]Excludes intergovernmental expenditures.

SOURCE: See Table 6.

relatively small proportion of state, 15.9 percent, and local, 21.2 percent, expenditure increases can be attributed to additions to their work force. Thus, it would appear that, certainly in the case of local governments, inflation and employment growth account for such a large share of expenditure growth that little of the increasing costs can be attributed to increases in the real rates of employee compensation. There can be little doubt that inflation has been a major factor underlying the increasing cost of state and, more particularly, local governments.[10]

Inflation is also important on the revenue side of the government ledger, for inflation affects the monetary values of property, retail sales, and personal and corporate income as well as other components of the state and local tax base. However, none of the generally available price indexes provides an appropriate measure of the extent to which price increases have affected tax bases and tax revenues. Inflation indexes for state and local government revenue systems have been developed and implemented as a result of the project mentioned earlier (Table 6). These indexes indicate what effect inflation-induced increases in the nominal value of local revenue bases would have had on revenues if such increases had been taxed at the rates which prevalied in the base year.

An examination of these indexes indicates a number of interesting findings. First, there is a good deal of variability in the extent to which inflation impacts on the tax bases of various types of government. For example, county and school district tax bases appear to have been fairly responsive to inflation, while those of state systems appear to be somewhat less so. Second, during the 1972-74 period of double digit rates of price increases, inflation had a greater effect on expenditures than on tax bases, although in the period 1974-76, the dampening of inflation did allow inflation-induced increases in tax bases to nearly match inflation-generated expenditure increases.

Perhaps a more illustrative way to depict this effect is to consider the effect

---

[10] In an earlier analysis of the 1967-72 period, these proportions were reversed; i.e., employment accounted for the major share of expenditure growth, while only about twenty percent of cost increases could be attributed to inflation. See Greytak and Jump, The Effects of Inflation on State and Local Government Finances..., op. cit.

of inflation on the purchasing power of government tax bases (Table 8). This analysis clearly identifies the strain which has been placed on local governments by inflation. The purchasing power of state and local tax bases fell by about 8.5 percent between 1967 and 1972, and by another 7.6 percent between 1972 and 1976. Given this erosion in tax bases, there can be little doubt that inflation has been a major source of fiscal strain to state and local governments. However, during the period 1972-74, when price increases were at double digit rates, inflation reduced the purchasing power of state and local government tax bases to 93.3 percent of their 1972 level. Between 1974 and 1976, inflationary pressures declined such that purchasing power of the combined state and local tax base was eroded only slightly, i.e., by one percent. However, it must be noted that, between 1974 and 1976, when inflation really hit the land and housing markets, those governments heavily dependent on property taxes (municipalities, townships, and school districts) experienced an increase in the purchasing power of their tax bases. For no level of government was this increase sufficient to offset the purchasing power loss they had experienced since 1967. However, between 1974 and 1976, inflation so enhanced the tax bases of school districts that, by 1976, the purchasing power of their tax bases had been re-established at 1972 levels. No other level of government has been so fortunate.

What these data portray is the susceptibility of state and local governments to inflation. Moreover, they imply that inflation impacts on governments depend critically on the structure of their tax system and the pattern of price increases. For surely, if property values had not so greatly inflated between 1974 and 1976, property tax dependent governments (municipalities, townships, and school districts) would not have experienced the increases in tax base purchasing power they did.

There remains the question of whether these governments were able to realize the increase in tax base purchasing power which occurred between 1974 and 1976. Realization of the changes in tax base purchasing power requires a tax structure capable of capturing as revenues inflation-induced increases in the nominal values

Table 8

Purchasing Power Indexes for State and Local Government Revenue Bases, Selected Periods, 1967-1976[a]

	1967-1972	1972-1974	1974-1976	1972-1976
States	90.59	92.98	98.04	91.12
Counties	92.43	93.06	98.04	94.88
Municipalities	91.39	92.03	101.03	92.96
Townships	92.51	91.40	101.11	92.37
School Districts	94.32	95.36	105.15	100.00
Special Districts	89.89	90.14	96.64	87.16
All State and Local	91.54	93.30	99.00	92.44

[a]Excludes intergovernmental aid.

SOURCE: See Table 6.

of tax bases, while maintaining compensation constant in real terms.[11] Realization of tax base expansion, whether due to inflation or not, essentially is automatic in the case of those taxes whose bases are defined in the market and which are self reported, e.g., retail sales, personal income, and corporate income. The revenues from taxes with progressive rate structures, as is the case with most state income taxes, will increase faster than the tax base because taxpayers automatically move to higher rate brackets as their income increases. This suggests that the inflation indexes understate the effect of inflation on the revenues of those governments which rely on a progressive income tax Alternatively, realization of the revenue potential of tax base expansion of those taxes whose bases must be measured is not automatic. The property tax is most representative of this type of tax. Reassessment lags are common, and suggest that the indexes and the analysis based on them would overstate effects of inflation on tax revenues. However, in those jurisdictions where reassessments are frequent, base changes are quickly translated into revenues if tax rates do not decrease. One state in which prompt and accurat reassessment is the rule is California. This being the case, the analysis here suggests that the actual purchasing power of the local governments in California, although declining between 1972 and 1974, increased markedly between 1974 and 1976.

The implication, of course, is that, for a period of at least seven years (1967-74), the pressure of inflation for expenditure increases exceeded that on the expansion of nominal tax bases. Then suddenly, between 1974 and 1976, a reversal occurred and the inflation-induced expansion in nominal tax base and, because of timely and accurate tax reassessment, tax revenues was greater than that for expenditures. In such a situation, it does not take much imagination to envision the plight of local public officials. Conditioned by the experience of the past seven years, the budgetary slack produced by inflation between 1974 and 1976 was a surprise, and,

---

[11] For an expanded discussion of these considerations, see David Greytak and Bernard Jump, <u>The Impact of Inflation on the Expenditures and Revenues of Six Local Governments, 1971-1979</u> (Syracuse, N.Y.: Metropolitan Studies Program, Syracuse University, Occasional Paper, December 1975).

no doubt, a welcome one. However, uncertainty as to the permanence of the newly emergent source of revenue growth most likely precluded either the adoption of new expenditure commitments or, via tax cuts, the sharing of what might be a one-time shot of relief from the longer term pressures of inflation on public budgets. All the same, it does not take a great deal of understanding to comprehend the plight of the taxpayer. Subjected to a progressive state income tax, income taxes, at least since 1967, increased more than proportionate to income as inflation moved taxpayers to higher tax brackets. Property taxes were also increasing as inflation drove up assessments at rates which accelerated. As a result, at mid-decade, California's already high tax burdens increased at even greater rates. Such circumstances lead to tax burden increases unaccompanied by service level expansion, and they are fuel for tax revolt.

PART II

PUBLIC POLICY

There are at least three objectives which should guide public policy directed toward the control of local government cost increases. The first is the equity objective, i.e., to improve or at least not reduce the absolute or relative real income and living circumstances of the poor and disadvantaged. Proposals to cut local government service levels under this objective require close scrutiny and evaluation, for reductions in the major local government programs (police, fire, sanitation, and education) are likely to fall particularly on the poor and disadvantaged.

A second, or efficiency, objective of public policies should be to improve the management capabilities of local governments. Here, federal and state programs of technical assistance, improvements in financial management, programs of longer term facilities and fiscal planning, better coordination among governments, coordination of state and federal grant programs, and improved reporting and monitoring of all programs are all part of reforms that might improve the management capabilities of local governments.

A third objective should be the maintenance of local control over local expenditure decisions. This extends beyond the simple one man, one vote notion of local government. Rather, it refers to the ability of locally elected officials, first, to perceive the expenditure needs and preferences of their citizenry and then to move toward the satisfaction of them without undue interference from higher levels of government. In part, this requires that local officials be informed of and responsive to the desires of their constituents and the circumstances surrounding their lives. It also implies that local officials not be so circumscribed by regulations and legal restrictions that they are unable to alter the types and levels of service their governments provide.

In fact, the equity objective is the one which should dominate in the consideration of policy options. If the concept of expenditure control is to have substance, it argues for a realignment of expenditures consistent with the needs of local governments' clientele. In a real sense, it means excessive and unessential service must be cut back and the cost of increases of the necessary activities of local governments restrained. Since such a large part of the services and programs provided by local governments, especially education and police and fire protection, is of greater importance to the poor than to the rich, and since access to private market alternatives is greater among the non-poor, expenditure control means achieving the equity objective with a smaller share of local income.

The substance of the management and productivity objective is efficiency in the use of public resources to achieve public ends. In this sense, it is an objective which is subservient to the others. However, administrative and management reorganization have the appealing characteristic of being relatively inexpensive, although their success is difficult to evaluate. The local control objective dictates a careful evaluation of the possible responses to taxpayer revolt. Limitations and controls which are rigidly set by law can impede or preclude local officials responding to changes in the desires or circumstances of their constituents. State assumption of local functions as well as federal and state mandated programs and aid programs which are designed to promote priorities set above the local level can similarly reduce local control.

Policy Options and Problems

Perhaps the policy most often associated with attempts to restrain expenditure growth involves employment and wage freezes. In light of the labor intensity of local governments and the importance of labor cost in their budgets, such policies would seem appropriate. However, in addition to their unpopularity among employees and their bargaining agents, the effectiveness of employment and wage freezes depends on a number of factors. Indeed, it is possible that, even with employment or wage freezes, the number of public workers and/or their compensation rates may increase.

Unless lids are placed on the number of actual employees rather than authorized positions the actual government workforce can continue to grow as budgeted, but vacant positions are filled. Similarly, wage freezes may not eliminate labor cost increases, even if they are accompanied by no growth in the local government employment. This is so for wage freezes generally do not apply to such things as seniority and cost of living raises which are incorporated in salary scales and employment contracts. While these considerations question the efficacy of employment and wage freezes, there are other equally important considerations.

Employment and wage rate freezes, particularly those of the across the board variety, can interfere with the efficiency and local control objectives. On efficiency grounds, it can be argued that freezes preclude or make difficult the allocation of new resources, and perhaps the reallocation of existing public money in accordance with changing priorities and/or changes in the basic prices and costs of providing public services. The inefficiency is, of course, that government resources will not be allocated in a manner which conforms with the basic productivity and relative cost characteristics of production.

In terms of local control, freezes have the effect of setting budget shares and/or employment levels at some specified level, usually those in effect at the initiation of the freeze. In effect, for the duration of a freeze, local control over the setting of budget or employment priorities is replaced by the fiat of regulation. Beyond this, policies which preclude or make difficult a shift of public monies among local government activities may violate the equity objective. This would occur when priorities dictate that additional money be allocated to activities which are of particular benefit to the low income or needy population.

There also exist questions of interjurisdictional as opposed to interpersonal equity. Just as there are rich and poor people, there are rich and poor jurisdictions. Public policies which apply to all jurisdictions may not affect all equally. For example, freezes or cutbacks in revenues or expenditures will likely have a greater effect on poor jurisdictions where expenditure needs are already high relative to their tax base, e.g., central cities.

If the patterns of past behavior of those governments which have attempted to reduce costs are indicative of what the future holds, then reductions in local government employment levels can be anticipated. Reduction in public employment levels, however, unless accompanied by major increases in employee productivity, will lead to reductions in the quantity or quality of public services. This alternative raises serious equity questions, since the economically disadvantaged are among the major beneficiaries of the local public services, particularly in central cities.

Moreover, this alternative must confront the resistance of public employee organizations to reductions in their numbers. While the fact is that some cities and their unions apparently have been able to negotiate employment reductions, the potential for really major deductions is limited, for major service reductions, unless accompanied by similar reduction by all neighboring governments, are likely to incite or accelerate the outmigration of the more mobile upper income population, and thus aggravate the localities' fiscal problems.

Alternatively, non-labor expenditures may be cut with little or no immediately perceptible impact on the quality of public services. In particular, capital expenditures for the maintenance and repair of public capital may be curtailed. The efficacy of such a move is indeed questionable for such a policy does not eliminate expenditures in a real sense, but rather simply defers them to a later date. Moreover, the deterioration of public facilities such as streets, bridges, schools, sanitation facilities, and the like may lead to outmovement of business and industry, as well as upper income populations. This, too, may result in complicating rather than relieving city fiscal problems, although this may not occur immediately.

Another often advocated alternative for reducing the scope of local government is that of shifting responsibility to higher levels of government. This is most often suggested in regard to courts, some aspects of education, welfare, and health and hospital programs, as well as some administrative operations, e.g., property assessment. This alternative must confront a set of equity questions which

.: always recognized. For, if states are to adopt the financial responsibilities .ograms currently funded out of local revenues, then states will either have to ..k expenditures on other programs or raise additional taxes. State adoption .cal programs, if financed by reducing expenditures on programs of primary benefit :. economically disadvantaged, are unpalatable on equity grounds. Alternatively, . assumptions financed by new state revenues may have adverse income distribution .quences. For example, if the state relies on sales taxes rather than on .essive income taxes, the aggregate tax burden on the poor will likely increase.[12]

Whether a greater state role in combined state-local spending accommodates the .y objective is a serious question. On the one hand, most equity type programs grow .f broad social concerns and thus would seem to be the responsibility of state (or .al) rather than local governments. Moreover, there is a general presumption that : is a greater degree of progressivity in state than local tax systems, and that .y improvements will be achieved by state financing. However, increasingly, .ists and tax experts are of the opinion that the property tax is progressive, and .s to a very high degree. Thus, the equity implications of state versus local tax ..ing have become a serious issue, and one which is not likely to be quickly resolved .ly, there is serious question as to whether state legislatures, increasingly domi- .d by suburban legislators, will be responsive to the special needs of central cities .he relatively low-income population. Equity issues aside, state financing raise issue of local control, for, if state control accompanies state financing, then it . contrary to the local control objective.

Additional intergovernmental aid is often recommended as a means of reducing . local expenditure requirements associated with the services and activities of .l governments. If intergovernmental aid money is fully substituted for local .y, the serious issue is the same as that confronting state assumption of pro-

[12] Roy W. Bahl and Walter Vogt, "State and Regional Government Financing of Urban .lic Services," in A.K. Campbell and R. Bahl (eds.), State and Local Government: Political Economy of Reform (New York: The Free Press, 1976), pp. 96-126.

grams, i.e., the implications for the tax burdens of the poor. On these grounds, federal aid would seem preferable to state aid because of the greater progressivity of its tax system. An equally serious issue, and one which strikes at the heart of the argument for intergovernmental aid, has to do with the question of whether such aid substitutes for or stimulates the expenditures of recipients. Although this question has been subjected to a great deal of research, a definitive answer has not been produced as yet. However, in collaboration with the Advisory Commission on Intergovernmental Relations, the Metropolitan Studies Program of the Maxwell School has recently completed a review of the evidence and an analysis of the substitution-stimulation question of a wide variety of state and federal aid programs.[13] Their findings, while not lending themselves to a single unqualified evaluation, strongly indicate that aid has led to increased rather than reduced local expenditures. Whether the current dissatisfaction with the operation of the local public sector would be sufficient to make local officials see additional aid monies as a means of dollar for dollar tax reductions rather than providing the budgetary slack for additional expenditures is a question which cannot now be answered.

Finally, with regard to intergovernmental aid, there is the issue of local control. Here the question is whether programmatic aid leads to the provision of the types of service which are most desired by the constituents of local governments. If one takes the statements of the officials whose responsibility it is to implement state and federal aid programs at the local level as indicative of popular sentiment, then the efficacy of current aid programs is questionable. Generally, local officials are close to unanimous in the opinion that expenditure restrictions associated with aid programs mitigate their ability to provide the types and levels of service in conformity with local preferences and priorities.[14] Thus, many aid programs are in conflict with the objectives of local control.

---

[13] Advisory Commission on Intergovernmental Relations, Federal Grants: Their Effects on State-Local Expenditures, Employment Levels, Wage Rates, A-61 (Washington, D.C.: U.S. Government Printing Office, 1977); and The States and Intergovernmental Aids, A-59 (Washington, D.C.: U.S. Government Printing Office, February 1977).

[14] David B. Walker, "A New Intergovernmental System in 1977," Publius 8, No. 1, (Winter 1977):101-116.

To many, however, this may not constitute a legitimate issue, for many aid programs have as their purpose the provision of services which, if left to local discretion, woul not be provided; or, if provided, would be at levels not consistent with the preference of the broader society. While there can be little doubt that reduction or elimination of many of the expenditure restrictions associated with aid programs would accommodate the objectives of local control, there remains the question of their consistency with other objectives. As to efficiency, one would guess that restrictions and their monitoring generate a good deal of accounting and paperwork. If relieved of these encumbrances some reduction in the costs of local government management could occur. However, it is unlikely that such savings would be sizable.

State and federal dictates as to types and levels of local expenditure extend far beyond aid programs. Mandates necessitating local expenditures are common, and extend from state safety specifications dictating the number and position of traffic lights to conventions governing property tax collections.[15] These, too, may be deemed necessary and appropriate for social achievement, with benefits to broader society. As there is little known about the actual cost implications of such mandates, little can be said about the magnitude of local expenditure reductions which could be associated with the elimination of or compensation for state or federal mandated expenditures. What can be said, however, is that full reimbursement of the cost of local activities which are the results of state and federal mandates would relieve local governments of the associated financial burdens. It is difficult to identify the amounts of money that would be involved, for so little is known about the fiscal implications of mandating.

The most common alternatives to expenditure freezes and cuts are limits placed on local taxes and taxing power. In the first instance, revenue limits place greater pressure on public officials to monitor and evaluate their expenditure commitments and

[15]The local government cost implications of state and federal mandates is an area in which our knowledge is vastly deficient. Initial study of this topic has been undertaken by the Advisory Commission on Intergovernmental Relations, "Tax Lids and Expenditure Mandates: The Case for Fiscal Fair Play," Intergovernmental Perspective 3, No. 3 (Summer 1977):7-12. For a list of state mandates affecting local governments in one state, see Connecticut Conference of Municipalities, "State Mandates to Cities and Towns" (New Haven, Conn.: CCM, mimeo, March 1976).

may lead to serious efforts to economize. The implications of such efforts are for better management and increased productivity. However, benefits of this nature, such as they may be, come about as a result of the loss of local control over taxation and revenue raising power which is inherent in the establishment of tax limits. In this regard, limits on local powers of property taxation are particularly important, for the property tax is the one tax over which local governments have had control. In effect, property tax limits greatly curtail local fiscal authority, although they may have the beneficial effect of enhancing management of the principal area rémaining under local control, i.e., the expenditure size of the local budget. One cannot be sanguine about such possibilities, for, although local tax and revenue limits have a long history, their effectiveness as a means of expenditure control is not a matter of certitude. The Advisory Commission on Intergovernmental Relations recently reported research findings which indicate that local tax limits are associated with lower level expenditures from own sources.[16] However, the bulk of evidence suggests that local tax limits have no effect on total state and local expenditures and tax burdens. The implication is that, to the extent that local tax limits are restraining taxation and spending by local governments, the state government adopts additional expenditure responsibilities. Wheth such shifts in expenditure responsibilities mitigate the incentive of tax limits for better management of local government is an open question. In addition, the implication is that tax limit policies give rise to the broader equity and local control issues associated with state assumption and state aid.

Within the class of actions which attempt to achieve expenditure control indirectly by limiting revenues are full disclosure restrictions. Generally, these restrictions require a public hearing and a vote by public officials whenever property tax is to be levied at a rate above some previously specified rate.[17] Such procedures closely confor to the objective of local control. However, if local control involves middle and upper income groups voting out of narrow self-interest, additional funding to the smaller poverty population may not be forthcoming. Here, too, then, equity must be considered.

---

[16] Advisory Commission on Intergovernmental Relations, State Limitations on Local Taxes and Expenditures, A-64 (Washington, D.C.: U.S. Government Printing Office, February 1977).

[17] Most commonly, these procedures are required whenever the property tax is to be set at a rate which would yield revenues greater than the previous year's revenues, or, in some cases, a specified amount greater than the previous year's

CONCLUDING COMMENTS

Many of the possibilities for local government expenditure reduction involve activities which would reduce either service levels or local responsibility for the financing of service. The recent experience of California, as well as that of New York City, would suggest that state governments, however reluctant they may be, will be involved in any major attempts to cut local government expenditures. Whether this involves state aid increases or state adoption of local expenditure responsibilities, the implication is for a shift of tax burden from local to state taxpayers without any clear guarantee of a reduction in combined state and local tax burdens. Whether shifts in tax burdens are sufficient to dampen the forces of taxpayer revolt is a matter of speculation. If they are not, then the search for ways to cut the costs, or at least restrain cost increases,of state and local governments will gain force. Virtually all the alternatives raise serious questions related to the equity and local control objectives of the public sector. Care must be taken that these concerns are not lost in any attempt to reduce tax burdens.

The analysis of the factors related to the increasing cost of government has identified the growth in average employee costs as a major contributor to increases in the cost of government activities. However, despite the fairly large increases in employee compensation, the data reported herein indicate that wage rate increments in large part serve to offset increases in costs of living. In fact, inflation alone may have contributed more to the growth in local government expenditures than all other factors combined.[18] Clearly, short of major service cuts, little relief from increasing costs of government can be expected unless the federal government is more effective in its fight against inflation.

---

[18] It is worth noting that inflation also induces an increase in the income tax liabilities of federal taxpayers. One recent study estimates that, between 1972 and 1974, inflation alone may have increased the federal income tax liabilities of taxpayers by substantial amounts, e.g., between \$185 and \$470. See David Greytak and Richard McHugh, "The Effect of Federal Income Taxation and Inflation on Regional Income Inequalities," Journal of Regional Science 18, No. 1, April 1978.

Chairman REUSS. Thank you, Dr. Greytak.

And now, the widely respected John Shannon, Assistant Director of the Advisory Council for Intergovernmental Relations.

STATEMENT OF JOHN SHANNON, ASSISTANT DIRECTOR, ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS

Mr. SHANNON. Thank you, Mr. Chairman and members of the committees.

I have been asked to concentrate on the local tax situation, property tax and other related issues, and that part of my prepared statement, from page 14 on, I will summarize.

Actually, there are two questions that I hope to answer for the committee. The first: Does it still make political and economic sense to retain the property tax as a major source of local revenue in an inflation-ridden economy?

Despite obvious defects and a very poor public image, the property tax has significant political and fiscal virtues. First, it is the one major revenue source directly available to local government and, therefore, serves as a traditional defense against fiscal centralization.

Second, it is the only major tax that can capture for the community the property values created by the community.

Third, it has a high visibility, and it can work in the direction of greater public accountability.

But beyond these three considerations, there is an inescapable element of fiscal realism. The Nation's local governments will not quickly come up with an acceptable substitute for this powerful $65 billion revenue producer. That figure alone is more than the gross national product of most of the members of the United Nations. We are talking about a revenue instrument that produces more than the individual income tax and the sales tax at the State levels combined.

In view of the conservative mood of the country, it is also not likely that many State legislative bodies will be willing to solve the local property tax problem by granting broad discretion to local governments to levy income and sales taxes or by quickly relieving the local property tax of all responsibility for the financing of schools.

State legislators are much more likely to use their surplus funds to grant tax relief to property owners, rather than work out fiscal relief strategies for local governments. The State-financed plans of aid to property owners will take a variety of forms, and we are seeing it now: expanded circuit breakers, State reimbursement for partial homesteading exemptions, more tax rebates for part of the school taxes, part—not all—of the school taxes borne by homeowners. There is a major proposition under consideration in Texas on that latter point right now.

Because State takeover of local school costs is an extremely expensive venture, we are not likely to see many dramatic breakthroughs on this front immediately. It is happening over time, but is going to be slow-going.

Well, for all of these reasons, prudent public policy would dictate the adoption of measures at the State level, designed to conserve the local property tax by reducing as much as possible the high irritant content of this levy.

Well, what is the ACIR prescription for keeping the irritant level of the property taxes at tolerable levels, particularly during periods of inflation?

Our first prescription—and we think all of these need to be worked together—is a uniform system for administering the property tax. Market value appraisal of all taxable property, professional appraisers, strong supervision of local assessors, and the preparation and the disclosure of assessment ratio findings to enable taxpayer to judge the fairness of their assessments. But that all goes under the traditional rubric of assessment reform.

Second—and this is very important—is a "truth in property taxation" process, along the lines of the Florida plan, that will enable taxpayers to fix political responsibility for higher property taxes without placing fiscal shackles on local government.

In my prepared paper, I go into some detail explaining the Florida plan. Basically, there has to be a rollback of rates roughly commensurate with the increase in the base, unless the local spending authorities go through a very rigorous full-disclosure process so that the taxpayer knows that it is the school board or the city council or the county board that is responsible for that tax increase and not the assessor.

The third element in this five-ply protection program is a State-financed circuit breaker to shield homeowners and renters with low and fixed income from property tax overload situations. And, again, in the earlier part of the paper, I described why we consider the circuit breaker the instument of choice for granting taxpayer relief.

The fourth—and this bears on the Federal policymakers as well as State—is an intergovernmental "fairplay" policy. When the State mandates additional expenditure responsibilities on local government, it should be prepared to help finance the added expenditure burden. When a State mandates a partial or complete exemption from the local property tax, such as a partial homestead exemption, it should reimburse the locality for the revenue loss. And this fairplay concept, also makes good sense at the Federal level.

And the fifth would be a tax utilization philosophy that recognizes that the best property tax is a moderate tax. As with any other tax, the heavier it becomes, the less obvious its virtues, the more glaring its defects.

In my view, a moderate property tax would fall into the 1 to 1½ percent of market value range. Beyond 1½ percent of market value, the amber warning light turns on; and beyond 2 percent, certainly the red light flashes.

If a State, at least gradually, can assume the full cost of welfare and medicaid and at least 65 percent of the cost of local schools, it will probably be able to hold property tax levels below the 2-percent level. We have a map on the next page that gives FHA effective rates back in 1975. Now, there has been some change since then, but basically the picture is that the Southern States have moderate rates, the Northern States are close to 2 percent or above. In the case of Massachusetts the effective rate is, by far and away, the highest. It is 3.26, so that on a home of $100,000 in 1975, the property tax was $3,260.

There is room for guarded optimism. Many legislators may find this five-point reform program more acceptable than the radical surgery alternative prescribed by Drs. Jarvis and Gann. If this turns out to be the case, June 6, 1978, Proposition 13 Day, will also become a red letter day in the long and troubled history of the local property tax.

Thank you very much.

[Mr. Shannon's prepared statement follows:]

ADVISORY
COMMISSION ON INTERGOVERNMENTAL RELATIONS
WASHINGTON, D.C. 20575

AFTER JARVIS--A TOUGH REAPPRAISAL OF STATE-LOCAL FINANCE

A Statement by

John Shannon, Assistant Director
Advisory Commission on Intergovernmental Relations

to the
Subcommittee on the City
Committee on Banking, Finance, and Urban Affairs
U.S. House of Representatives

Washington, D.C.
July 25, 1978

Shock waves of increasing intensity have jolted the state-local finance sector during the last four years. If their severity could be measured on a scale of 1 to 10, then the 1975 New York City crisis might register a Richter-type reading of 5, the 1974-1976 recession about 8, and the 1978 California tax revolt almost 10.

While the first two shocks--the New York City crisis and the recession--strengthened the hands of the fiscal conservatives, the California tax revolt provided them with a four-point action program for slowing down the growth of state and local government.

- <u>A Massive Local Property Tax Rollback</u>--Because property cannot be taxed at more than 1 percent of its estimated 1975-1976 market value, this necessitated a property tax cut of approximately $7 billion.

- <u>A Partial Property Tax Assessment Freeze</u>--No property tax assessment can be increased in any one year by more than 2 percent unless that property is sold, at which time it can be reassessed on the basis of its market value.

- <u>Very Tight Constitutional Restrictions on Local Revenue Raisers</u>--After July 1, 1978, no tax can be increased or a new tax imposed without the approval of two-thirds of the qualified voters.

- <u>Fairly Tight Constitutional Restrictions on State Revenue Raisers</u>--No additional state taxes can be imposed unless approved by at least two-thirds of the total membership of both the Senate and the House.

Proposition 13 raises several hard questions for state and local policymakers.

<u>First, does the Jarvis approach for controlling the growth of public spending represent the wave of the future?</u> It is highly unlikely that many states could replicate all of the factors that gave such strong support for the massive rollback in local property taxes. California had a $5.5 billion surplus to cushion the initial shock of the local property tax rollback. This extraordinary surplus, together with a well above average property tax burden, a high and rising fiscal blood pressure reading, a strong populist tradition, and an unusually rapid growth in residential property values in South California all combined to give explosive support for Proposition 13.

It should also be noted that the partial assessment freeze fairly bristles with equity and uniformity issues--not many states are likely to enter this legal thicket.

While huge local property tax rollbacks or partial assessment freezes appear unlikely in most other states, the strong support for Proposition 13 will certainly hurry history along on three fronts.

1. More Restrictions on Local Tax and Spending Powers--Since 1970 at least 14 states have placed restrictions on the power of local officials to raise property taxes (Table 1).

2. More Restrictions on State Tax and Spending Powers--Since 1976 New Jersey, Michigan, Colorado, Tennessee, and now California have taken various restrictive actions to check the growth of state spending (Table 2).

3. Greater Support For Home Owner Property Tax Relief--Proposals calling for expanded circuit-breakers, split rolls, larger homestead exemptions, and tax deferrals will compete even more intensively for state legislative support.

Second, is it possible to moderate state expenditure growth rates without placing fiscal shackles on state legislative bodies? Two considerations give this question an urgency that cannot be denied. First, there is clear evidence that an increasing number of citizens no longer want the state-local sector to keep growing at a faster clip than the growth in their own income. Ever since World War II, all systems have been "go" for the Nation's largest growth industry.

The Growth of the State-Local Sector, 1948-77
(State-Local Expenditures and Taxes as a Percent of State Personal Income)

	State-Local Direct General Expenditures			Exhibit:
Fiscal Year	Total	From Own Funds (excluding federal aid)	State-Local Tax Revenue	State-Local Employees per 10,000 Population
1948	9.32%	8.34%	7.03%	240[1]
1958	12.93	11.53	8.85	298
1968	16.38	13.64	10.81	396
1976	20.32	15.90	12.47	475
1977est.	20.75	16.05[2]	12.87	485

[1]Based on population including armed forces overseas.
[2]This 1976-77 slight increase varies from an earlier ACIR finding of a slight decrease in the relation of state and local spending to gross national product. This tabulation used census data, fiscal year, and personal income. The earlier analysis used national income accounts, calendar year, and gross national product.

Source: ACIR staff computations based on U.S. Bureau of the Census, Governments Division, various reports, and staff estimates

Table 1

STATE LIMITATIONS ON LOCAL GOVERNMENT POWER TO RAISE PROPERTY TAX REVENUE, 1977

States	No Limitations	Full Disclosure of Effect of Assessment Increases on Property Tax Rate[1]	Property Tax Rate Limitation[2]	Property Tax Levy Limitation[3] (Levy = Rate x Tax Base)	Expenditure Limitation
ALABAMA			CMS		
ALASKA			M	M ('73)	
ARIZONA			M	CM	S
ARKANSAS			CMS		
CALIFORNIA			CMS		
COLORADO				CMS	
CONNECTICUT	M				
DELAWARE	MS		C		
DIST. OF COLUMBIA		M ('75)			
FLORIDA		CMS ('70)	CMS		
GEORGIA			CMS		
HAWAII		C ('76)			
IDAHO			CMS		
ILLINOIS			CMS		
INDIANA			CMS	CMS('73)	
IOWA			CMS	CM ('72)	
KANSAS			CMS	CMS ('70)	S
KENTUCKY			CMS		
LOUISIANA			CMS		
MAINE	CM				S
MARYLAND		CM ('77)			
MASSACHUSETTS	M				
MICHIGAN			CM		
MINNESOTA			MS	CM ('71)	
MISSISSIPPI			CMS		
MISSOURI			CMS		
MONTANA		CM ('74)	CMS		
NEBRASKA			CMS		
NEVADA			CMS		
NEW HAMPSHIRE	M				
NEW JERSEY					CM ('76)
NEW MEXICO			CMS		
NEW YORK			CMS		
NORTH CAROLINA			CM		
NORTH DAKOTA			CMS		
OHIO			CMS		
OKLAHOMA			CMS		
OREGON				CMS	
PENNSYLVANIA			CMS		
RHODE ISLAND	M				
SOUTH CAROLINA	CM		S		
SOUTH DAKOTA			CMS		
TENNESSEE	CM				
TEXAS			CMS		
UTAH			CMS		
VERMONT	M				
VIRGINIA		CM ('76)			
WASHINGTON			CMS	CM ('71)	
WEST VIRGINIA			CMS		
WISCONSIN				CMS ('75)	
WYOMING			CMS		

C = counties
M = municipalities
S = school districts (in some states school districts have no independent taxing authority or depend on county government for taxes, in which case the limits on the independent general government impact on school districts.)

Where underlined, the restriction is constitutional.

[1] Under a full disclosure procedure, a property tax rate is established that will provide a levy equal to the previous year's when applied to some percentage of the current year's tax base. In order to increase the levy above the amount derived by using the established rate the local governing board must advertise its intent to set a higher rate, hold public hearings, and thereafter approve, the higher rate by vote of the board.

[2] Property tax rate limitation sets a maximum rate that may be applied against the assessed value of property.

[3] Levy limitation places a maximum on the amount of revenue that can be raised by the property tax (e.g., 105% of the prior year levy).

TABLE 2

RECENT STATE RESTRICTIONS ON STATE TAX/SPENDING POWERS

State	Type of Restriction and Year of Enactment: Constitutional	Type of Restriction and Year of Enactment: Statutory	Remarks
Colorado		1977	Allows a 7% increase in general fund spending with an additional 4% to reserve fund. Amounts over 11% refunded to taxpayers.
		1978	Indexation of the state personal income tax to prevent inflation from pushing taxpayers into higher tax brackets.
Michigan		1977	Budget stabilization fund provided. Amounts in excess of 2% of adjusted personal income multiplied by previous year general purpose revenue to determine amount to be deposited in budget stabilization fund. Withdrawals are provided if there is a decrease in adjusted personal income.
New Jersey		1976	Spending increase limited to increase in the state personal income (federal series). Increase of between 9 [illegible] 10% for this year.
Tennessee	1978		Spending increase limited to growth in the economy. Increase approximately 11% this year. Provisions for full or shared costs for mandated programs to local governments.
California --	1978		Proposition 13 (Jarvis-Gann), by Constitutional revision, provides that any changes in state taxes enacted for the purpose of increasing revenues must be imposed by an Act passed by not less than two-thirds of all members elected to each of the two houses of the legislature, except that no new ad valorum taxes on real property or sales or transaction taxes on the sales of real property may be imposed.

Legislation restricting state spending powers by either Constitutional or statutory means is under a consideration in the following states: Arizona, Florida, Georgia, Hawaii, Idaho, Illinois, Iowa, Maine, Maryland, Massachusetts, Minnesota, Missouri, Ohio, South Dakota, Texas, Utah, Virginia, Washington, and Wisconsin.

Source: ACIR staff compilation. 6/9/78.

Second, there is also evidence to suggest that a part of this growth rate can be traced to imperfections in our system for holding elected officials clearly accountable for the growth in taxes and expenditures--imperfections that become more serious during inflation in these ways:

- <u>Unlegislated Tax Rate Increases</u>--Inflation subtly pushes taxpayers into higher federal and state income tax brackets.

- <u>The Diffusion and Misdirection of Political Responsibility for Higher Local Property Taxes</u>--Is the taxpayer to blame the assessor, the school board, the city council, or the county board for his tax increase?

- <u>Diffusion and Misdirection of Political Responsibility for New Spending Programs</u>--In many instances, Congress takes the political credit for enacting a new program (such as the Safe Drinking Water Act) while mandating the additional expenditure requirements on states and localities. Similarly, state legislatures often mandate new services or the upgrading of the wages and pension benefits of local employees and force the added expenditure requirements on local governments. There is also the frequent case in which one legislature will take political credit for the enactment of a new program but leave to the next legislature the task of funding it.

In order to remove these imperfections from the political marketplace, the political accountability of elected officials must be strengthened. By so doing, expenditure growth rates can be slowed down without doing violence to the concepts of representative government, majority rule, and fiscal flexibility. Examples of this strengthened accountability approach can be found on both the tax and expenditure sides of the fiscal equation.

A good example of strengthening political accountability for expenditure decisions is the 1978 Tennessee constitutional amendment that restricts state spending to the growth in the state economy. The state legislature can exceed this limit by a simple majority vote, provided it follows a full disclosure procedure. This amendment also directed the state legislature (a) to at least partially reimburse local governments for state expenditure mandates, and (b) to fully fund the first-year cost of all new state programs. In effect, then, it directs the state legislature to put its money where its mouth is.

The state of Colorado strengthened political accountability when it indexed the personal income tax this year so as to prevent inflation from pushing taxpayers into higher tax brackets. Similarly, Arizona passed a law indexing its deductions, credits, and exemptions. The ACIR has recommended this action on the grounds that higher income tax rates should result from overt state legislative action rather than as the silent consequence of inflation.

Admittedly, these various means for focusing a sharper spotlight on tax and expenditure decisions will come under attack from the hard line fiscal conservatives as very "weak tea." Underpinning their objectives is the firm conviction that elected representatives can no longer say "no" to all the various pressure groups--that their backbones must be stiffened by replacing a simple majority requirement with a constitutional provision that calls for two-thirds majority approval as the prerequisite for either the enactment of new taxes or a decision to raise expenditures significantly. In effect, this hard line approach gives the conservative minority a veto power over all major tax or expenditure decisions. It, of course, completely undercuts the concepts of representative government, majority rule, and fiscal flexibility--the Jarvis prescription.

A policy of strengthening political accountability will also come under fire from the left side of the political spectrum. Liberals are apt to oppose some of these policies on the grounds that they represent a foot in the door for the fiscal conservatives. Many liberals believe that the public sector is still undernourished, particularly in those program areas that are of most concern to the poor and minority groups. Thus, in their judgment, tax and expenditure questions should be resolved in favor or meeting these urgent public needs--not in figuring out new ways to slow down the growth in state and local government.

33-595 O - 78 - 13

Confronted with these conflicting demands and philosophies, many policymakers will opt for the middle course--that of slowing down expenditure growth rates by strengthening the political accountability of elected officials.

Third, when is a state justified in imposing a tight, permanent, lid on local property tax authorities? In the judgment of the Advisory Commission, the state is justified in adopting a permanent, tight lid policy only if the state is willing to provide adequate financial compensation to local governments. The tighter the lid, the more persuasive the case for a new source of local revenue. Adequate compensation could take the form of a major new source of tax revenue for local governments or the enactment of a substantial state program of unconditional aid to localities.

Without this compensatory action, the trend toward fiscal centralization will become even more dramatic. This centralizing tendency was clearly underscored by our findings--while state lids on local levies reduced property tax levels, this effect was offset by higher state taxes.

Fourth, can state policymakers prevent locally elected officials from reaping inflation "windfalls" from rapidly rising property tax assessments without imposing arbitrary tax and/or spending lids on localities? This issue becomes especially acute during periods of inflation when property values generally and residential property values in particular rise at a faster clip than the income of the property owner.

In many cases, local legislative bodies fail to cut back their property tax rates roughly commensurate with a substantial hike in the tax assessment base. Thus the assessor--not the local spenders--is mistakenly blamed for the resultant increase in the property tax load.

Florida has resolved this property tax windfall issue and thereby helped to moderate the growth in local spending through the adoption of a "truth-in-taxation" procedure--rather than through the imposition of arbitrary lids on local fiscal action. The author of this pioneering legislation, State Representative Carl Ogden of Florida, recently described the full disclosure procedure:

> "Every year, the tax appraisers reassess homes in light of current market values, which generally are higher than the year before. The tax rate is then reduced, so as to generate no additional revenue from the reassessment. The only "fudge factor" is new construction, which can be taxed outside the normal rolls for the first year.
>
> If last year's revenue plus the fudge factor aren't enough for this year's public expenditures, the taxing unit--for example, the city council--has to put the following quarter-page ad into the local newspaper of largest circulation: 'The City Council proposes to increase your property taxes. Hearings will be held on (such-and-such a date).'
>
> Lest you overlook the ad, it must be surrounded by thick black border.

> "If after the public hearing, the council goes ahead and raises taxes, another black-bordered, quarter-page ad must be placed: 'The City Council has voted to raise your property taxes. Hearings will be held (on such-and-such a date).' After the second set of hearings, there's another vote. Only then can taxes actually be increased."1/

While such a procedure may appear restrictive to many local officials, it nevertheless permits them to raise rates as high as they want by a simple majority vote. In effect, local officials have as much fiscal leeway as they want to exercise--provided they're willing to accept full responsibility for their decision to raise taxes.

Fifth, what is the instrument of choice for providing property tax relief to home owners? In the judgment of the Advisory Commission, a state-financeh "circuit-breaker" gets the nod. Three considerations support this judgment.

First, the circuit-breaker can provide tax relief to those who need it most at a lower cost than the homestead exemption. If the objective is to relieve residential property taxes that are unduly burdensome, the circuit-breaker can provide more meaningful relief at less cost. It targets relief dollars to those most in need of relief--those who are carrying extraordinary tax loads in relation to family income.

Second, in contrast to homestead exemptions, renters as well as home owners can be given relief under circuit-

---

1/ The Washington Post, June 19, 1978, p. D10.

breakers. On the assumption that landlords pass on a good share of their property taxes to renters in the form of higher rents, the majority of circuit-breaker states designate some percentage of rent as a property tax equivalent which enters the circuitbreaker calculation in exactly the same manner as owners' tax payments.

Third, the circuit-breaker is less likely to encounter legal obstacles than the homestead exemption or the "split roll." Because of uniformity provisions, a constitutional amendment appears to be a prerequisite in many states for homestead exemptions on proposals to tax business property more heavily than residential property. By contrast, because the circuit-breaker can grant relief from residential property taxes without adjusting tax assessments or tax liability, the courts have consistently held that the circuit-breaker does not violate state constitutional uniformity provisions.

Our latest survey reveals a sharp increase in state reliance on circuit-breakers. In 1977, 30 states paid out almost $1 billion in circuit-breaker relief to five million householders--contrasted to $500 million in tax relief payments to three million householders in 1974 (Table 3).

Table 3 [illegible] RATES OF STATE PROPERTY TAX CIRCUIT-BREAKER PROGRAMS: FISCAL YEARS 1974 AND 1977*

State	Total Cost of Programs ($000) 1974	Total Cost of Programs ($000) 1977	Number of [illegible] 1974	Number of [illegible] 1977	Average Cost Per Claimant ($) 1974	Average Cost Per Claimant ($) 1977	Cost Per Capita ($) 1974	Cost Per Capita ($) 1977
Arizona	N.A.	[illegible]	N.A.	58,019	N.A.	200.19	N.A.	[illegible]
Arkansas	166		2,735	5,916	59.34	75.76	.05	0.16
California	61,000	93,[illegible]	302,000	440,000	201.98	[illegible]	2.96	[illegible]
Colorado	2,355	11,[illegible]	27,251	58,875	86.41	187.00	0.96	4.20
Connecticut	6,193	24,754	19,533	101,574	317.05	243.70	2.10	7.96
Dist. of Columbia	N.A.	600	N.A.	6,000	N.A.	100.00	N.A.	0.87
Hawaii	-	4,200	-	N.A.	-	N.A.	-	4.65
Idaho	1,871	4,000	15,924	17,323	117.49	231.00	2.42	4.67
Illinois	21,950	100,000	144,647	405,000	151.74	250.00	1.95	8.85
Indiana	1,800	844	44,000	28,665	40.90	29.45	0.33	0.16
Iowa	2,540	9,600	37,000	83,800	68.64	114.56	1.26	3.34
Kansas	3,149	8,874	31,307	62,955	100.58	140.17	1.38	3.84
Maine	1,974	4,347	13,468	20,786	146.56	209.10	1.92	4.06
Maryland	-	20,808	-	83,863	-	248.12	-	5.03
Michigan	129,000	275,582	810,000	1,234,800	159.25	223.18	14.26	30.24
Minnesota	10,010	134,200	110,000	857,277	91.00	156.54	2.56	33.94
Missouri	4,709	7,008	58,031	56,260	81.14	124.57	0.98	1.46
Nevada	80	1,350	1,994	10,560	40.12	127.84	0.14	2.20
New Mexico	-	1,500	-	40,000	-	37.50	-	1.26
New York	-	N.A.	-	N.A.	-	N.A.	-	N.A.
North Dakota	35	1,198	5,052	9,969	70.00	120.20	0.55	1.86
Ohio	33,000	44,614	264,300	329,462	124.86	135.42	3.20	4.26
Oklahoma	N.A.	357	N.A.	4,159	N.A.	85.93	N.A.	0.13
Oregon	70,730	74,140	509,000	502,575	138.95	147.52	31.78	31.20
Pennsylvania	56,100	58,918	410,000	413,974	136.82	142.32	4.71	4.99
Rhode Island 1/	-	12	-	249	-	51.92	-	0.01
South Dakota	-	1,487	-	15,095	-	95.51	-	2.17
Utah	-	950	-	10,000	-	95.00	-	0.73
Vermont	4,731	7,670	16,400	36,516	288.47	210.05	10.19	16.08
West Virginia	166	18	8,529	1,265	19.46	13.94	0.09	0.01
Wisconsin	35,411	48,139	189,521	234,201	186.84	205.55	7.75	10.31
Total (21 states in 1974 29 states plus D.C. in 1977 2/)	446,970	949,561	3,020,755	5,112,758	147.97	185.72	4.41	6.90
Percentage increase		112.4		69.3		25.5		56.5

*For several states data are for other than year indicated, see Appendix Table 6.

N.A. - Not available. New program for year indicated.

- No circuit-breaker program in 1974.

1/ New program, data are for period January 1 thru April 10.

2/ Excludes the following new programs for which data was not available: 1974-Arizona, District of Columbia, and Oklahoma; 1977-New York.

Source: Appendix Table 6.

Sixth, does it make political and economic sense to retain the property tax as a major source of local revenue in an inflation ridden economy? Despite obvious defects and poor public image, the property tax has significant political and fiscal virtues. First, it is the one major revenue source directly available to local government and therefore serves as the traditional defense against fiscal centralization. Second, it is the only major tax that can recapture for the community the property values the created by the community. Third, its high visibility works in favor of greater public accountibility.

Beyond these three considerations there is the inescapable element of fiscal realism--the Nation's local governments will not quickly come up with an acceptable substitute for this powerful $65 billion revenue producer.

In view of the current conservative mood of the country, it is not likely that many state legislative bodies will be willing to solve the local property tax problem by granting broad new discretion to local governments to levy income and sales taxes. The legislators are far more likely to support proposals granting fiscal relief to taxpayers than to local governments.

The state financed relief will come in a variety of forms--expanded circuit-breakers, state reimbursement for partial homestead exemptions, or tax rebates for part of the school taxes borne by property owners.

Because state "takeover" of local school costs is an extremely expensive venture, we are also not likely to see many dramatic breakthroughs on this front.

Prudent public policy, therefore, would dictate the adoption of measures designed to reduce the irritant content of the property tax levy.

Seventh, what is the ACIR prescription for keeping the irritant level of local property taxes at tolerable levels--particularly during periods of inflation?

1. A uniform system for administering the property tax marked by:

   a. market value appraisal of all taxable property;

   b. professional appraisers;

   c. either strong state supervision of local assessors or state administration of the tax assessment system;

   d. the preparation and disclosure of assessment ratio findings to enable taxpayers to judge the fairness of their assessments.1/

2. A "truth in property taxation" process along the lines of the Florida plan that will enable taxpayers to fix political responsibility for higher property taxes without placing fiscal shackles on local government.2/

3. A state-finance circuit-breaker system to shield home owners and renters with low and fixed income from property tax overload situations.3/

1/ ACIR, The Role of the States in Strengthening the Property Tax, A-17, reissued 1976. ACIR has drafted suggested legislation to implement these recommendations.

2/ ACIR, State Limitations on Local Taxes & Expenditures, A-64, 1977. ACIR has drafted suggested legislation to implement this recommendation.

3/ ACIR, Property Tax Circuit-Breakers: Current Status and Policy Issues, M-17, 1975. ACIR has drafted suggested legislation to implement this recommendation.

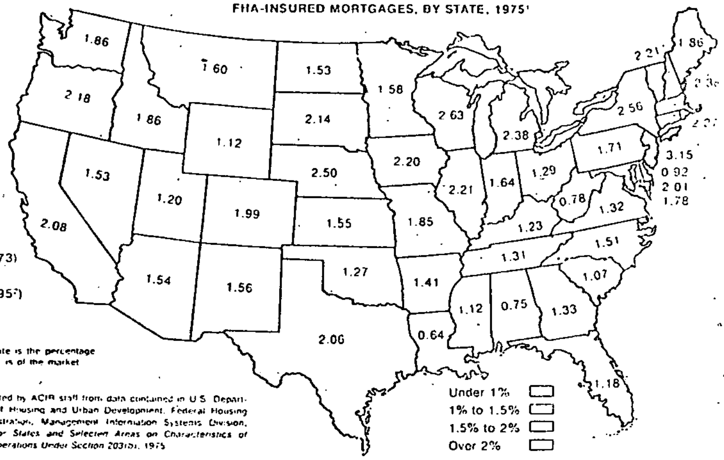
4. An intergovernmental "fair play" policy. When the state mandates additional expenditure responsibilities on local government, it should be prepared to help finance the added expenditure burden. When a state mandates a partial or complete exemption, from the local property tax (i.e., homestead exemption), it should reimburse the localities for the revenue loss. 1/

5. A tax utilization philosophy that recognizes the best property tax is a moderate property tax. As with any other tax, the heavier it becomes the less obvious are its virtues and the more glaring are its defects. In my view, a moderate property tax should fall in the 1 to 1.5 percent of market value range. Beyond 1.5 percent of market value the amber warning light turns on--beyond 2 percent the red danger light flashes. If a state assumes the full cost of welfare and medicaid and at least 65 percent of the cost of local schools, it will probably be able to hold local property tax levels below 2 percent of market value (See map).

There is room for guarded optimism. Legislators in many states may find this five point reform program more acceptable than the radical surgery alternative prescribed by Doctors Jarvis and Gann. If this turns out to be the case, June 6, 1978--Proposition 13 Day--will also become a red letter day in the long and troubled history of the property tax.

1/ ACIR, State Mandating of Local Expenditures, forthcoming report. ACIR has drafted suggested legislation to implement this recommendation.

AVERAGE EFFECTIVE PROPERTY TAX RATES, EXISTING SINGLE FAMILY HOMES WITH FHA-INSURED MORTGAGES, BY STATE, 1975[1]



(Alaska-1.73)

(Hawaii-0.95[2])

[1]Effective tax rate is the percentage that tax liability is of the market value.

[2]1974 rates

Source: Computed by ACIR staff from data contained in U.S. Department of Housing and Urban Development, Federal Housing Administration, Management Information Systems Division, *Data for States and Selected Areas on Characteristics of FHA Operations Under Section 203(b), 1975*

Representative MOORHEAD. The committee would now like to hear from Lyle C. Fitch, president of the Institute of Public Administration.

STATEMENT OF DR. LYLE C. FITCH, PRESIDENT, INSTITUTE OF PUBLIC ADMINISTRATION

Dr. FITCH. Mr. Chairman, and members of the two committees, I have filed a statement with the committee, the title of which is "Better Government or Less Government—The Response to Taxpayer Revolt." I would like to summarize the major points of that statement.

The first point follows Mr. Greytak in its emphasis on inflation in State and local government costs, and the role of inflation precipitating the taxpayer revolt.

In brief, what has happened in the last 20 years is that the unit cost of goods and services purchased by local governments, in order to provide public services, has increased by some 189 percent, compared with an increase in the cost of consumer goods and services of something like 104 percent. There has been a dramatic inflation in the cost of the inputs going into the State and local government process, compared with the cost of consumer goods.

Second, the amount of resources used by State and local governments per capita increased by 100 percent in the last two decades. In other words, State and local governments are now using twice the amount of resources for each man, woman, and child that they did two decades ago.

Now, I doubt if many taxpayers feel that they are getting double the services. On the contrary, they see many evidences of declining public sector effectiveness, such as increases in school dropouts, more traffic congestion, dirtier streets, more potholes, worsening public transportation, rising delinquency, and the rest.

There are many reasons for the rise in real per capita costs, and some of them do reflect increased services. But being a battered old public administrator, I conclude that there has been a substantial drop in the productivity in the State and local government service industries, and that the average citizen is not wrong in concluding that he is getting relatively less for his taxes than for most other purchases he makes. Of course, this is what the antigovernment people—of whom I do not count myself one—have been telling us all along.

We next have to consider whether the heating up of the taxpayer revolt can be turned to good account in providing better government as opposed to merely cutting services and having less government. Government reforms usually result when the money runs out or when the existing machinery becomes glaringly inadequate or when the existing power structure gets into difficulty because of corruption or mismanagement.

There are two main approaches which I would like to mention briefly. The first is structural and administrative overhaul. There is a lengthy agenda of needed structural and procedural reforms. Most of them have long been advocated by your distinguished chairman, Congressman Reuss, and I will not go into the list.

But the greatest structural deficiencies are in the large urban areas where government is a thicket of municipalities, county and regional agencies, and special districts, all of which are incomprehensible to most citizens.

Ten years ago the Committee for Economic Development noted that there were 80,000 local governments in the United States, most of which are too small to function efficiently. The CED thought the country would be much better off with only about a tenth of that number, with local governments large enough to operate efficiently.

However, I have always had some reservations about cutting back so drastically, because structural reform and paraphenalia by themselves do not assure good performance. New York City is a case of a government with all of the paraphenalia of modern administration. It was the first and is still the largest metropolitan consolidation; it has well-staffed budget, planning, and personnel agencies; it has a strong executive equipped with professional assistants; and it has gone through periodic charter revisions to keep the system up to date. But all of this did not keep the city from getting into a horrendous financial pickle, mainly through skyrocketing costs financed by short-term borrowing. We have had tax and debt limits, but these were circumvented with the connivance and assent of the State government and the city's elected officials, the public employee unions, and the banks, all of which stood to gain in the short run by the city's financial irresponsibility.

I therefore suggest that the main problem of many governments is not inadequate size, but arteriosclerosis of the bureaucracies and the lack of incentives for economizing. Government agencies, by nature, are more interested in organizational growth, status, and power than service improvements and economical functioning, and I think this is one thing we have to keep hammering at.

The second road to improving government costs is through productivity, which implies delivering more public services, and more relevant services, with less resources. Raising productivity involves overcoming a lot of negative factors. These include ineffective management and supervision and lack of employee incentives and hostility of employee organizations to the very notion of productivity. It also involves greater emphasis on a number of positive factors, including better utilization of technology, more effective job analysis and personnel scheduling, overhauling antiquated civil service systems, and introducing better definitions of agency objectives and missions, and measures of performance.

On a still higher plane, productivity means modifying old notions of hierachical control, and devising new patterns of organization structure and new incentive systems for executive supervisors and street level workers. Such things are especially difficult to achieve when programs are being cut back and workers are being laid off. When layoffs are by seniority, there is no relationship between quality and performance in job security. New methods, new machines, and other innovations cannot be financed when money is tight.

But in conclusion, I think that the taxpayer revolts manifested by Proposition 13 and less drastic measures can accelerate the pace of government improvement, both structural improvement and productivity improvement. Such improvement depends on strong political leadership which can mobilize and sustain support from citizens, business and taxpayer groups, and other constituencies. But the payoff is in the long run, not the short run, and this is a heavy handicap in the business of politics, where horizons extend only until the next election.

The continued interest of most elected officials depends on the number of votes which can be garnered by vigorously responsive government reform, which is a grubby business, at best. The Federal and State governments can lend a hand by putting their own grant programs in better order and making judicious use of the power of the purse to promote structural reform and encourage productivity.

Finally, how can taxpayer resistance constructively affect government expenditures in the short run? I would say mainly by flashing "go slow" signals to officials, legislators, and employee unions. As Governor Carey of New York put the matter in his inaugural address in January of 1975, "The days of wine and roses are over."

The great danger is that drastic reductions like proposition 13 will lead to drastic expenditure reductions which wipe out the amenities of urban existence, beginning with parks, libraries, and the arts. This leads me to say that crash economy programs, like crash diets, are almost invariably ineffective; they usually damage the patient; they are painful and are very soon abandoned. Truly effective government economizing, like weight reduction, requires laying out a well-balanced diet and sticking to it.

Thank you.

[Dr. Fitch's prepared statement follows:]

BETTER GOVERNMENT OR LESS GOVERNMENT? -- THE RESPONSE TO TAXPAYER REVOLT

Statement of Lyle C. Fitch
President, Institute of Public Administration
Before the
Subcommittee on the City,
Committee on Banking, Finance and Urban Affairs
U. S. House of Representatives

July 25, 1978

Why Taxpayers Revolt--The Cost Explosion

Whether Proposition 13 is a highwater mark or only an interim marker in the contemporary American tax revolt, it clearly calls for greater effort than we have seen to date to check government expenditures and taxation. California voters opted for an absolute reduction of property taxes while making it difficult to replace them with increased state or local nonproperty taxes. It is less clear that they opted for reduced services, but many seem to have felt that the cost of public services has been outrunning benefits, implying that the extra bang is not worth the extra buck.

The revolt has been gathering steam for years, of course, with many communities vetoing increases in school and other budgets, and several states putting new limits on state-local expenditures and taxes. For example, New Jersey two years ago tied state expenditure increases to the growth in New Jersey state income payments, and put a 5-percent limit on annual increases in local government budgets. Tennessee is moving to put similar restrictions into the state constitution. More or less draconian measures are being urged on many other states.*

How account for the whopping increase in state-local government expenditures in the postwar period? Professor Greytak has discussed the factors accounting for recent increases in government expenditures. I

* "States Vie to Curb Taxes, Spending." Congressional Quarterly, July 8, 1978, pp. 1727-30.

want to emphasize two points which bear on what I will say later.

1. In the twenty-year period 1957-77, the unit cost of state-local government increased 179 percent compared with an increase of 108 percent in the price of goods and services purchased by consumers.* This was in large part due to the fact that average wages of state and local government employees more than trebled. Contrary to the claims of public employee unions, the average wage of state-local government employees started higher and rose faster than the average wage in the private sector until the early 1970s when taxpayer resistance began stiffening and the increase rate slowed to approximately the pace of private-sector wage increases.**

2. Adjusting for inflation and for population increases, we find that per capita <u>real expenditures</u> on state-local government services approximately doubled. This datum measures the amount of manpower and other resources which state and local governments bought in order to provide public services.

To complete the picture, transfer expenditures, mainly welfare and related grants, went from $4.8 billion to $20 billion.

The most significant fact is that the per capita real cost of state and local government doubled. Other things being equal, the

* The indices referred to are the Gross National Product deflators for state and local government and consumer goods and services, <u>Economic Report of the President</u>, 1978, Table B-4.

** The averages conceal a great diversity among governments and among employee groups. In some states and cities public employee compensation still lags behind that of comparable jobs in the private sector, in others, public pay rates have exceeded private. Usually this situation is found in the mass-employee occupations, though in a few cases middle- and higher-level occupations have outrun lower.

quality and quantity of public services--government outputs--also should have doubled, to match the increase in input. But while it is impossible to measure the quantity of government outputs, let alone the quality, I see little reason to believe that per capita output rose by anything like 100 percent. On the contrary, many indicators point to a decline in the quality and quantity of amenities affected by public services as evidenced by increasing school dropouts, growing traffic congestion, worsening public transportation, dirtier streets, deteriorating housing stock, and other indications of declining public-sector effectiveness.

Granted that for several reasons the real cost and difficulty of providing some types of public services did increase, particularly in central cities which had to take care of increasing proportions of low-income groups in need of special education, social and other services. Nonetheless, it is difficult to escape the conclusion, which is supported by special studies of several limited areas,* that productivity of state and local government service industries declined substantially over the period. Averages are deceptive, and we can expect great variation in the performance of state and local governments. But the average citizen of many states and localities is not wrong in thinking he is getting less from his tax dollar. Parallel data from the federal government, on the other hand, indicate moderate increases in productivity and this indication is borne out by reports of the federal government's Joint Financial Management Improvement Program.

---

* John P. Ross and Jesse Burkhead, Productivity in the Local Government Sector, Lexington Books, 1974; David Greytak, Donald Phares and Elaine Morley, Municipal Output and Performance in New York City, Lexington Books, 1976.

Meanwhile, inflation and declining productivity in the economy at large frustrated taxpayers by whittling away their purchasing power. The weekly wage of the average private-sector worker bought less in 1977 than in 1969, and this is true of wages in most occupational sectors. The purchasing power of per capita disposable income (income after taxes) was lower in 1974 and 1975 than in 1973, and modest increases in 1976 and 1977 barely made up the gap. In other words, per capita purchasing power in 1973 approximately equalled the average of the following four years.

To cap the climax, the eruption of the Watergate scandals created an atmosphere of distress in national government which overflowed into state and local governments. This, added to inflation and depletion of purchasing power and the soaring costs of state-local government, contributed to the growing taxpayer revolt by giving plausibility to the conservative credo that government has gotten out of hand.

Financial brinksmanship

Fiscal emergencies are nothing new to state and local governments. In particular, large cities in the midwest and east such as Cleveland, Detroit, St. Louis, Philadelphia, and Newark have been living for years in a state of financial desperation stemming partly from economic decline and partly from taxpayer resistance.

Responses to revenue shortfalls come more or less in the following order:

1. Position freezes and vacancy controls, and suspension of travel allowances and transportation and other perquisites of higher-level employees. Position freezes are economy by happenstance since they fall wherever vacancies happen to occur. Economizing on executive perquisites may strike at needless expenditures but may also reduce employee effectiveness and

deter professional development, and thereby increase the difficulty of recruiting management talent.

2. Reductions in force. These are usually in order of seniority, striking the younger and more vigorous employees and the minority groups who are particularly dependent on public employment because they have fewer private-sector opportunities. Many people laid off will draw unemployment compensation and eventually public assistance, so that the net effect is to shift the cost of maintaining them to other pockets while wasting whatever contributions they might have made if employed.* Layoffs may be across-the-board or may reflect a considered set of priorities in which basic services such as police, fire, sanitation and health are favored at the expense of amenities such as libraries, parks and recreation, school enrichment programs, and the arts.

3. Top administrators and legislators, who are usually most careful about new programs, will give more attention to ongoing ones and will comb over old programs in search of places to cut, even though they do not go all the way with zero-base budgeting. Managers may uncover opportunities for genuine economies or may employ the old trick of cutting services whose loss will be most conspicuous and keenly felt, but this has dangers since it is likely to be exposed by unsympathetic sources--the party out of power, the media, or sharp-eyed civic organizations. Alert agency heads will draw upon program planning and budgeting techniques, better to justify their program requests. In governments which have long been strapped for funds, however, there is little room for reordering priorities and savings through administrative reform because existing agencies and ongoing programs have survived the harsh

* Federal CETA grants have made it possible for states and localities to avert some of this waste.

political test of survival of the fittest. The budget-making process of one such government has been described as follows:

> There is loose talk to the effect that budget-making involves resource allocation. So far as the few American cities we know are concerned, we believe this rumor to be unfounded. . . . Since cities are in a financial straitjacket and officials can make only small changes in their budgets, the rationale for resource allocation is not entirely clear. *

4. All expenditures that can possibly be deferred will be, particularly maintenance expenditures and capital outlays. Hard-pressed city and county governments have already been doing this for years; consequently vast amounts of deferred maintenance are accumulating, with water and sewer mains falling apart, streets filled with potholes, and deterioration of highways and bridges to the point where they have to be closed. Bridges are an especially serious problem in cities which depend heavily on them, such as New York and Pittsburgh.

5. Since a major cost-increasing factor in many jurisdictions has been large wage and pension increases, one of the most important effects of taxpayer resistance may be to stiffen resistance to pay and fringe benefit increases while tempering union demands. It is unfair to blame unions along for kiting labor costs, however, since management has to agree to settlements. New York City got into trouble because its management not only agreed to impossible settlements but borrowed money to pay the bills until the city's credit was gone.

---

* Arnold J. Meltsner and Aaron Wildavsky, "Leave City Budgeting Alone!" in John P. Crecine, ed., Financing the Metropolis, Sage Publications, 1970, p. 311.

How To Economize

In considering how to hold down government costs, taxpayers need to determine whether they want less government or better government, or perhaps both. A distinction must be drawn between the anti-government people who want government cut back on ideological grounds, and those who have concluded that government is simply wasteful and ineffective and need to be assured that it can perform better. I think that results of recent polls show that a majority of protesting taxpayers are in the latter group; they simply have concluded that they are not getting their money's worth and are demanding tax reductions even if this means giving up some overpriced services. The fact that so many single out welfare is probably a result of seeing their own aspirations frustrated by inflation and the economy's mediocre performance.

Government reforms commonly result when the money runs out, or when existing machinery becomes glaringly inadequate, or when the existing power structure gets into trouble because of conspicuous incompetence or corruption. The contemporary taxpayer revolt and financial troubles of many local governments may give new impetus to government improvement through structural and administrative reform and to more rigorous cost controls as an alternative to drastic cutbacks in public services.

Lagging capacities of state and local governments

In discussing whether the taxpayer revolt can be put to good account in improving state-local government, I will look first at existing deficiencies and the agenda for reform.

State governments have come some distance in the last decade since the Committee for Economic Development complained (in 1967) that many of them lacked the requisite organizational and administrative tools for effective performance,* and the Advisory Commission on Intergovernmental Relations noted (in 1970) that most state governments are on the verge of losing control over mounting problems of central-city deterioration and the rapid growth of metropolitan areas.** To mention a few areas of improvement:

- States have proceeded with a standard agenda of administrative reform, including departmental restructuring, strengthening of accounting and budgeting, etc.; taken over functions formerly performed by local governments; increased grants to local governments; established agencies which furnish information and technical assistance to local governments; passed enabling legislation for intergovernmental service agreements, regional organization, service transfers to county governments, etc. On the debit side they have yielded to pressure from local government employee groups, piling costs on local governments in violation of home rule principles; harpooned municipal administrative and planning reforms; further complicated local government structure by creating new special districts and substate regional agencies; and engaged in other disorderly conduct. But most conspicuous have been their sins of omission--not moving faster to tidy their own houses; rescue their faltering cities; and prune their local government jungles. It should be noted, however, that without local support and cooperation state governments are limited in what they can do, particularly in the strong home rule states.

---

* Modernizing State Government, 1967.

** ACIR, Federalism in 1970, Twelfth Annual Report, p. 7.

As for local governments, the Committee for Economic Development in 1966 noted the following deficiencies, most of which are still around.

> Very few local units are large enough--in population, area, or taxable resources--to apply modern methods in solving current and future problems, Even the largest cities find their major problems insoluble because of limits on their geographic areas, their taxable resources, and their legal powers.
>
> Overlapping layers of local government abound--municipalities, townships, school districts, special districts--which in certain areas may number ten or more. They may all have power to tax the same land, but frequently no one has the power to deal with specific urban problems, or to coordinate related activities.
>
> Public control of local governments is ineffective or sporadic, and public interest in local politics is tepid. Contributing factors are the confusion resulting from the many-layered system, profusion of elective offices without policy significance, and increasing mobility of the population.
>
> Most units are characterized by weak policy-making and antiquated administrative machinery. Organizational concepts considered axiomatic in American business firms are unrecognized or disregarded in most local governments.
>
> The administrative process is handicapped by low prestige of municipal service, low pay scales of administrative and executive personnel, and lack of knowledge and appreciation on the part of elected officials and legislators of professional qualifications. *

Structural reform

A CED policy paper drafted by Dr. Alan K. Campbell, present Civil Service Commission chairman, advocated two-tier metropolitan government with region-wide jurisdictions performing functions which

* CED. Modernizing Local Government, 1966.

for various reasons need to be handled on a metropolitan scale, and community jurisdictions performing community-scale functions.* Subsequent ACIR reports have explored at length the various functions and sub-functions appropriate for each level.**

The concept of metropolitan jurisdictions—to administer and coordinate metropolitan-scale functions and to equalize the financial burdens of providing urban services--has been around for some decades without having made any great impact on the American governmental system. New York City's consolidation, which occurred in 1898, is still the only example of consolidation on a grand scale. Other metropolitan organization has been on a much less ambitious scale, with a dozen or so county-city consolidations, mainly in the south, and expansion of city boundaries through annexation in states which permit this solution; multi-purpose regional organizations in Seattle and Portland. and the well-publicized Twin Cities Metropolitan Council. County governments have increasingly taken over and coordinated large-scale functions and are the handiest solution where they are big enough, but in many metropolitan areas functions spill over county boundaries and in some areas over state boundaries.

Purposes of metropolitan organization

There are three main purposes: (1) scale economies involving functions which can be performed most cheaply, or performed at all, only by metropolitan-wide agencies; (2) coordination of metropolitan functions; and (3) fiscal equity which involves sharing tax burdens of services which benefit both city and suburbs, and of special services required by low-income disadvantaged groups.

---

* Committee for Economic Development, Reorganizing Government in Metropolitan Areas, 1970.

** Advisory Commission on Intergovernmental Relations, Government Functions and Processes: Local and Area Wide; Substate Regionalism and the Federal System, vol. 4; A-45, 1974; also, Improving Urban America: a Challenge to Federalism, M-107, 1976.

Scale economies are most adequately achieved of the three purposes, usually by single-function special districts or authorities, of which there are now some 8,000 in the country's metropolitan areas.

Coordination of metropolitan functions is much less adequate because of the penchant for special districts. Some coordination is achieved through the numerous councils of governments (COGS) and federal requirements for grant application review (commonly handled by the COGS), but most COGS have little muscle beyond their review powers and correspondingly little control of the policies of their member jurisdictions or of the special districts. The ACIR has recommended the creation of umbrella multijurisdictional organizations (UMJOs) as a means of improving coordination.*

Equalization of fiscal burdens, the third main objective of metropolitan organization, is usually desired by the central cities but almost everywhere opposed by most suburbs. It is more amenable to alternative solutions than are the other objectives, since state and/or federal governments can assume the cost of providing welfare benefits and special services to low-income groups who congregate in central cities and older suburbs.

Another and separate problem is the continuance in some areas of many general-purpose municipal governments which are too small to perform efficiently or adequately the functions assigned to them. The solution of combining small units into larger ones, or into metropolitan general governments, has never taken hold in the United States (except in the instances noted above) for several reasons. One is the attachment of residents to their own communities and their fear of domination by larger entities. Another is the people's choice principle,

* ACIR, _Improving Urban America_, Chapter 4.

particularly admired by economists, of maintaining a number of jurisdictions with different amounts and kinds of services in order to provide a variety of choices to urban residents. A third is the principle of neighborhood or community control, which argues for smaller jurisdictions as a means of giving residents a larger voice in the decisions that affect them.

There are two other obstacles to metropolitan consolidation, less justifiable but still politically potent. The first is a fear of racial integration on the part of suburban whites, primarily concerned with the impact on property values, and central-city blacks who fear that black dispersal would diminish their political power. The second obstacle is officials of small municipalities who resist the idea of displacement and possible unemployment which would result from consolidation.

Bottom-up reform

The CED's second proposed reform is based on the premise that units of government wherever possible should be small enough to enable residents to have some voice and control. This version of "maximum feasible participation" applies to a variety of services which may appropriately be handled by small to medium sized units. "Voice and control" might include the power to allocate part of all of the funds available for public services in the community, and the power to implement such decisions by hiring personnel, purchasing materials, and making contracts, and the power to sign checks--in short, the budgetary-expenditure powers ordinarily exercized by municipal general governments. There are several arguments for such decentralization, including the public-choice principle and the participation principle--previously noted in the discussion of consolidation.

Also there is an administrative efficiency argument which holds that giving a community greater control over suppliers through the power to hire, fire and make contracts will compel a bureaucracy to pay attention to clients' needs and serve them more effectively.

Though I am not unsympathetic with these objectives, I have always wondered why deconsolidating existing urban governments should produce any better results than the already-existing small suburban governments whose members, particularly the poor ones, are not models of administrative competence, however much beloved by their residents. I am also bothered by the fact that in most experiments with decentralization I have observed, the decentralized units have failed to improve services regardless of their other achievements. Decentralization in New York City's educational system was followed by an accelerated decline of pupil performance, a sharp increase in administrative costs, and in most districts minimal involvement in communities.

I would certainly agree that the urban poor generally, and large-city poor minority groups in particular, should be more involved with public decisions that affect them. But there are less drastic mechanisms for achieving participation, including community councils which are consulted on development plans, service priorities, and similar matters; neighborhood service centers to make health, welfare and other services more readily accessible to clients with regard to both hours and locations; and devices for improving communication between neighborhoods and central agency administrators. Even such relatively simple measures have not been exploited by most cities, although an increasing number are moving to improve communication and access, including access to services.

One difficulty is defining "communities." Sometimes they already exist but more often they do not. Annmarie Hauck Walsh has observed that

> Power never did reside in general population groups within the neighborhoods of our large cities, and it remains to be seen if there is any sense of community in most of them. Their image of neighborhood power has cultural roots in our ideology, namely our yearning for a town-meeting society, but it has little place in urban political history. *

The taxpayer revolt and structural reform

Can action on the long agenda of needed structural reforms be accelerated by taxpayer revolts? I think it can be, but only if there is forceful political leadership to mobilize taxpayer support. California's governor, as part of the response to Proposition 13, appointed a commission to consider the state's basic condition, including its economy and governmental organization. Already there have been some significant changes in state intergovernmental relations as a result of the fiscal rescue effort designed by the governor in cooperation with a select legislative committee and passed by the legislature. These changes include:

- A state takeover of county welfare, food stamps and and health functions.

- Allocation to counties of funds for special districts and authorities, which makes these units dependent on locally elected county officials. This may pave the way for creation of multipurpose authorities, which may in turn achieve better coordination and reduce overhead costs.

- City authorization to raise charges and impose new charges, which may lead to greater use of public pricing--an objective advocated by many economists. **

---

* "What Price Decentralization in New York?" New York City Almanac, June 1972.

** See Selma Mushkin, Public Prices for Public Products, The Urban Institute, 1972.

° In addition, the diminished fiscal capacity of local government and increased dependence on the state will inevitably trigger other moves, including moves required for maximum utilization of federal grant programs.

° A degree of preference to poor districts in allocating school funds, continuing the state's gradual adjustment to the Serrano decision requiring more equitable access to school finance resources.

The most significant single effect of Proposition 13 has been the shift in financial and other powers to the state government in what traditionally has been a strong home-rule state.

New York State also moved strongly to rescue several of its faltering cities from financial collapse, most prominently the Big Apple. When New York City proved unable to handle its own finances and required outside help to get the budget under control, the state created the Emergency Financial Control Board with wide powers over city budgeting, including the authority to review financial plans and modifications, contracts and proposed borrowing for conformity with the long-term objective of restoring a balanced budget. The EFCB was an important structural change which now seems likely to endure indefinitely, though it is hotly opposed by the city employee unions.*

The New York State intervention was an emergency measure, not concerned with government organization or managerial structure. But many other things have been going on, including increased financial assistance to local governments, including New York City. The governor also set in motion the latest round of New York City charter reforms which culminated in the adoption, in 1975, of a new city charter designed in part to correct the management deficiencies which had led the city to the verge of bankruptcy. Thus far, however, the new charter changes have made little difference in the way the city actually operates or in its management structure.

* The state also created the Municipal Assistance Corporation (MAC) to serve as a surrogate borrower for the city. MAC obligations are backed by a first claim on city sales tax revenues.

Another interesting organizational innovation prompted by financial desperation was creation of the Metropolitan Transportation Authority, which in 1967 put under one organizational roof the city's subway and bus agencies, the New York commuter rail services, and the Triborough Bridge and Tunnel Authority. The basic purpose of the consolidation was to enable the use of the Triborough Authority's surplus revenues, derived from auto tolls, to meet transit and commuter rail deficits. As a management organization, however, the MTA has been ineffective; it lacks even the information for managerial supervision. Operations, long-term planning, budgeting and policy coordination are still largely in the hands of individual agencies which were brought together in the consolidation.

Without going into more detail, I will jump to a conclusion about structural changes which involve established organizations: they usually take a long time in gestation and winning approval, and a long time for effective implementation. Government reorganization, whether toward metropolitan consolidation or deconsolidation of existing givernment, is not calculated to produce savings in the short run. Metropolitan consolidation has been primarily a means of spending more money more efficiently, not of spending less money. It ordinarily concerns regional water, sewage disposal, air pollution control, transportation and, more recently, manpower programs, economic development, and health programs. Most of these involve raising expenditure levels to meet needs not previously met or, in many cases, not even recognized.

In Quest of Productivity

Despite the fact that governments have fallen far short of meeting organizational and other standards which most of the experts tell us are needed for effective performance, many state and local governments have made some progress in the last two decades, a few have made considerable progress. Notwithstanding, productivity seems to gave declined, as measured by results. But are the indifferent results attributable merely to the fact that the difficulty of the problems increased so greatly that they couldn't be handled as well even by doubling the resources employed? I think not, for we can identify a number of other factors associated with productivity decline.

1. The considerable amount of manpower going to make up for improvement in working conditions: shorter work weeks, lighter work loads, increased vacation time and work breaks, more sick leave, etc.

2. The continued deterioration in many state and local governments of technical, professional and managerial positions, three occupational groups which generally are not protected by strong unions, by adequate civil service structures or by political constituencies.

3. The continued degeneration of civil service and merit systems into instruments for protecting mediocrity and defying administrative control, tendencies which are strengthened by the increasing power of public employee unions.

4. Whereas capital-intensive industry, notably manufacturing, offsets such productivity-reducing factors by providing workers with more machine power, in government, which is labor-intensive, opportunities for mechanization have been more limited and existing ones tend to be smothered by featherbeds.

5. The anti-poverty programs of the 1960s encouraged the creation of new organizations--community action agencies, concentrated employment programs, neighborhood service centers, model cities programs, etc.--in many cases outside the established political and administrative framework. In the process, old-fashioned notions of organization, management, and accountability went largely down the drain, and many cities are still repairing the damage.

6. The most important fact that elected officials and legislators tend to be more interested in inputs--jobs, franchises, contracts--than in outputs--delivery of goods and services. Dominance of putput interests leads naturally to rising government costs and deteriorating government putputs.

I continue to be impressed by the multiplicity of demands on the public sector. One of the greatest impediments to economy in government is that the interests of those who want economical and efficient public services frequently clash with the interests of those who want jobs and contracts, union expansion and security, welfare and other direct grants, and other rewards of political influence. These conflicts tend to be greatest in heterogeneous jurisdictions, particularly the large cities with heavy concentrations of poor minorities. Smaller and medium-sized cities, dominated by middle-class interests, tend to put greater stress on services, good management and productivity.

Chances of cost reduction through productivity

Like the abominable snowman, productivity in state and local governments has a devoted body of faithful believers, while skeptics believe it is largely mythical.

Views and hopes for the potential of achieving productivity for the public sector in general and state-local governments in particular span the spectrum. At one end is the view that the service industries, including public service, are inherently resistant to productivity measures--a view that is based on rather superficial examples such as services of barbers, musicians, and like occupations. At the other end is the view that the service industries are an undeveloped frontier of productivity, and that there have already been enormous gains; for example, recordings and electronic transmission enormously multiply the listeners served by musicians and musical ensembles; home kitchens have become heavily mechanized; earth-moving equipment has replaced the pick and shovel; and so on. More pertinent to government paper and data processing are the computer and word processing revolutions.*

In the opinion of management enthusiasts, equally significant potentials lie in management improvement with the main emphasis on planning, goal setting, program development, program monitoring and evaluation, continuing appraisal of employee performance and accountability, reiterative use of information for program improvement, and responsiveness to changing client needs.

My own appraisal of the potential runs somewhat along the following lines. In some cases agencies faced with loss of funds may accept the challenge and finds ways of maintaining their level

* See Theodore Leavitt, "Management and the Post Industrial Society," The Public Interest, Summer 1976.

of services. as by improving procedures or redeploying personnel, or redefining the services. But more basic programs to get at the root causes of low productivity,involving subtle changes in techniques, attitudes, communication, worker-supervisor relationships, and incentive structures, cannot be developed and implemented under a fiscal gun. Programs are being cut back and workers are being laid off, when tensions and resentment are usually high, and workers are preoccupied with fear of the pink slip and the falling axe. Even where the layoffs go largely by seniority, there is no relationship between quality of performance and continuance on the job, and correspondingly little incentive for extra effort. It is difficult to increase personnel productivity by machine power if there is no money to purchase and install machines and go through the necessary period of breaking in and adjustment which usually attends any innovation that involves a change in routine. Training and executive development programs are likely to be pruned, and short-handed agencies ordinarily must spend all of their time dealing with exigencies of the moment and have little left over for devising more effective means of operation.

Back to management

"The gloomy account of a low-productivity service economy," Leavitt observes, "is rooted in an almost wanton disregard of the historical role and future possibilities of the managerial arts for improving labor productivity."*

There is a familiar litany of management deficiencies which includes: lack of a progressive management philosophy, lack of provision for an effective administrative class in the civil service, too few management positions, erosion of management authority and effectiveness through expansion of collective bargaining; a long-standing

* Ibid., p. 71.

lack of adequate compensation for managerial positions; lack of incentive for and bureaucratic obstacles to productivity innovations; inflexible and inappropriate civil service regulations. However, productivity problems cannot be solved simply by enlisting a corps of trained management people and handing them authority to "manage." To begin with, government bureaucracies, particularly the more professionalized ones, resist outside control whether from chief executives, citizens boards or legislatures, as "political interference" with their functions and prerogatives.

Moreover, management control, particularly in large public-sector organizations, is limited by the fact that the actual work is done by the "foot soldier out on his own on the beat, on the garbage truck, or in the classroom," so that "urban bureaucracies have precious little administrative control over service delivery at the crucial point of contact between city and citizens."* In such a context, productivity is at best a gossamer concept, much easier to damage than to improve.

Management experts, particularly those with business or engineering orientations, put great stress on defining and measuring outputs. My own observation is that unless handled very carefully they will likely be seen as aspersions on professional integrity, or threats to employee security or working conditions. Moreover, as I have previously stressed, outputs of many government activities cannot be closely defined and the objectives of government activities are frequently vague and conflicting.**

The attitude of workers toward productivity in some degree reflects the attitude of the top executives who in turn take their cues from public attitudes. Unless business and citizen groups show

* Douglas Yates, "Service Delivery and the Political Order," in Willis D. Hawley and David Rogers, eds., Improving the Quality of Urban Management, Sage Publications, 1974, p. 219.

** Aaron Wildavsky, New York Affairs, Spring 1977.

an active interest in productivity, it is likely to have low priority and the expert personnel required will be crowded out by patronage requirements.*

The public employee unions have been suspicious of productivity, which is at odds with the traditional goal of more pay for less work and which implies stretchouts, work quotas, and management snooping. Such biases may be softened by relating productivity to compensation gains and making cost-of-living adjustments dependent on demonstrated "productivity savings." But such meaurements tend to degenerate into a mere numbers game unless they are carefully supervised and audited from the outside. In any case, they run into the familiar difficulty of measuring public-sector productivity.

In some cases, a fiscal crunch can help avert productivity losses by easing pressure for employee benefits which reduce working time. However, it should not be imagined, as naive consultants sometimes do, that productivity can be increased by eliminating benefits already won, such as holidays, training and vacation time, and so on; once having become imbedded in the system, productivity-defeating benefits are almost impossible to dislodge. New York's mayor rediscovered this fact during the wage negotiations in the spring of 1978 when he insisted on "givebacks" in return for wage increases, and lost the argument. On the other hand, skillful and persistent bargaining, can obtain important concessions-- for example, the Seattle transit system has obtained union agreement to use part-time workers to handle rush hour shifts; a similar limited concession was obtained by the New York City transit system. This one innovation could significantly reduce costs of the labor-intensive transit industry.

* The poverty-prone minority groups pay little attention to productivity issues; although they suffer from poor services they ascribe them to the discriminatory system rather than to low output-input ratios. Their leaders tend to be more concerned with jobs and status symbols than with service improvement.

A major problem of state and local government labor negotiations is that government representatives tend to regard themselves as mediators between workers and taxpayers rather than as negotiators. Until recently the rewards of meeting employee demands and of avoiding strikes and other job actions have been perceived to outweigh taxpayer protests. Stiffened taxpayer resistance is changing this attitude, but the responses vary. California has imposed a wage freeze on state employees, and local governments must follow suit. In New York City, the unions hung tough, fortified by the city's continued dependence on pension funds as a source of financing. Despite an ostensible wage freeze, employees have continued receiving cost-of-living adjustments (COLAS) plus substantial increases in the 1978 round of wage negotiations.*

* In principle, the cost-of-living adjustments were to be based on productivity improvements formulated through joint labor-management committees on productivity. Although there seem to have been a few genuine instances of productivity improvement, few observers believe that they are in any way commensurate with the cost of the COLAS. In fact, one union whose members claim substantial productivity increases is demanding a special wage increase in recognition thereof, over and above the COLAS and increases granted to other city workers.

Outside support for productivity

State and federal governments can help the cause by measures to encourage productivity in lower-level governments and judicious use of the grant system for this purpose. The Committee for Economic Development has recommended "that state governments establish and enforce minimum standards for local government budgeting, accounting, and performance and reporting systems that would provide data on the level, quality, results, and costs of services. . . . where enforcement [of data requirements] proves difficult, states could require compliance as a condition for receiving state grants." Also, "State governments should provide financial assistance to local governments for the purpose of developing and implementing performance measures, experimenting with or implementing techniques or programs that have the greatest likelihood of success, and undertaking other programs that would improve productivity."

As for the federal government, "we recommend that federal grants, including revenue sharing, block grants, and categorical programs be redesigned to encourage improvements in the structure and internal management of state and local governments that will enhance productivity."*

In considering upcoming legislation for federal grant reform, the Congress should also keep in mind last year's complaint of the National Governors' Conference that

> Congress continues to legislate more narrow and special purpose programs which, added to hundreds of existing programs, lead directly to an unmanageable maze of conflicting regulations and requirements. These impediments unnecessarily divert state and federal resources to paperwork and other overhead which should be used for services. Programs are often poorly drafted and passed without a clear understanding of their impact on state and local

* Improving Productivity in State and Local Government, 1976, pp. 70-1, 75.

> budgets or administrative structures. Federal, state and local program administrators cannot make rational budgetary or administrative decisions, recipients cannot understand what is expected of them, and the public is irate over government's inability to be responsible.
>
> The Ninety-Third Congress passed "landmark legislation" to reform the way in which it dealt with the budget. . . . The same principle must now be extended to the process by which programs are created, amended and extended. The intergovernmental process cannot be effectively managed until it is simplified and categorized; the creeping recategorization of existing block grants must be reversed. *

Obviously there is a lot of ground to be plowed, and higher-level governments which dispense program funds should be sticking closer to the plow. It should be noted, however, that program evaluation as a basis for continued funding has many problems which go beyond performance measurement. Once programs have been launched, personnel hired, managers selected, and money begins flowing, the shutting off of funds because management is sloppy or federal or state directives are not followed is like taking a lamb chop away from a hungry wolf or trying to fire a civil servant for poor work. Funding agencies may conclude that the struggle is not worthwhile and go on tolerating indifferent performance and misfeasance. Or they may be caught between a rock and a hard place with the continued dangers, on one hand, of vengeful congressmen seeking to reduce appropriations if their constituents have been damaged by strict supervision and, on the other, danger that the GAO will conduct a management audit and produce a damaging report.

To reiterate a previous point, however, productivity is not an emergency measure but the result of continuous attitude and process which will help avoid energencies. A recent study of productivity

* Federal Roadblocks to Efficient State Government, an agenda for intergovernmental reform, National Governors Conference, February 1977.

programs puts the point thusly:

> Previous experience with crash programs to improve decision systems overnight have been disillusioning. A productivity program may best evolve naturally out of continuing attention to improving the overall management of state government, beginning with a few carefully selected targets of opportunity, where opposition would not be likely to destroy the effort, where significant results are anticipated, where activities are most susceptible to measurement, and within the limitations of available staff. *

Epilogue: Congressman Reuss's reform program and what happened to the Big Apple

Congressman Henry Reuss, a long-term advocate of government modernization, wanted to use federal grants as incentives to improve state-local government machinery. The list of criteria included in the Reuss-Humphrey bill, for example, included personnel reform, overhauling state and local fiscal systems according to long-accepted principles, liberalizing municipal annexation powers, authorizing city-county consolidation, intergovernmental contracts, metropolitan councils of government, metropolitan study commissions and planning agencies, and making local governments more responsible and democratic by decentralizing power and functions back to the neighborhoods.

Recent experience has emphasized that these are essential but not sufficient conditions. New York City long ago adopted most of them. It was the country's first and largest metropolitan government; it has most of the formal apparatus of good government, including well-staffed planning, budgeting, and personnel administration; has put through three charter reforms in the last forty years (the last in 1975), and has launched productivity drives which attracted national attention. But it managed to get into a horrendous financial pickle from which it

---

* Edgar J. Crane, Bernard F. Lentz, J.M. Shafritz. State Government Productivity: the environment for improvement. Praeger Publishers, 1976.

has not yet extricated itself. Underlying the city's problems were its economic decline, the arteriosclerosis of its elephantine bureaucracy, the number and range of services it tried to maintain, and low productivity. The immediate cause, however, was simply bad management and a refusal to recognize that city expenditures could not indefinitely continue rising at an annual rate twice that of revenue increases. In the period 1971-76, debt service and pension costs alone absorbed three-fourths of the increases in city-financed expenditures. By 1976 these two categories amounted to some 56 percent of the city's total revenues from its own sources.

The city's fiscal streamlining included the familiar moves previously mentioned, including laying off employees, paring services and reducing maintenance. And like a football club owner changing coaches it mounted new productivity drives. Productivity gains offer the only hope of containing the cost of government, and we are always driven back to it, even though it is often difficult to measure or even define, lacks political sex appeal, and requires the patience of Job.

But we have to keep hammering away.

Chairman REUSS. Thank you very much, Mr. Fitch.

Now the very patient Representative Cavanaugh.

Representative CAVANAUGH. Thank you, Mr. Chairman. I want to commend the chairman of this subcommittee for the excellent panel you have convened. It has been a remarkable education for me and I think we run the gamut of opinion on tax revolt and reform and expressions.

Mr. Fitch, you are an appropriate anchor, I think, to this panel. You have quite articulately drawn together many of the conflicts which this issue presents us. I think that the dichotomy between Mr. Jacoby and Mr. Cooper is the most dramatic that we are presented with.

Mr. Cooper, you seem to indicate that you saw in the vote for proposition 13 no demand from the public for less government and less services; and in fact seem to indicate the contrary, that here is an ever-increasing demand and a more sophisticated demand for government services, in an ever widening array of human activities. But what you see is an erosion of local control and an increased demand for Federal spending to provide those services.

I would have to say that there have been strong indications to suggest your contention. We received a resolution from the Los Angeles City Council urging a continuation of Federal funding and matching grants and a change in the criteria. Immediately after the vote, the Governor made that same expression to the President. I would presume that after the State surplus is dissipated after the first year, that the California congressional delegation is going to be under increasing pressure to approach the Congress on the basis of replacing those local funds with Federal revenues in order to continue the services.

Mr. Jacoby, on the other hand, you seem to express that it was a demand not for reduced taxes, but an educated demand for less services. I think that brings me to a point. What are those services, because it does get back to some extent to Senator McGovern's problem. Were the people of California—and I know they have cut back some library services—did they feel that their library services were excessive? Did they feel that they had too many parks, or that expenditures on parks and recreation have been extravagant and beyond what they desired for their recreational purposes?

I notice that in education, the summer school and extracurricular athletic programs have been reduced. Were those intelligently understood and anticipated consequences by the people of California, did they determine that summer school or extracurricular recreational athletic programs were excessive and unwanted uses of their tax money?

In those particular categories, which are some of the implications of proposition 13, were those valid and intelligent judgments and anticipations made by the people of California? Is that what they wanted?

Mr. JACOBY. I think you misinterpreted my earlier remarks. In my view—and I think I was a rather close observer of the whole proposition 13 episode—the overwhelming vote of the public for proposition 13 may be attributed not to a rejection of governmental services that were being performed, but to a belief that, as Mr. Fitch has pointed out, they were being inefficiently performed.

Every study that I am aware of has shown that productivity in the public sector—that is, the actual output of service—is low compared with the private sector.

Representative CAVANAUGH. Well, I would like to examine that, because you seem extremely supportive of the consequences of proposition 13 in education. It is my understanding that summer school activities have been curtailed in most school districts.

Mr. JACOBY. I believe that is true.

Representative CAVANAUGH. Now, my question is: Was that an unintended consequence? Did the people expect they could get the same level and quality of education for their children, including summer school, with this reduction in taxes? If that is true, it would be my interpretation that the implementation of proposition 13 is not going as intended. Is that a correct interpretation?

Mr. JACOBY. No; I think not. I can't, of course, tell you what all of the people of California believed about the great coterie of services. I can say this: That the people of California have seen the cost of education soar upward in terms of amount per pupil-year, while the quality of education has gone down. I think they are asking themselves a question: Is more money the answer?

As far as summer school is concerned, a number of school districts have eliminated it and voluntary efforts have been made by parent groups to get together to form summer school groups.

But there has been no general cutback in the educational outlay in California. The Los Angeles School District, which initially terminated 30,000 teachers, has rehired them all and is now advertising in the adjoining States of Arizona and New Mexico for 1,800 additional teachers. So there has been no general cutback in education.

Mr. COOPER. I would like to comment. The people did not vote for proposition 13 in a mass or a block. There are about five different groups that voted for proposition 13, for five different reasons. Some people were upset with the schools, feeling that they do not get their money's worth out of the schools. On the other hand, many of those same people will object when the law goes into effect that says: Your kid does not leave the sixth grade until he passes certain tests. The same people that will object that the schools are not adequate will also want their kid promoted every year, regardless of how well he does.

And these services that are being cut, however, are those that are not mandated by law. We are mandated in the county, for example, by law to provide the courts, the jails, welfare, hospitals and clinics, public health, police, and fire services. So that means when you have to cut, the cuts come in things that aren't mandated by law—mental health, service to the aging, social services.

That may change. The legislature added some mandates this year, and then next year they may add some more. But if you have to cut 10 percent out and you can't cut certain programs because they are mandated by law, then you are stuck with cutting the others.

Now, when you run public opinion polls in California, there is only one service that people, that about 50 percent of the people want cut, and that is welfare. Yet, Congress and the State legislature set the eligibility requirements and the benefit levels. The legislature says: If we cut the staffing too much and make too many mistakes, they will charge us for 100 percent of the extra mistakes. So it is one of the programs that can't be cut at all. But 48 percent of the people in California want you to cut that.

The next most popular program for cutting is support of chambers of commerce, which only 20 percent of the people in California want cut. So it is not a conscious thing. Some people voted for proposition 13. There was a woman who said: I am going to use the money I save to go to Europe. That was her idea. And others said: I want to send a message to Sacramento, and this is the only game in town.

Representative CAVANAUGH. Of course, I understand that and we all understand that, that there was no referendum on services. But the problem it presents to those of us in the decisionmaking process is how to make those judgments, and we're going to have to make them in the public interest. The problem with Mr. Jacoby is he doesn't seem to address that.

Mr. COOPER. Many people wanted everything cut. I presented messages from some of my constituents to the chairman that some of the people said that, and others said other things.

Chairman REUSS. Mr. McKinney?

Representative MCKINNEY. Gentlemen, this is a little bit like trying to cover the globe on a bicycle in one day. But I must say, I enjoyed your testimony and will read it again.

I would just like to add to this discussion that has been going on: I find people don't want less services. I find that people want more. I am continually being besieged, particularly by senior citizens who are saying: We can't afford the inflation today, but increase our pensions, for instance. I find people mad at government, and that this was the only ball game in town. All you have to do is ask anyone about the simple little trivia of government: licensing their dog, getting their car registered. All of those things irritate people. They don't see government being delivered to them, and yet they see their taxes going up and up and up.

I think that the real message here is that government has got to be run, which it is not being done now in many cases, and the government has got to be run for the people that pay for it. Often this type of thing happened when I have walked into the Federal building where I have my office. I have found an old lady crying in the hallway. And I asked why are you crying? She said, that girl was rude to me in there, and she has given me all of these forms, and I can't understand them, I don't read English very well. So I took the little old lady into the social security clerk, and I said, what is the problem? And she said, well, she has to fill out these forms. I said, well, who do you work for? She said, I work for the Social Security Administration. I said, you do not; you work for this lady. So fill out the forms for her. But that was absolutely untoward. The supervisor came over and asked me why I was interfering. I said, because you people in this place work for the taxpayer. You don't work to abuse the taxpayers.

I could go on on this subject forever. I want to ask a couple of technical questions. Mr. Peterson or somebody down at this end of the panel, there is one thing that really bothers me about the surplus figures I see in the State government scene and the local government scene—do you have any idea of how much of that, quote, unquote, "surplus" is really depreciation, what we would call a depreciation loss in business, or what is deferred maintenance, things that just aren't being done just because the pressure is on to show a surplus so that the State or local governments are ignoring the truth that bridges have to be painted every 2 years?

Mr. PETERSON. We don't know the answer to that question. Presently we in the Urban Institute are in fact engaged in a study which we hope will produce the answer to that question, but we do know that the number in some cities is substantial. A sizable part of the apparent surplus is being taken out of assets through depreciation.

I might add that locally reported surpluses are in any event highly inexact figures. If you look at almost any city which is laboring under hard fiscal circumstances and start to scrutinize its accounts, you will find some ingenuity in moving cash back and forth to affect the reported budget balance.

Let me cite two alarming trends. One is that almost all of the large cities under fiscal strain are transferring large sums from enterprise accounts which have been used in the past to provide water, sewer services, and so forth, and which provide a principal source of funding for capital investment for those functions, to cover operating deficits under their general funds. This has accelerated greatly.

Second, several of the cities, Cleveland is the most conspicuous example, are not just undermaintaining, but selling off their physical assets and using the proceeds to close their current account deficits. Cleveland sold its sewer system and covered its operating deficits for 3 years. It now has suburban land up for sale that the city had the foresight to buy in the 19th century. They have been negotiating the sale of their electricity-generating system for the last couple of years.

This is an extreme example, but on a lesser scale is found in several of the cities; they are unloading their assets to get cash to cover operating deficits.

Representative MCKINNEY. I just wanted to say, I sit on the audit commission for the District of Columbia, and they have a tendency to move money around, too.

Mr. COOPER. I would like to point out, our year-end balance in my county is $16 million. That is 4 percent of our annual budget, and because we can't go into debt, that is a contingency fund. But what seems to be overlooked is that if 13 hadn't passed, this coming fiscal year we would prepare a budget, we would say, all right, we need $180 million. We will carry over $16 million from last year. So that means we only have to raise the property tax to the tune of $164 million. So it isn't like the surplus is passed out as a dividend. It goes into the next year's budget and it is taken into account. The bigger the surplus you have, the fewer property tax dollars you levy.

Now, that is the standard way we operate, and I would assume that most jurisdictions operate that way. It is, of course, true you do have special funds for capital improvements or various things that in an emergency you can raid. And a lot of jurisdictions in California——

Representative MCKINNEY. One of the problems you find, though, in a Cleveland or Boston or New York or Washington is that their auditing system is so poor that they can't operate in the neat, cool way you suggested, which is one of the underlying things, that again bothers me.

You read today that we have a $112 billion bill facing us on fixing the highway system, and we haven't even finished building it. I wonder what's going on on the local level with this sort of time bomb.

Representative FENWICK. Could I make an observation, Mr. Chairman?

Chairman REUSS. The time is Mr. McKinney's.

Representative MCKINNEY. I am through.

Representative FENWICK. What is driving people crazy, I think, are the questions Mr. Fitch and Professor Jacoby have addressed themselves to. People know, because it is in the papers daily, that business can make a profit by picking up the garbage at a 29-percent drop per house in the pickup costs. Why don't we do it? Because we are frozen into arrangements that are more expensive. Nine people are employed by the municipality in place of the five employed by the business, and the business is not only making a profit but paying taxes, also.

This is just one example. We haven't the courage, those of us in politics. Let's face it. I was on my borough council, in my State legislature, too. We haven't the courage to come out and do what needs to be done. This is what I think proposition 13 is trying to tell us to do: For heaven's sake, face up to the real issues.

Mr. COOPER. I have an opponent on the ballot in November who was recruited by the county union after a 7-week strike 2 years ago to run against me, because they weren't happy that I refused to give them what they want. I know exactly what Professor Jacoby is saying. And a lot of jurisdictions don't have the guts. I was not disagreeing with him 100 percent or even 30 percent, as far as that goes. There are things that need to be done. There is no question.

We just hired a private firm to administer our county hospital, to try and get it operating more efficiently.

Chairman REUSS. Representative Moorhead?

Repesentative MOORHEAD. Thank you, Mr. Chairman.

First, Professor Jacoby, you propose Federal spending limits, and when we can't make that, to reduce spending. One of the things the committee is looking into is the intergovernmental relationships.

Wouldn't you include in the reduced spending the item which has grown so much in recent years, which is transfer payments from the Federal Government to the State and local governments through revenue sharing, CETA, and similar programs?

Mr. JACOBY. Yes. I don't think any item of the Federal budget should be exempt from an effort to find opportunities for saving. And I think there is a lot of water in these Federal grants..

In fact, I saw a study recently by an academic economist. I haven't looked at it, but I merely cite it. I am not sure how solidly it is based. But his contention is that nearly half of the people holding CETA jobs are not qualified for them under the Federal standards; that it is being misused and abused by many local governments, and hasn't been adequately audited by the Federal Government; and apparently a great deal of waste is occurring in that one program, just which you mentioned.

You can go down the whole list of Federal grants, and I am sure you will find equal opportunities for either doing them more efficiently or, perhaps, where the output doesn't justify the input, eliminating them.

Representative MOORHEAD. So take general revenue-sharing where there is no auditing. That would be a prime candidate for a reduction in Federal expenditures.

Mr. JACOBY. Yes, I would think so, sir.

Representative MOORHEAD. Just to get the Panel working here, Mr. Bryce, in your testimony you said the small cities have become more dependent on the Federal Government in recent years.

Do you share Professor Jacoby's feeling that we can cut back on Federal transfers to smaller cities?

Mr. BRYCE. I think we can cut back almost anything we choose to cut back. And having said that, I really do intend to emphasize what I think is a far easier statement to make than to implement. As I listen to individual comment upon the inefficiency of government, and compare that with business, a number of things go through my mind.

First of all, I do agree that there is an inefficiency in government, but there is also inefficiency in business. Businesses also have losses, so I don't know why we must malign governments in particular for having that problem. Most of the businesses which are in some of these cities are reasonably small in comparison with the local government. Many of them do not produce products which are as complex or as difficult to assess or as difficult to provide to their consumers. So whereas I might conclude that there is a similar amount of inefficiency, I think it is an oversimplification to assume that simply because some businesses work well, many of them, I want to reiterate, simply do not work all that well, that we ought to expect the same thing of local governments.

I would like to use your question to make one other statement, and that is, I would like a little bit to go back to an earlier question to me about capital spending, and I would like to make two other points.

As I listened to Mr. Peterson make his reply, two things went through my mind. One is that it is true that, as he pointed out, there has been a general trend in the aggregate spending of State and local governments with respect to capital programs. I was not referring to the aggregeate spending. I was referring particularly to small cities. The second thing, as he does suggest, there has been a question of difficulty of acquiring capital in the capital markets for some of these localities.

I would like to underscore one point, and that is that one of the significant differences between financing capital programs in large cities and financing capital programs in small cities is that many small cities do not rely as much on the capital markets as the larger cities do. It is a very common thing to find in many smaller cities, that although they do have the authority to borrow, they finance capital programs either through reserves, as was implied earlier by one of the panelists, or they do it through grants or through other means.

Representative MOORHEAD. Mr. Peterson, can large cities get along with reduced Federal transfer payments?

Mr. PETERSON. I would like to answer that question in two steps. First, I think that in the design of Federal programs we are beyond the stage where we need the temporary programs of urban assistance designed to relieve financial strain. Both the CETA legislation and the antirecession fiscal assistance legislation are scheduled for expiration on September 30. The local public works part of the package has already expired. I think this is a good opportunity to turn one's attention from short-term fiscal sustenance to the design of more permanent programs, as we begin to phase out some of those temporary ones.

Second, I believe that in any discussion of the cost implications of the Federal grant programs, more attention has to be given to the structure of aid programs and their implications for local public sector prices. In a sense it is quite deceptive to speak of inflation at the State and local level as if prices were beyond Government control.

A good deal of the increase in State and local costs has been increases in relative prices—public sector wages, for example, and capital costs that have increased beyond the national inflation rate. Federal grant-in-aid programs have contributed to that price inflation by lowering the cost to local governments of acquiring certain kinds of services. I think there has been a direct linkage between State and local wage levels and the prices paid for goods and services, and the design of aid programs. Until very recently Federal aid program were designed to stimulate spending and often had the effect of raising prices, as well. The original purpose of general revenue sharing in fact, was to stimulate State and local spending to make sure that State and local spending increased as a portion of gross national product.

We have come a long way in the last decade in our perception of that issue. We now want to restrain State-local spending, where possible. It is therefore important to design Federal grant programs not to deliberately stimulate spending, first; and, second, to be sure the expenditure impacts are not captured simply in price increases.

Representative MOORHEAD. I wonder if Mr. Gramlich would like to comment. I think a very significant statement has been made; namely, that we should be changing our emphasis from fiscal relief measures to more targeted economic development measures if we are to stay in the business of assisting localities at all.

Mr. GRAMLICH. Well, I agree with that. I don't have too much to add except for one other point. That is that a lot of the temporary measures that Mr. Peterson was referring to were things that were part of the economic stimulus package of 1976; measures explicitly designed to stimulate the economy by changing the spending of local governments, and I think that the people who have looked at the success of that effort—including myself, but there have been others—have found that in general there really wasn't that much spending that was stimulated.

I think that one can conclude that if you are interested in stimulating the economy, which you have to be from time to time, that the best way to do that is by direct income tax cuts and increases and not by grants through local governments, that that is not a particularly effective way to alter the national economy.

Representative MOORHEAD. Thank you, Mr. Chairman.

Chairman REUSS. Thank you, Representative Moorhead.

The one overriding conclusion I draw from this enormously interesting discussion is that while the immediate bolt of lightning from proposition 13 fell on the heads of local government, there is enough sin to go around at the State and Federal level, too, and that the problems we are talking about are really the problems of our Federal structure, and thus an approach like that taken by the Joint Economic Committee and the Subcommittee on the City, which doesn't try to distinguish too much between levels of government but tries to look at the total of what is done, seems to me the direction in which we have to go, and I congratulate each one of you for pursuing the problems before us in that light.

It has been an extremely helpful session. We could go on for a long time, but we have been working hard for more than 3 hours, and I now thank you and thank Representative Moorhead for his generosity in agreeing to this joint session. The Subcommittee on the City will convene here at 9:30 tomorrow morning for a continuation of these hearings.

[Whereupon, at 12:45 p.m., the hearing adjourned, to reconvene at 9:30 a.m. on Wednesday, July 26, 1978.]

LOCAL DISTRESS, STATE SURPLUSES, PROPOSITION 13: PRELUDE TO FISCAL CRISIS OR NEW OPPORTUNITIES?

WEDNESDAY, JULY 26, 1978

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON THE CITY OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
Washington, D.C.

The committee met at 9:35 a.m. in room 2128 of the Rayburn House Office Building, Hon. Henry S. Reuss (chairman of the subcommittee), presiding.

Present: Representatives Reuss, Pattison, Oakar, Hanley, Cavanaugh, Kelly, and Fenwick.

Chairman REUSS. Good morning. Yesterday our Subcommittee on the City in cooperation with the Joint Economic Committee, surveyed many of the economic, political, and social impacts likely to stem from proposition 13. We also considered some alternative approaches.

What is readily apparent is that local governments need all the intelligence they can muster to economize without letting essential services deteriorate. Today's witnesses promise to give some guidance in this direction. If the experiences they describe on how to better manage limited resources are found to have widespread application, what they have to say should be like money in the bank to beleaguered local officials.

While we are sensitive to the depth of citizen agitation for tax relief, I would like to hope that Americans generally are not prepared to give up the struggle to revitalize our neighborhoods and cities, or to neglect our commitment to increase opportunities for the least well-off. To persist in these goals in the face of restricted funding poses severe challenges. The imagination and administrative capacities of the public sector will be put to the test.

The private sector, too, should prepare to carry its full share of responsibility in meeting the Nation's social and economic needs.

One of our scheduled witnesses, Edward H. Belanger, will be unable to be with us today, and his statement will be placed in the record.

[The statement of Edward H. Belanger, task force leader, city management advisory board, Niagara Falls, N.Y., follows:]

33-595 O - 78 - 16

Testimony of

EDWARD H. BELANGER
Task Force Leader
City Management Advisory Board
Niagara Falls, New York

U.S. House of Representatives
Subcommittee on the City
Committee on Banking, Finance and
Urban Affairs
July 26, 1978

In 1976 the problems of American cities generally were all present in Niagara Falls, New York, specifically: too much outgo, too little income; too many people on the payroll; poor organization; no fail-safe lid on spending; no accurate way to predict receipts and expenditures; no warning system to prevent a cash crisis; no planning. Niagara Falls had a seven year history of increasing budget deficits; the $1.6 million accumulated surplus of 1968 had become a $5.8 million accumulated deficit at the end of 1975.

When local industries proposed that the public sector accept help from the private sector, the consultants assigned by their firms to investigate city government found a very bleak situation. City personnel did not forecast short or long term cash needs, or control or invest the cash they had when they had any. Financial statements were usually months late and seldom accurate. Organization was unstructured and unwieldy. There were no job descriptions and no attempts to measure performance. Decentralized purchasing left to chance the ability to pool purchases and buy at lowest cost. Non-essential services consumed too much police and fire department time. None of the computer systems were documented. No one was concerned with energy use, energy costs or energy conservation. On-going urban renewal activities were not examined for their future impact on the budget.

In the remaining months of 1976 the consultants of the City Management Advisory Board, first proposed by William H. Wendel, then President of the Carborundum Company, the only Fortune 500 firm headquartered in Niagara Falls, and their counterparts in city hall, examined, probed, analyzed and dissected every area of city operation. For example, they installed a cash forecasting system, reduced head count by nearly twenty percent, reduced insurance costs by thirty percent, created a manageable organization, wrote job descriptions, examined budgets, centralized purchasing, leased instead of bought, increased police street patrol time, cracked down on overdue parking tickets, reduced one hundred ninety computer reports to forty, lowered the heat in municipal buildings, and reduced street lighting. The consultants even cost their firms money by suggesting that the city replace an antiquated system with new utility meters for industry.

Such efforts will work only if the public sector recognizes the need for and welcomes help so that cooperation is total, the city's chief executive is competent, the commitment to assist is made by the top level of the private sector, and qualified executives are assigned to help. All of these factors were true in Niagara Falls.

Niagara Falls could not have paid for the expertise of industry. It was given over three quarters of a million dollars in man hours alone. It could not pay for CMAB's on-going help in installing sophisticated management techniques in city hall. But then, industry in Niagara Falls could not afford to have the city go bankrupt.

There is a great deal of comment today regarding "Corporate Social Responsibility." By participating in the City Management Advisory Board, industries and businesses in the Niagara Falls area are responding to that aspect of social responsibility which deals with maintaining the financial integrity of the community. There is a desperate need for effective management in the business of running a government. Public officials are apt to be chosen because of their expertise in specific areas such as mental health, education, personnel, etc., rather than for their expertise in management. The main objectives of business and industry are not as easily applied in government.

It is advantageous for businesses to have an effective local government and businessmen have a unique capability of contributing the major ingredient which government lacks--managerial experience and expertise.

The City Management Advisory Board is a voluntary organization made up of businessmen, with varied functional expertise. Its main purpose is to restore financial and operational integrity and effectiveness to government in Niagara Falls. To this end, CMAB has the concurrence and active cooperation of the Mayor, City Council and City Manager. There are approximately twenty consultants available to CMAB from key area businesses. Each consultant gives anywhere from four to ten hours weekly to assist the City Administration in specific areas.

The substantial effort on the part of CMAB has engendered truly impressive results. I will attempt to illustrate our major accomplishments by functional area.

I. REORGANIZATION

A city wide management reorganization was effected. A cost effective organization structure was developed, reducing the number of people reporting to the city manager and creating a more manageable organization. Similar functions and administrative duties were consolidated. Productivity was increased by implementation of new management and measurement techniques, job descriptions, work guidelines and close monitoring of all functions. Performance measurements were adopted to measure the success of the above procedures. Professional help was brought in where needed. Management by objectives (MBO) was adopted by all departments to assure that employees accomplish the most important objectives based on essential community services. Training of department heads is now in progress to assist them in learning this new skill. A long range management development program has been begun, to further improve the management skills of department heads.

II. FINANCING

Major accomplishments were achieved in the finance area. A twenty million dollar financing was ultimately accomplished after the financial community in New York City snubbed the city's offer. Not a single bid was received. With the help of four local banks $7.5 million of the notes was bought. The people of Niagara asserted their support of the city by purchasing $1.2 million of the notes. Community response to the issue led two Manhattan brokerage firms to buy the remaining $11.4 million of the note issue at 9.3 percent interest twenty four hours before the city would default.

During 1976 the city verged on the brink of default at several times, and the CMAB assisted in developing contingency plans in case the city actually defaulated.

Other financings were successfully arranged, evidencing regained confidence in the city's control capabilities. The city sold $5.87 million in revenue anticipation notes at 4.2% in June 1977 down from a rate of 9 percent the previous year. In July 1977 the city sold $20.5 million of permanent financing at 6.2 percent. In March 1977 the city sold $3.45 million dollars of parking garage bond anticipation notes at an interest rate of 4.88 percent. The same notes were sold at 8.5 percent one year earlier.

A New York City public relations firm was engaged in order to disseminate information on the city's ever improving financial status to further assist the city in obtaining future financings.

III. BUDGETING & FINANCIAL PLANNING

CMAB assisted in reviewing accounting and budgeting procedures. Controls were established to better monitor receivables and disbursements to avoid a cash crisis. A cash forecasting and control systems was instituted and monitored weekly, and city personnel were trained to use the system, in order to avoid the city's cash flow problems of the past. Short term financing of $2.7 million was arranged with local banks at one point in order to also assist the city in its cash flow problem. Area banks were also educated regarding city finances to provide a more knowledgeable atmosphere for future financings.

The CMAB assisted in reviewing and modifying the 1977 budget to produce a realistic budget which could generate a surplus of $1.6 to $3.3 million in 1977 for reduction of the city's deficit of $5.8 million at the end of 1975.

The forecasting and financial planning areas were significantly restructured. This function played a major part in large cost reductions. The city switched to a private refuse collector with an annual savings of $300,000 to $400,000. A review of group and liability insurance premium yielded $160,000 three years savings. This insurance revision was accomplished by combining county and city insurance needs. Surplus city property was sold in order to raise cash.

A review of the city's financial reporting system and evaluation of outputs disclosed that financial formats were totally useless for effective management decisions; sound accounting discipline was lacking; budgets were not prepared on a calendar basis and no effective monitoring of plan performance was in operations. Outside consultants were engaged to review systems including accounting operations in depth.

In conjunction with 1977 bond financing, a realistic five year financial plan was developed which should assure stability and make tax reductions likely by 1980.

IV. HUMAN RESOURCES

In the personnel regorganization area, a trimmer staff was formed. A ten percent personnel cut was instituted immediately; other personnel were reassigned for greater efficiency. Related activities were combined to create a more manageable organization. Thirteen reporting relationships will eventually be reduced to 8 with attendant improved communications, reporting ease, and faster response times. Job specifications were developed for new positions. An Assistant City Manager, Director of Public Services and EDP Manager were recruited.

Personnel policies were changed to eliminate full pay for temporary military leave. Where weekend duty is frequent, as in the police and fire departments, military obligations were rearranged on days off.

The CMAB provided assistance and recommendations on contract negotiations considering cost versus ability to operate within a budget. Considerable cost reductions were achieved.

V. PROCUREMENT

In the procurement and contract services area, a complete review of all procedures was instituted. An analysis of the city's spending practices revealed many inefficiencies. An updated procedures manual incorporating more stringent policies was produced; improved inventory management resulted in savings of approximately $20,000 annually. Purchasing was centralized, budgeted and analyzed. Cost reduction targets were prioritized. $80,000 was saved on an annual basis by leasing, rather than purchasing, public works equipment. The CMAB recommended that common items used by multiple departments be identified, combined, and negotiated to reduce inventories and costs. It was also found that the city was paying higher prices for specific items than private industry was, and a recommendation to place greater emphasis on competitive bidding was made.

The city's entire paperwork flow was analyzed and changed to prevent bottlenecks which delayed processing and payment of invoices, without increasing control.

VI. PUBLIC PROTECTION

In the public protection area, effective working relationships were established. An atmosphere of mutual trust and cooperation was created among the Fire Department, Police Department, consultants, and City Management; Fire and Police personnel now actively solicit and accept advice from the consultants.

Through analysis, definition, internal training, and public relations, the public protection area implemented a program to eliminate non-essential police services, in particular, the filing of insurance forms at the station house, and the elimination of sixty school crossing guards. Police were instead assigned to the busiest school crossings on an "as needed" basis. The elimination of non-essential police services added more than 200 street patrol hours per month.

Substantial savings were made by upgrading firehouses instead of building new ones. A policy was implemented to reduce absenteeism from twelve to fifteen percent to approximately six percent. Initial results on this program are positive.

VII. ENERGY MANAGEMENT

At the end of 1975, no adequate budgeting procedures for variance reporting and forecasting in the energy area existed. No professional expertise in street lighting, power contracts, equipment purchasing, traffic patterns and vehicle usage resulted in increased costs. To implement cost reduction in the energy conservation area, CMAB recommended that the city install new utility meters for industries to generate additional annual revenues of $75,000. In addition, thermostats in municipal buildings were set at 65°, saving $15,000 annually. Street lighting costs were analyzed, with an objective of $100,000 reduction. It was determined that immediate savings of $20,000 annually could be achieved by reducing lighting in a specific area. Recommendations were also made by CMAB on equipment purchases, vehicle usage, traffic movement patterns, office lighting standards, and office heating and cooling standards.

VIII. PUBLIC WORKS

In the public works area, new procedures for street repairs, resulted in an annual savings of $80,000 in materials and labor. Fifteen to twenty employees involved in garbage "roll-out" were laid off. Instead, citizens were asked to roll out their own trash to the curb. Snow plow runs were revised, resulting in better utilization of labor and equipment savings of $45,000 annually. Increased productivity of parks and public roadway crews by reducing manpower without reducing work load brought about an annual savings of $36,000. Sewer treatment plant costs were analyzed and resulted in a reduction of utility usage, at an annual savings of $30,000.

IX. DATA PROCESSING-MANAGEMENT INFORMATION SYSTEMS

The CMAB discovered that one hundred fifty data processing systems reports were being produced, and succeeded in reducing the number of reports to less than forty. The MIS/EDP area was instrumental in instituting new procedures and producing $65,000 in overdue parking tickets, and incremental revenues of $90,000 by faster processing of water and sewer billing. The payroll system was determined to be unsound and technical support was given for normal maintenance. A basic financial control system was established to monitor non-personnel expenses, and a voucher control system was established to avoid duplicate systems.

In conclusion, the CMAB program has been extremely successful in the accomplishment of specific goals and objectives. The success can easily be measured in real terms. Niagara Falls had a seven year history of increasing budget deficits; at the end of 1975 there was a $5.8 million deficit. With the help of CMAB, the City, in 1976, turned a projected deficit of $1 million into a $748,000 surplus. In 1977 the surplus was $6.7 million. This completely extinguished the remaining accumulated deficit of $5.1 million and created a cumulative fund balance of $1.6 million as of December 31, 1977. The deficit of $5.8 million was eliminated in two years. The "proof of the pudding" as to the merit of this program can clearly be seen in the cited accomplishments. These results certainly indicate that the endeavors of CMAB have been more than worthwhile. Together, a lot of good men have turned an imminent disaster area into a viable and financially stable community. This experience is also proof that citizens of a community can be called upon in times of crisis to assist in the rescue of a city. Without the citizens of Niagara Falls, and their willing sacrifices, patience and understanding, the accomplishments of the CMAB could never have been achieved.

Chairman REUSS. I am pleased that Scott Fosler will be able to cover some of the private sector experience on which Mr. Belanger was going to testify.

I would like to personally thank Phyllis Lamphere for her forethought in suggesting that these hearings be held many, many months ago. I would also like to thank the staff of the National Center for Productivity and Quality of Working Life for their valuable assistance in organizing today's agenda.

The panel will be led off by the inspiring official, Phyllis Lamphere, who has been president of the Seattle city council and a member of the council since 1968. She served as president of the National League of Cities in 1977, and has been active in numerous national, State, and regional organizations dealing with urban problems, including the National Center for Productivity, Neighborhood Housing Services, and the Puget Sound Council of Governments.

So, Ms. Lamphere, we are grateful to you, not only for your presence and testimony here this morning, but for your inspiration for today's hearings. Would you lead off?

Under the rule and without objection, the excellent and compendious prepared statements and annexes of all witnesses will be received in full into the record. We are going to ask you to proceed in whatever form you like. Try to hold your presentation to around 10 minutes so that the panel and those who join us will have plenty of opportunity to exchange dialog.

STATEMENT OF PHYLLIS LAMPHERE, PRESIDENT, SEATTLE CITY COUNCIL

Ms. LAMPHERE. Mr. Chairman, Mr. Hanley, and interested persons present:

I want to extend my appreciation to you, Chairman Reuss, for your leadership in focusing on the problems of cities, the impact of proposition 13, the opportunities that lie ahead, and to do something constructive about such happenings.

At yesterday's hearing, there was discussion of why the taxpayers are in revolt and the consequences of that revolt for local government. You also heard proposals for curbing Government spending through structural and tax reform.

Today I am happy to introduce to you a more positive picture of how local governments can help themselves in a time of inflation and citizen unrest. Though sufficient and well-designed Federal and State programs are necessary to assure healthy cities, local governments can improve their efficiency by better management of existing technical, capital, and human resources.

Local governments are faced with a choice—bringing revenues and expenditures into balance by raising taxes, cutting services, or stretching service dollars through innovation, technology transfer and management improvement.

At this point, in the interest of time, I shall depart from my prepared text and just give you a few comments.

For a number of reasons, many of which were described to you yesterday, we now find ourselves at a place and time where citizens are more and more critical of Government, and there tends to be a widespread feeling that Government is doing too many things too poorly for too many people, and at too high a price. We are criticized for waste, mismanagement, bureaucratic empire-building, and deteriorating services. Soaring costs are eclipsing revenues, fanning inflation, and straining taxpayers to the point of rebellion.

But this perception as it applies to local government does not have to continue. Many cities are overcoming the problems through productivity improvements. In the 1977 report of the International City Management Association, it lists 285 examples of service improvements local governments have achieved through innovation.

The challenge before cities is how to respond more effectively to legitimate public needs for goods and services, without adding unnecessarily to the tax burden.

Productivity improvements are part of the answer to minimizing the costs of governmental services. Unfortunately, the term productivity is relatively new in the public sector and needs to be better understood. For local government, increased productivity implies changes in management, procedures, structure, and technology that either reduce costs or improve the quality of existing service delivery.

The tools for improving service delivery are available. Examples include: management-employee cooperation strategies, business techniques such as work measurement; management systems and manpower allocation programs; and structural and procedural alternatives.

Technological innovations are also extremely helpful to local governments, but in and of themselves cannot solve problems.

My colleagues on the panel this morning will describe many of the types of improvements that are being tried in cities today. We see several actions that must be undertaken simultaneously. We have to undergo an institutional introspection, to examine how local governments can bring about changes in service delivery and improve public accountability.

First, we must analyze how well we are functioning as institutions. Do we have the right audit techniques, budget procedures, and paper processing as streamlined as they can be.

Second, we must identify community needs and the level of satisfaction that exists with current services.

Third, governments must solicit employee attitudes, suggestions, and responses.

And finally, there must be an exchange of information and an analysis of effective practices in the private sector and in other jurisdictions.

The second thing we have to do is look at our relationship with citizens to see if we have the most effective partnership. We can apply marketing techniques. They can be used to change behavior and to alter the demand for public services. For example, if a citizen learns to conserve energy or avoid littering, the cost of those services will be reduced. The fact is, there are many activities that would be extremely difficult or costly to regulate. So the obvious alternative is to develop a sense of citizen responsibility to deal with the problem in another way.

By marketing transit, we realize an alternative to private transportation, and the end result is reduced congestion and pollution and a more desirable place to live in the city context.

The third area of emphasis should be in the field of employee relations. You heard yesterday many discussions about employee demands and about the inability of management to resist those demands. One way that we have found to make some real progress is through cooperative labor-management efforts within the public sector, where managers can emphasize job fulfillment and satisfactory working conditions, and employees can get a fuller appreciation of what the real constraints are within the system.

The notion of labor-management committees, particularly in unionized cities, is gaining more and more favor and a more favorable track record.

The fourth area of concentration is in the field of public-private cooperation, where communication and interaction with the private sector is becoming a reality. Local government can take the initiative to mobilize a community to solve its problems.

Just one example is a revitalization of Jamestown, N.Y., where the mayor got the unions and management from the town's many industries together to discuss how to improve labor-management relations to prevent continuing strikes, and to prevent industries from moving out of the city. The results were: growth of existing industry, attraction of new industries, 50 percent reduction in unemployment, widened worker participation, and improved quality of working life.

There is much we can learn from the private sector in its technical expertise and in availing ourselves of public services which can be provided through the private sector. Further, the private sector is in a position to hold public officials accountable, as are citizens at large. The stability of business and industry depends upon how responsive local governments can be.

I am concerned about some of what I heard yesterday. I am a politician and I can't subscribe to the Government is bad school, although I concur we have got to clean up our act. But let's not close our eyes and apply the Jarvis-Gann meatax indiscriminately. Let's use critical and selective judgment. As a spokesperson for local government, I am delighted to see signs, such as your committee, Chairman Reuss, that the Federal Government is becoming more aware of its people constituency and less protective of its bureaucratic turf.

Mr. McKinney's tale yesterday about the little old lady and the IRS was typical and we all know it. As president of the National League of Cities, I testified frequently in front of congressional committees, and I frequently use the phrase: No one lives at the Federal level. We share the same constituency, and the more we are able to concentrate on that constituency, collectively and cooperatively, the better job will we perform and the better service we will provide for our citizens.

But to suggest, as I heard yesterday by some, that we respond to Jarvis-Gann by cutting such programs as general revenue sharing, is in my judgment absolutely ridiculous. Setting criteria, demanding good planning and performance and decentralized decisionmaking is cost effective. Local government can make tough decisions and tough choices, and it is in the best position to do so. We don't need the

State and/or Federal Government constantly looking over our shoulders and compounding our costs by overregulation, monitoring, evaluation, and duplication. The citizens will do that through initiative or referendum when reason fails.

And let me cite one other example. One program, that shall remain nameless, aimed at hitting targets of unemployment in cities, as it played out in my State of Washington, resulted in the city's largest, or the State's largest city, in the center of its poverty problems, getting not 1 cent of funds and a city of 327 getting $1.6 million.

We also heard about deferred maintenance, and I think there are ways of dealing with that, by encouraging productivity improvement in State and local government, by setting up a revolving fund where cities could take out a loan for technological or system or communication improvement, and repay it out of savings realized.

In summary, there are things we can do. We can group them under the rubric of productivity improvements. We can address responsibilities, and we can do it with greater effectiveness. So today you will hear from some of those individuals who have personal experiences with successful productivity in their cities.

I want to thank you for allowing us to come before you today. We think we can find the answer to the urban fiscal dilemma in proposition 13. Thank you, Mr. Chairman.

[Ms. Lamphere's prepared statement follows:]

REMARKS BY

THE HONORABLE PHYLLIS LAMPHERE
PRESIDENT
SEATTLE CITY COUNCIL

BEFORE THE
SUBCOMMITTEE ON THE CITY
OF THE
COMMITTEE ON
BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

JULY 26, 1978

PRODUCTIVITY WORKS FOR
LOCAL GOVERNMENT

AT YESTERDAY'S HEARING YOU HEARD DISCUSSION OF WHY THE TAXPAYERS ARE IN REVOLT AND THE CONSEQUENCES OF THAT REVOLT FOR LOCAL GOVERNMENT. YOU ALSO HEARD PROPOSALS FOR CURBING GOVERNMENT SPENDING THROUGH STRUCTURAL AND TAX REFORM.

TODAY I AM INTRODUCING TO YOU A MORE POSITIVE PICTURE OF HOW LOCAL GOVERNMENTS CAN HELP THEMSELVES IN A TIME OF INFLATION AND CITIZEN UNREST. THOUGH SUFFICIENT AND WELL DESIGNED FEDERAL AND STATE PROGRAMS ARE NECESSARY TO ASSURE HEALTHY CITIES, LOCAL GOVERNMENTS CAN IMPROVE THEIR EFFICIENCY BY BETTER MANAGEMENT OF EXISTING TECHNICAL, CAPITAL, AND HUMAN RESOURCES.

LOCAL GOVERNMENTS ARE FACED WITH A CHOICE -- BRINGING REVENUES AND EXPENDITURES INTO BALANCE BY RAISING TAXES, CUTTING SERVICES, OR STRETCHING SERVICE DOLLARS THROUGH INNOVATION, TECHNOLOGY TRANSFER AND MANAGEMENT IMPROVEMENT.

BEFORE EXAMINING SOME OF THE INNOVATIONS THAT HAVE PROVEN SUCCESSFUL, IT IS IMPORTANT TO UNDERSTAND THE IMPACT OF THE PUBLIC SECTOR ON THE ECONOMY AS A WHOLE AND WHY PRODUCTIVITY MEASURES ARE SO NECESSARY.

THE ROLE OF THE PUBLIC SECTOR IN THE ECONOMY IS SUBSTANTIAL, WITH STATE AND LOCAL GOVERNMENT ALONE ACCOUNTING FOR ALMOST 15% OF THE GROSS NATIONAL PRODUCT. STATE AND LOCAL GOVERNMENTS EMPLOY 15.4 MILLION PERSONS OR 17% OF ALL EMPLOYEES IN THE NATION.

33-595 O - 78 - 17

MANY OF THE SERVICES PROVIDED BY THE PUBLIC SECTOR ALSO CONTRIBUTE DIRECTLY TO THE PRODUCTIVITY AND QUALITY OF WORKING LIFE OF OTHER SECTORS OF THE ECONOMY. FOR EXAMPLE, LOCAL GOVERNMENTS PROVIDE THE BASIC INFRASTRUCTURE FOR CITIES -- THE ROADS WHICH TRANSPORT GOODS AND MATERIALS AND THE UTILITIES UPON WHICH RESIDENTIAL AND INDUSTRIAL DEVELOPMENT DEPENDS. MOREOVER, MANY IMPROVEMENTS IN THE STANDARD OF LIVING -- BETTER HOUSING, INCREASED RECREATION OPPORTUNITIES, HEALTH AND DAY CARE AVAILABILITY -- DEPEND UPON GOVERNMENT SUPPORT AND LEADERSHIP.

SINCE 1954 LOCAL GOVERNMENT EXPENDITURES HAVE INCREASED ALMOST NINE-FOLD,BECAUSE OF EXPANDED ACTIVITIES, AN EXPANDED WORK FORCE, HIGHER WAGES, AND HIGHER COSTS OF GOODS AND SERVICES PURCHASED. FACTORS CONTRIBUTING TO THIS CONDITION ARE MANY. SPECIFICALLY, THERE HAS BEEN AN INCREASE IN THE NUMBER OF PEOPLE SERVED BY LOCAL GOVERNMENT. THE WORKLOAD HAS INCREASED WITH URBAN GROWTH AND THE NEED TO DEAL WITH SUCH PROBLEMS AS TRAFFIC CONGESTION, SOLID WASTE DISPOSAL, CRIME, AND PARK AND STREET MAINTENANCE. CITIZENS HAVE DEMANDED HIGHER LEVELS OF SERVICE FOR EXISTING FUNCTIONS. TRANSFER PAYMENTS AND OTHER BENEFITS TO LOWER INCOME GROUPS HAVE EXPANDED. LOCAL GOVERNMENTS HAVE BEEN DIRECTED BY FEDERAL LEGISLATION INTO NEW FIELDS SUCH AS MANPOWER DEVELOPMENT, ENVIRONMENTAL PROTECTION, AND SPECIAL OCCUPATIONAL TRAINING FOR THE YOUNG. THESE FACTORS ARE EXACERBATED BY RAMPANT INFLATION. SINCE 1970 ALONE PRICES HAVE INCREASED ALMOST 36%.

TO COMPLICATE THIS DILEMMA, CITIZENS ARE MORE AND MORE CRITICAL OF GOVERNMENT AND THERE TENDS TO BE A WIDESPREAD FEELING THAT GOVERN-

MENT IS DOING TOO MANY THINGS TOO POORLY FOR TOO MANY PEOPLE AND AT TOO HIGH A PRICE.

GOVERNMENT IS CRITICIZED FOR WASTE, MISMANGEMENT, BUREAUCRATIC EMPIRE BUILDING, AND DETERIORATING SERVICES. SOARING GOVERNMENT COSTS ARE ECLIPSING REVENUES, FANNING INFLATION, AND STRAINING TAXPAYERS TO THE POINT OF REBELLION.

BUT THIS PERCEPTION OF LOCAL GOVERNMENT DOES NOT HAVE TO CONTINUE. MANY CITIES ARE OVERCOMING THE PROBLEMS THROUGH PRODUCTIVITY IMPROVEMENTS. MANY MORE CITIES CAN LEARN FROM THEIR EXPERIENCE. A 1977 REPORT OF THE INTERNATIONAL CITY MANAGEMENT ASSOCIATION LISTS 285 EXAMPLES OF SERVICE IMPROVEMENTS LOCAL GOVERNMENTS HAVE ACHIEVED THROUGH INNOVATION. TRUE, NO TWO CITIES ARE ALIKE, BUT TECHNOLOGIES AND SYSTEMS CAN BE ADAPTED TO FIT THE NEEDS OF CITIES OF VARYING AGE, SIZE AND GOVERNMENTAL STRUCTURE.

THE CHALLENGE BEFORE CITIES IS HOW TO ENABLE GOVERNMENT TO RESPOND MORE EFFECTIVELY TO LEGITIMATE PUBLIC NEEDS FOR GOODS AND SERVICES WITHOUT ADDING UNNECESSARILY TO THE TAX BURDEN.

PRODUCTIVITY IMPROVEMENTS ARE PART OF THE ANSWER TO MINIMIZING THE COSTS OF GOVERNMENTAL SERVICES. UNFORTUNATELY, THE TERM PRODUCTIVITY IS RELATIVELY NEW IN THE PUBLIC SECTOR AND NEEDS TO BE BETTER UNDERSTOOD. FOR LOCAL GOVERNMENT, INCREASED PRODUCTIVITY IMPLIES CHANGES IN MANAGEMENT, PROCEDURES, STRUCTURE, AND TECHNOLOGY THAT EITHER REDUCE COSTS OR IMPROVE THE QUALITY OF EXISTING SERVICE DELIVERY. IT SHOULD BE MADE CLEAR THAT ECONOMIES ARE MEANINGLESS UNLESS THE QUALITY OF SERVICE IS MAINTAINED OR IMPROVED.

THE TOOLS FOR IMPROVING SERVICE DELIVERY ARE AVAILABLE. EXAMPLES INCLUDE, MANAGEMENT/EMPLOYEE COOPERATION STRATEGIES, BUSINESS TECHNIQUES SUCH AS WORK MEASUREMENT, MANAGEMENT SYSTEMS AND MANPOWER ALLOCATION PROGRAMS, AND STRUCTURAL AND PROCEDURAL ALTERNATIVES. TECHNOLOGICAL INNOVATIONS ARE ALSO EXTREMELY HELPFUL TO LOCAL GOVERNMENTS, BUT IN AND OF THEMSELVES CANNOT SOLVE PROBLEMS. FRONT END COSTS ARE OFTEN HORRENDOUS AND UNLESS A GOVERNMENT HAS SKILLED MANAGEMENT, TRAINED EMPLOYEES, AND PROCEDURES DESIGNED TO MAKE THE BEST USE OF THE TECHNOLOGY, THE POTENTIAL BENEFITS OF NEW TECHNIQUES AND EQUIPMENT WILL NOT BE REALIZED.

LET US EXAMINE THE POTENTIAL OF PRODUCTIVITY IMPROVEMENTS AS THEY ARE SURFACING IN VARIOUS CITIES ACROSS THE NATION.

MANY OF THE BASIC DAILY NEEDS OF CITIZENS - GARBAGE COLLECTION, STREET MAINTENANCE, ANIMAL CONTROL, PUBLIC SAFETY, AND FIRE PREVENTION, ARE TOTALLY THE RESPONSIBILITY OF LOCAL GOVERNMENTS TO ADMINISTER. IN ORDER TO PROVIDE ESSENTIAL SERVICES WITH EXISTING RESOURCES, LOCAL GOVERNMENTS HAVE FOUND WAYS TO IMPROVE EXISTING INTERNAL OPERATIONS AND EXTERNAL DELIVERY SYSTEMS. IN KANSAS CITY, THE LOCAL GOVERNMENT TOOK ON THE FIRE DEPARTMENT AND CAME UP WITH BETTER ALLOCATION OF FIREMEN AND LOCATION OF TRUCKS FOR DETACHMENT. IN DETROIT GARBAGE COLLECTION WAS IMPROVED BY OFFERING GARBAGEMEN A SHARE IN THE SAVINGS ACCRUED THROUGH BETTER PICK UP PRACTICES.

SAVANNAH SURVEYED THE PHYSICAL CONDITION OF THEIR NEIGHBORHOODS TO FIND OUT WHAT IMPROVEMENTS WOULD HELP EACH DIVERSIFIED

AREA. RATHER THAN RESPONDING TO SPECIAL INTERESTS, SAVANNAH REDESIGNED THEIR SERVICE DELIVERY BASED ON ACTUAL NEED. THE RESULTS WERE TREMENDOUS WITH A READJUSTMENT IN HOW FUNDS WERE BEING SPENT IN DIFFERENT AREAS OF THE CITY.

LONG BEACH, CALIFORNIA WAS SUCCESSFUL IN SURVEYING THEIR CITIZENS AND EMPLOYEES TO DETERMINE HOW SERVICES SHOULD BE READJUSTED AND FOR WHAT PURPOSES.

BUT LOCAL GOVERNMENTS CANNOT BE CONCERNED WITH JUST DAILY SERVICES. THEY MUST BE CONCERNED WITH FACTORS AFFECTING THE QUALITY OF LIFE SUCH AS TRAFFIC CONGESTION, SCARCE RESOURCES, AND DETERIORATING HOUSING STOCK.

GOVERNMENTS ARE APPROACHING THIS CHALLENGE IN MANY INNOVATIVE WAYS. ALEXANDRIA, VIRGINIA HAS ESTABLISHED A FLEXITIME PROGRAM TO REDUCE TRAFFIC CONGESTION CAUSED BY HAVING ALL EMPLOYEES REPORT FOR WORK AT THE SAME TIME. THIS ALSO IMPROVED EMPLOYEE ATTITUDES AND JOB SATISFACTION WHICH LED TO GREATER OUTPUT. CINCINNATI HAS BEGUN A COMPREHENSIVE PROGRAM TO ENCOURAGE PEOPLE TO MOVE BACK INTO EXISTING CITY NEIGHBORHOODS.

AS ENERGY RESOURCES BECOME MORE AND MORE SCARCE, AND THE ENVIRONMENTAL COSTS OF PRODUCING BECOME MORE APPARENT,LOCAL GOVERNMENTS ARE SEEKING WAYS TO REDUCE CONSUMPTION. DALLAS HAS DEVELOPED ENERGY CONSERVATION STANDARDS FOR NEW BUILDINGS AND THEREBY REDUCED ENERGY LOSS AND HEATING COST SUBSTANTIALLY. MEREDITH, NEW HAMPSHIRE WITH A POPULATION OF ONLY 3,000 HAS DEVELOPED EFFECTIVE SOLID WASTE RESOURCE RECOVERY METHODS.

THIS IS JUST A SMALL SAMPLING OF THE MANY CITY INNOVATIONS UNDERWAY BUT AS YOU CAN SEE, A LOT OF CITIES ARE DOING A LOT OF EXCITING THINGS ON THEIR OWN.

LET US NOW EXAMINE HOW LOCAL GOVERNMENTS CAN BRING ABOUT CHANGES IN SERVICE DELIVERY AND IMPROVE PUBLIC ACCOUNTABILITY.

LOCAL GOVERNMENTS MUST FIND OUT WHERE THEY ARE AND DECIDE WHERE THEY ARE GOING IN ORDER TO MAKE USE OF PRODUCTIVITY TOOLS. THE STRATEGY FOR CHANGE INCLUDES FOUR STEPS. FIRST, LOCAL GOVERNMENTS MUST ANALYZE HOW WELL THEY ARE FUNCTIONING AS AN INSTITUTION -- ARE AUDIT TECHNIQUES, BUDGET PROCEDURES, AND PAPER PROCESSING AS STREAMLINED AS THEY CAN BE? SECOND, GOVERNMENTS MUST IDENTIFY COMMUNITY NEEDS AND SATISFACTION WITH CURRENT SERVICES. THIRDLY, GOVERNMENTS MUST SOLICIT EMPLOYEE ATTITUDES, SUGGESTIONS, AND CAPABILITIES. AND FINALLY, THERE MUST BE EXCHANGE OF INFORMATION AND ANALYSES OF EFFECTIVE PRACTICES IN THE PRIVATE SECTOR AND IN OTHER JURISDICTIONS.

TO DETERMINE HOW WELL A GOVERNMENT IS DOING ITS JOB TAKES A STRONG COMMITMENT TO MANAGE AND A CAPABLE ANALYTIC STAFF. SPECIFIC ANALYTICAL SKILLS ARE NECESSARY TO DEVELOP POLICY OPTIONS AND DETERMINE FINANCIAL AND SOCIAL IMPACTS OF PARTICULAR PROGRAMS. SOUND DATA IS ESSENTIAL FOR SETTING CLEAR PRIORITIES AMONG COMPETING PROGRAMS AND IDENTIFYING BETTER WAYS OF OPERATING THOSE PROGRAMS. IF POLICY DECISIONS ARE BASED ON REASONABLE CRITERIA AND PROGRAMS OPERATE EFFICIENTLY, THE CREDIBILITY OF ELECTED OFFICIALS WILL IMPROVE.

ONCE A CITY HAS ASSESSED ITS INTERNAL OPERATIONS IT MUST IDENTIFY LEGITIMATE COMMUNITY NEEDS AND SATISFACTION WITH SERVICES.

THE TOOL OF CITIZEN AND DEMOGRAPHIC SURVEYS HAVE BEEN MOST HELPFUL TO DETERMINE WHAT SERVICES SHOULD BE PROVIDED AND WHETHER RESOURCES SHOULD BE REALLOCATED. UNLESS YOU ARE KEEPING SCORE, IT IS DIFFICULT TO KNOW WHETHER YOU ARE WINNING OR LOSING. THIS APPLIES TO BALL GAMES, CARD GAMES AND NO LESS SERVICE DELIVERY.

AT THE SAME TIME CITIZENS MUST BE AWARE WHAT GOVERNMENT CAN AND CANNOT DO. CITIZENS WANT POLICY DECISIONS THAT WILL IMPROVE THEIR QUALITY OF LIVING -- WORK, HOUSING, AND RECREATIONAL OPPORTUNITIES AT REASONABLE COSTS.

IT IS UP TO LOCAL GOVERNMENT TO IMPROVE THE INTERACTION AND COMMUNICATION WITH ITS CITIZENRY SO THEY HAVE A BETTER UNDERSTANDING AND APPRECIATION OF THE PROBLEMS FACING THEIR CITY AND THE CAPACITY FOR SOLVING THEM. MARKETING OF PUBLIC SERVICES IS A TOOL TO BETTER INFORM THE PUBLIC. AGGRESSIVE INFORMATION CAMPAIGNS HAVE MADE PEOPLE FEEL THAT A SYSTEM OR SERVICE IS GOOD AND THAT IT IS THEIRS. BY EDUCATING AND WORKING WITH THE PUBLIC, GOVERNMENTS CAN STIMULATE THE USE OF UNDERUTILIZED SERVICES SUCH AS HOUSING STOCK.

CITIZENS CAN ALSO BE ENCOURAGED TO BECOME A PART OF THEIR CITY AND HELP REDUCE GOVERNMENT COSTS. FOR EXAMPLE, IF A CITIZEN LEARNS TO CONSERVE ENERGY OR NOT TO LITTER, THE COST OF GOVERNMENT SERVICE DELIVERY WILL BE REDUCED. THE FACT IS, THERE ARE MANY ACTIVITIES THAT WOULD BE EXTREMELY DIFFICULT OR COSTLY TO REGULATE SO THE OBVIOUS ALTERNATIVE IS TO DEVELOP A SENSE OF CITIZEN RESPONSIBILIITY. GOVERNMENT CANNOT REGULATE WHICH ROUTE COMMUTERS WILL TAKE OR MAKE CITIZENS GET OUT OF THEIR CARS ON TO BUSES, BUT IT CAN PROVIDE INFORMATION ABOUT ALTERNATIVE ROUTES AND PROVIDE INFORMATION ABOUT THE

CONVENIENCE OF TRANSIT SERVICE. SUCH EFFORTS ALSO SERVE A GREATER PUBLIC GOOD BY REDUCING CONGESTION AND POLLUTION WHILE MAKING THE CITY A MORE DESIRABLE PLACE TO LIVE.

BUT KNOWING WHAT NEEDS TO BE DONE AND HAVING THE COMMITMENT OF MANAGEMENT IS NOT SUFFICIENT TO IMPROVE SERVICE DELIVERY. GOVERNMENT EMPLOYEES MUST BE INVOLVED TO MAKE PRACTICAL SUGGESTIONS THROUGH THEIR ON-THE-JOB EXPERIENCE. EMPLOYEES MUST BE INVOLVED IN PROGRAM PLANNING. AFTER ALL, THE PERSON ON THE SHOP FLOOR KNOWS BETTER THAN ANYONE ELSE HOW TO IMPROVE HIS OR HER JOB. THERE MUST BE AN EMPHASIS ON JOB SATISFACTION AND EMPLOYEES MUST BE ALLOWED TO SHARE IN THE BENEFITS OF WORK IMPROVEMENT, INCLUDING WAGES, WORKING CONDITIONS AND JOB SECURITY. DUE TO HIGH RATES OF UNEMPLOYMENT AND RISING LABOR COSTS THERE IS MORE AND MORE NEED FOR COOPERATIVE LABOR/MANAGEMENT EFFORTS TO RAISE THE LEVEL OF PRODUCTION IN ORDER TO DECREASE LABOR COSTS AND INCREASE JOB SECURITY. INSTEAD OF DEMANDING GREATER OUTPUT OF EMPLOYEES MANAGERS MUST EMPHASIZE JOB FULFILLMENT AND SATISFACTORY WORKING CONDITIONS.

IN A TIME OF INFLATION WHICH ERODES WORKERS REAL EARNINGS AND ENDANGERS THEIR STANDARD OF LIVING, LABOR/MANAGEMENT COOPERATIVE EFFORTS ARE NEEDED FOR A NUMBER OF REASONS: (1) TO MAKE NEW ENERGY SUPPLIES GO FURTHER, (2) ELIMINATE WASTE OF MATERIALS AND SUPPLIES, (3) REDUCE BREAKAGE OF EQUIPMENT AND TOOLS, AND (4) REDUCE WASTE OF LABOR DUE TO ACCIDENTS, ABSENTEEISM, LACK OF TRAINING, LOW MORALE AND JOB DISSATISFACTION.

THE NOTION OF LABOR/MANAGEMENT COMMITTEES, PARTICULARLY IN UNIONIZED CITIES, IS GAINING MORE AND MORE FAVOR. WHILE NEGOTIATION AT THE BARGAINING TABLE IS ESSENTIAL TO PROTECT EMPLOYEES' RIGHTS, COMPLEX PROBLEMS ASSOCIATED WITH PRODUCTIVITY AND QUALITY OF WORK PLACE CAN MORE EASILY BE HANDLED THROUGH CONTINUOUS EXCHANGE OF INFORMATION.

INSTITUTIONAL REFORM IS ESSENTIAL TO REDUCING COSTS AND GIVING OFFICIALS THE FISCAL ABILITY TO ABSORB NEW PROGRAM, HOWEVER THE COMMUNICATION AND INTERACTION WITH THE PRIVATE SECTOR IS IMPERATIVE FOR THE SURVIVAL OF A CITY AS A WHOLE. GOVERNMENTS MUST OPEN THE DOOR FOR MORE CONTACT POINTS WITH PRIVATE BUSINESS--A TREMENDOUS FORCE THAT SHOULD BE HARNESSED. MOST PEOPLE TAKE IT FOR GRANTED THAT CERTAIN OPPOSITIONS EXIST BETWEEN THE PRIVATE SECTOR AND THE PUBLIC SECTOR. BUT THIS DOES NOT HAVE TO BE THE CASE. WE MUST OVERCOME AVOIDANCE AND UNDERTAKE NEW FORMS OF INTERACTION AND COOPERATION.

LOCAL GOVERNMENT CAN TAKE THE INITIATIVE TO MOBILIZE A COMMUNITY TO SOLVE ITS PROBLEMS OR CREATE THE CLIMATE NECESSARY FOR BUSINESS TO INITIATE INNOVATIVE PROGRAMS INDEPENDENTLY. AN EXAMPLE OF THIS IS THE REVITALIZATION OF JAMESTOWN, NEW YORK WHERE THE MAYOR GOT THE UNIONS AND MANAGEMENT FROM THE TOWN'S MANY INDUSTRIES TOGETHER TO DISCUSS HOW TO IMPROVE LABOR-MANAGEMENT RELATIONS AND PREVENT CONTINUING STRIKES AND INDUSTRIES FROM MOVING OUT OF THE CITY. THE RESULTS WERE GROWTH OF EXISTING INDUSTRY, ATTRACTION OF NEW INDUSTRIES, 50% REDUCTION IN UNEMPLOYMENT, WIDENED WORKER PARTICIPATION AND IMPROVED QUALITY OF WORKING LIFE.

THE PRIVATE SECTOR CAN FURTHER HELP BY CONTRIBUTING DIRECTLY TO THE SUPPORT OF COMMUNITY ORGANIZATIONS AND ACTIVITIES AND BY LENDING

ITS TECHNICAL EXPERTISE TO IMPROVE GOVERNMENT OPERATIONS AND SOLVE LOCAL PROBLEMS. THE PRIVATE SECTOR CAN PROVIDE SOME PUBLIC SERVICE PROGRAMS DIRECTLY. IN TACOMA, FOR EXAMPLE, THE PRIVATE SECTOR PROVIDED A FIRE PREVENTION SMOKE DETECTION PROGRAM. ANOTHER AREA FOR COOPERATION IS NEW DEVELOPMENT. SEATTLE IS WORKING WITH DOWNTOWN BUSINESSMEN TO BUILD A COMPLEX OF OFFICE BUILDINGS COMPLEMENTED BY PUBLIC AMENITIES. OTHER CITIES ARE BRINGING IN SPECIALISTS FROM INDUSTRY ON EXCHANGE PROGRAMS TO HELP THEM DEVELOP NEW BUDGETING PROCESSES.

THE PRIVATE SECTOR IS IN A POSITION TO HOLD PUBLIC OFFICIALS ACCOUNTABLE AS ARE CITIZENS AT LARGE. THE STABILITY OF BUSINESS AND INDUSTRY DEPENDS UPON HOW RESPONSIVE LOCAL GOVERNMENTS CAN BE.

IN SUMMARY PRODUCTIVITY PROGRAMS WHICH IMPROVE THE MANAGEMENT AND OPERATION OF LOCAL GOVERNMENT AND INCREASE THE INTERACTION AND COOPERATION BETWEEN THE PUBLIC AND PRIVATE SECTORS CAN HELP REDUCE COSTS. SUCH EFFORTS CAN GIVE LOCAL OFFICIALS THE FISCAL ABILITY TO ABSORB NEW PROGRAMS AND DEAL WITH NEW CHALLENGES.

MANY GOVERNMENTS HAVE SUCCESSFULLY REDUCED COSTS AND IMPROVED THE EFFECTIVENESS OF SERVICE DELIVERY AND OTHERS CAN LEARN FROM THEIR EFFORTS. ONLY RESPONSIVE, RESPONSIBLE GOVERNMENT WILL QUELL THE TIDE OF THE TAXPAYERS REVOLT.

TODAY WE WILL HEAR FROM SOME OF THOSE INDIVIDUALS WHO HAVE HAD PERSONAL EXPERIENCES WITH SUCCESSFUL PRODUCTIVITY IN THEIR CITIES.

I THANK YOU FOR THE OPPORTUNITY TO PUT BEFORE YOU EXAMPLES OF LOCAL GOVERNMENT PRODUCTIVITY WHICH PROVIDE PART OF THE ANSWER TO URBAN PROBLEMS TODAY.

Chairman REUSS. Thank you, Ms. Lamphere.

We will now hear from our first panel, which consists of four professionals: Camille Cates, assistant city manager of Dallas, Tex.; William Donaldson, city manager of Cincinnati, Ohio; Arthur Mendonsa, city manager of Savannah, Ga.; and Donald Wasserman, research director of the American Federation of State, County & Municipal Employees (AFSCME). They will focus on how can local governments make more efficient use of their limited resources, and following them will be a shorter panel on how can the public and private sectors cooperate in improving local government service delivery?

Ms. Cates, would you start off?

STATEMENT OF CAMILLE CATES, ASSISTANT CITY MANAGER, DALLAS, TEX.

Ms. CATES. It is a strange time for cities. Just as we got out of the social turbulence of the sixties, we found ourselves in the financial crisis of the seventies. Now as we begin to get our financial houses in order, we are faced with talk of tax revolt and limited revenues. This affects not just cities in trouble, but cities in relatively positive circumstances.

Dallas, for example, has the good fortune of a strong economy. In fact, Dallas has decreased its property tax rate for the last 2 years. We have established reserves. We are implementing the financial strategies that supposedly make for sound cities. And yet, this is the year when we hear from our own citizens in the city of Dallas and in the State of Texas that taxes are too high and that they must come down.

The responses to this type of tax revolt and tax inititiative are as varied and as complicated as its causes. There is no magic. Productivity is not a panacea. It is a hard, long-range process that depends on sound management. There are many obstacles.

I would like to identify some of the obstacles that we see to improving productivity and to increasing efficient use of resources.

The first one is complexity. Issues are complex. Information systems are complex. Organizations, government organizations, are now complex. We are operating big businesses and the tasks are not simple.

A second obstacle is conflicting and increasing demands. These demands come not just from our citizens, but from State and Federal mandates.

A third obstacle is the inertia of bureaucratic organizations, which is manifested in things like civil service systems and independent units functioning in one government organization.

A fourth obstacle is limited resources. Resources are not just revenue, but what inflation is doing to that revenue. There are other limited resources, such as energy.

In addition, another obstacle is the separation of spending discretion from responsibility for spending. We see this most prominently in our retirement systems. The benefits, the funding levels, are set by the State, and yet it is the city's responsibility to carry them out. We are now faced with an actuarial situation which puts our cities' financial condition in jeopardy. But these are not the only types of separations of spending discretions from responsibility. Federal mandates, in such things as water quality, impact the cost of doing business for us on a day-to-day basis.

Another obstacle that cities face is the lengthening time requirements to implement city policies. It now takes us 10 to 15 years to build a road, and 15 to 20 years to build a water reservoir. That plays havoc with those who insist on short-range plans, and makes it very difficult to continue to fly by the seat of our pants.

Another major obstacle is a lack of very many things: accountability, controls, skills, standards, and incentives.

On top of all of this, if we surmounted all these obstacles, the final one would make us start all over. The environment and the conditions are constantly changing.

This is not an unbeatable circumstance. In the light of these obstacles, the challenge is still acceptable, and success is still possible in cities. Here are some of the strategies that are used in the city of Dallas to face some of these obstacles.

To look at the issues of accountability and control and complexity, we have developed management systems and tie new programs into these systems. Particularly important are resource allocation systems, the target budgeting procedure that is explained in the written testimony, resource and performance monitoring, which is our automated FIRMS accounting system—financial integrated resource management system—and, performance evaluation. Evaluation not just of budget goals, but of individual managers' responsibility for their programs.

Besides developing systems, it is important to automate them. As I mentioned, the FIRMS system is an automated system. The more things that can be automated, the more things you can use technology, the more the manager's time can be spent on exceptions. This is a way to make efficient use of a very important resource: the manager's time.

Another very important strategy is to develop long-range plans. We have a 5-year financial plan as well as some specific multiyear performance criteria that have been accepted and adopted by the city council. Both give us guidelines into the future for such things as selling bonds and developing new capital programs.

It is also important to look at the role of government and to leverage the resources that we do have to produce programs without having to pay for them all.

One very important area is public-private cooperation. Dallas has just passed bonds to build a new central library, $15 million of which has been donated by the private sector. In addition, Dallas considers the use of volunteers in the city organization a valuable resource, not only to provide extra work for the citizens, but to give them an understanding of the workings of their own local government.

We participate with banks in a loan consortium program to provide loans for low-income housing. That enables us to use money as seed money and guarantee money, and encourage inner city housing.

We are also developing, with the private sector, major projects downtown. The most significant one, which has just been completed, is the Reunion project, which is a restaurant-hotel complex, with a revitalization of a historic transportation terminal.

Public-private sector cooperation is one way to leverage resources and to define the role of government. Another major way is in intergovernmental cooperation. The local level has many single-member districts, it has a county government—it has a city government—all of these things serving the same constituency and frequently with overlapping services. Working with these governmental units to decide whose job it is to do what is a very important task ahead of us.

Recently, the city of Dallas has cooperated with the county of Dallas to build a new criminal justice facility. The city of Dallas is now out of the jail business and we can retire the bonds from the savings in operating costs from the first 10 years alone.

Another major strategy is to conserve resources. Dallas has instituted a program for energy conservation in its buildings which ranges fom setting the thermostats at 68 and 78 degrees, to retrofitting old buildings, to developing design standards for all new construction of city facilities in Dallas.

Another major strategy which Dallas is using sounds very simple. It is to link the service with the cost of providing the service. What this translates into is a shift from the reliance on property tax in our municipal financial structure. It also disciplines the demand for service. When various levels of garbage collection are offered at various fees, only those who want backdoor pickup will pay for it.

In addition, we have established various enterprises in our operations, so that departments operate as subsidiaries of the municipal corporation and pay their own way. Our water utilities department, our aviation department, and various other enterprises in the city are operated on this private sector model.

We have also instituted nonresident fees, so that the citizens who are paying for the services can use them and those who are not paying taxes discipline their demand.

We have also established reserves, so that we can prepare for any unforeseen financial change.

We also make it a policy to continuously allocate a portion of our income to the capital facilities, so that we have a program of keeping up while we are catching up, so we don't have massive capital expenditures facing us 15 or 20 years down the road.

The last thing that we have tried to do is to develop incentives for productivity improvement and performance. We initiated a program to return a portion of the productivity savings to employees this year. In addition, we have a program called Dallas innovations, which highlights productivity programs in the various city departments, and recognizes managers. In addition, the managers—the department directors'—salary raises each year are tied, at least in part, to their performance on the budget and improving productivity.

What does this all mean? It means that tax revolt did not make cities start thinking about their financial condition. Cities have been worrying about this and taking positive steps about this for many years. We now have some good examples of how large cities can be run—and run effectively.

What we are after now, really, is not efficient use of resources, but wise uses of resources.

Chairman REUSS. That is very impressive. Tell us about yourself. Where did you learn all this?

Ms. CATES. Well, I have been to school a lot. And I've also worked in a couple of cities. I have a Ph. D. in public administration from the University of Southern California. I have also worked in the city of Washington, D.C., Grand Rapids, Mich., Sunnyvale, Calif., and now Dallas, Tex.

Chairman REUSS. What sort of jobs or work did you do? Were you a financial analyst?

Ms. CATES. No; I am in city management. The city management profession has taken me to those places.

Chairman REUSS. But many of the places in which you worked aren't city manager cities.

Ms. CATES. Washington, D.C., is not, Grand Rapids, Sunnyvale and Dallas are.

Chairman REUSS. What did you do in Washington?

Ms. CATES. I worked for the International City Management Association doing research, and also did some work in the center for governmental studies, looking at various Federal programs and the impact of them at the local level.

Chairman REUSS. Thank you very much. Mr. Donaldson?

[Text resumes on p. 345.]

[The following documents were submitted by Ms. Cates for inclusion in the record: "How Local Governments Can Make More Efficient Use of Their Limited Resources—'The Dallas Experience' ", and "City of Dallas 1977 Performance Report":]

HOW LOCAL GOVERNMENTS CAN MAKE

MORE EFFICIENT USE OF

THEIR LIMITED RESOURCES

THE DALLAS EXPERIENCE

U.S. HOUSE OF REPRESENTATIVES

SUBCOMMITTEE ON THE CITY

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

THE DALLAS EXPERIENCE

"Revolt" is a stong word. "Tax revolt" is a powerful force that two hundred years ago helped start this nation; now it is emerging to reshape local government, with reverberations in state and national government as well.

The task of government officials is not to lament the turn of events, but to use them to create, rather than destroy, good government.

Local government managers and politicians will have to make difficult decisions, adopt long-range planning horizons, report results regularly, undergo outside audits and inter-city comparisons and improve performance and productivity. The response to tax revolt is no less complicated than its cause.

Dallas, Texas is one city whose management practices incorporate these and other methods of making more efficient use of limited resources.

This report describes many of those methods. The first section describes the management philosophy and systems in the City of Dallas that have produced more efficient use of resources. The second section presents two case examples, detailing the process used in implementing productivity and performance improvements.

MANAGEMENT PHILOSOPHY AND SYSTEMS

As the eighth largest city in the United States, Dallas faces many of the problems of most large urban centers: confinement by suburban jurisdictions, a maturing central city, increasing costs of operation, and an increasing demand for city services in the face of limited resources. Yet, in this environment, the city's financial condition for the past two years has permitted a decrease in the ad valorem tax rate. Not only is Dallas' annual budget balanced, but revenues were higher and costs were lower, resulting in general fund performance at $8.2 million better than budgeted, for the fiscal year ended September 30, 1977.

In addition:

* Productivity savings surpassed $2 million
* $5 million was added to the Cash Emergency Reserve enabling it to reach its target level five years ahead of schedule
* Interest earned on temporarily idle funds increased $1.3 million up 9%
* The year's lowest bank cash level was $265 million, which was $50 million above the lowest point last year.
* Capital plant expansion continued at the $40 million level.
* General Obligation bond ratings were AAA from both Moody and Standard and Poors rating services.

These results are possible because of a sound economy and sound city management. Dallas management philosophy is similar to those

33-595 O - 78 - 18

exemplified by highly successful private corporations. Indeed, the corporate model plays an important role in Dallas management strategy.

> The truth is, we are a municipal enterprise, and like the private sector, we are unavoidably required to survive in the set of circumstances we share. (GEORGE SCHRADER, city manager of Dallas)

In a business sense, the city council serves as both a legislature and a Board of Directors. The city manager, appointed by and responsible to the council, is the chief executive officer charged with policy implementation and service delivery. As is true within the private sector, the executive officer becomes accountable for the financial management of the municipal corporation. Dallas remains the largest city in the world with a council-manager form of local government.

Using this corporate model, Dallas management has developed strategies for making effective use of limited resources. These strategies are:

* Upgrading and developing of financial systems
* Restructuring the organization
* Developing long-range, financial plans and reporting mechanism
* Increasing the responsibilities, opportunities and incentives for innovation.

Each of these successful management strategies and the specific programs or projects developed with their implementation are described below.

RESTRUCTURING THE ORGANIZATION

There have been several organization changes in the past few years that have enabled the City of Dallas to make more efficient use of resources.

In 1975, a national accounting firm was commissioned to analyze the financial management system of the City of Dallas. Their report documented the need for operational changes within the city's accounting system to facilitate both external and internal fiscal responsibility. Based on the recommendations of this study and subsequent departmental analysis, the city manager recommended organizational changes.

In April, 1976, at the recommendation of the city mananger and with the approval of the voters, the city council amended the city charter to establish the city controller's office as a separate entity from the city auditor. This action placed the fiscal responsibility of the city under the direct control of the city manager, leaving a separate auditor's office accountable to the city council. The auditor's office functions to evaluate both the accountability and the performance of the various city departments, reporting the results of its evaluations directly to the council.

Reorganization has also been undertaken to provide smaller, more homogenous departmental units with single or interrelated missions which provide better opportunities for managerial change and allow closer attention to previously neglected areas. Several large departments have been divided into several smaller departments to provide greater managerial accountability and to make the tasks more managable. The public Works department, for example, has been split into three departments: Public Works (engineering) Building Services (maintenance) and Streets and Sanitation. Each of the new departments are still among the largest departments in the city. There are now forty city departments, as shown on the organizational chart in Exhibit 1. Each department director is part of the executive mangement team of the city and responsible for a group of similar programs. The mangement team meets at least monthly to discuss city policy.

In addition to these organizational changes, the concept of an "enterprise" organization has been implemented. The "enterprise" is a subsidiary of the municipal corporation and organized to pay its own way. Examples of enterprise departments are Water Utilities, aviation and the municipal radio. These departments are operated much like a private business: they produce their own revenue and are responsible for insuring expenses do not exceed that revenue. In addition, the enterprise departments must pay for services (direct and indirect) provided by the general fund departments. This means, for example, the Water Utilities department pays for the legal services procided by the city attorney. Changes in organization, while vitally imprtant, was but the first step of the plan for achieving sound fiscal management. The quality of fiscal management can rarely exceed the quality of the accounting and information systems which support it. Indeed, these support systems can be said to form the heart of a good government system.

DEPARTMENTAL ORGANIZATION CHART
CITY OF DALLAS
OCTOBER, 1977

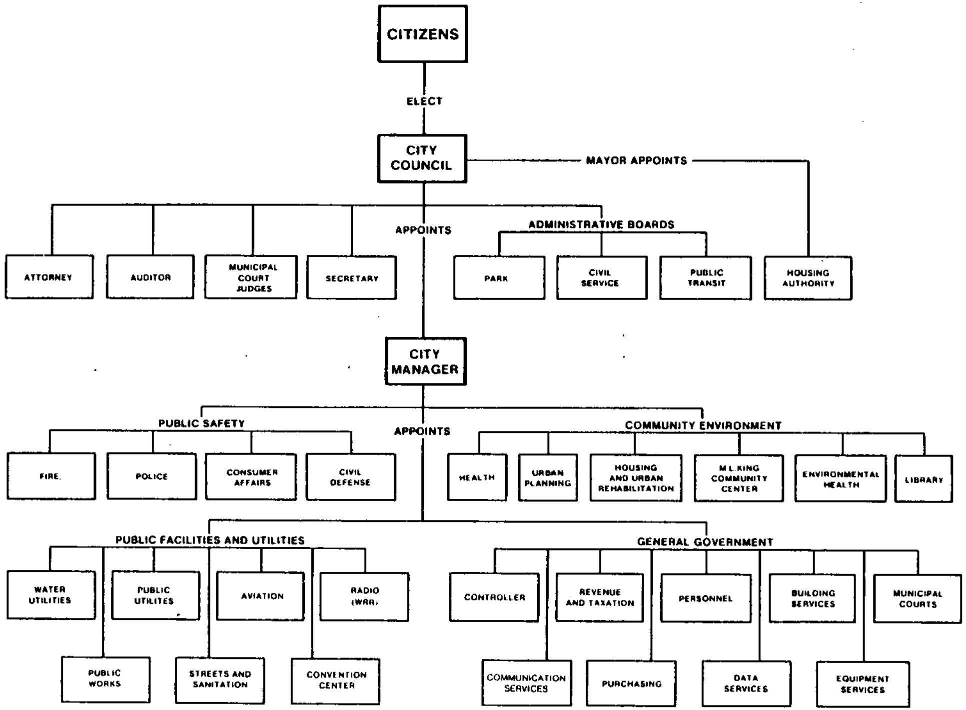


EXHIBIT 1

UPGRADING AND DEVELOPMENT OF FINANCIAL SYSTEMS

Two systems form the mainstay of the technical support systems: The Financial Integrated Resource Management System (FIRMS), an integrated, computer based accounting system, and the target budgeting system. The FIRMS system is administered by the Controller's Office; the target budgeting system by the office of management services, a subgroup of the city manager's office. Both systems were developed and implemented in the last five years.

Target Budgeting

In 1973, the City of Dallas began using a "target budgeting" system, which is a blend of the better aspects of traditional line-item budgeting, performance budgeting and zero-based budgeting. Target budgeting is unique to Dallas. It consists of the following components:

* Establishment of budget targets - Target amounts are determined by the city manager's office for each budgeted activity. The total of all target amounts can not exceed the revenue anticipated for the following year. This procedure produces a "pre-balanced" budget.
* Development of departmental requests - Departments are instructed to prepare the following items:
  - A detailed (line-item) request which totals no more than the target amount.
  - "Reduction packages" of budgeted items which can be removed, in priority order.

- "Improvement Packages" of needed items, again in priority order, which could not be included in the target amount.
- "Program indicators" which indicate the target level of performance at the target budget amount.
- Number of worker years needed to attain that performance level.
- "Service impact statements" in which the effect on services of adopting (or removing) any particular service is described.

* Development of overall budget - Final budget allocations are accomplished by adding and/or subtracting the packages prepared by the department based on relative service impact compared among departments.

Sample budget pages are reproduced in Exhibit 2.

Work continues to refine performance indicators and program objectives to make them (a) reflective of the actual work or product of the program and (b) measurable. Program objectives set targets of performance for the coming fiscal year. Examples of program objectives from the Health Department are:

1. To establish a health status index or other measure of the level of health of the community and collect data required by the index.

2. To consolidate programs at the Martin Luther King, Jr. Health Center under the direction of a full-time physician.

EXHIBIT 2

PURCHASING

PROGRAM DESCRIPTION

Purchasing is responsible for the procurement and sale of supplies and capital equipment for all City activities. This includes development of specifications and Request for Bids materials, receipt and evaluation of bids, issuance of purchase orders and contracts, verifications of merchandise receipts and the conduct of surplus property sales and auctions.

In addition, the Office of Minority Business Opportunity and the Contract Compliance function are operated by Purchasing. These functions involve informing minority business of purchasing procedures and bidding requirements and insuring compliance of contractors to City standards for equal opportunity.

PROGRAM INDICATORS	ACTUAL 1975-76	ESTIMATED 1976-77	ESTIMATED 1977-78
Purchase Orders Issued	39,658	40,000	41,000
Automobile Auctions	47	46	47
Number of Junk Cars Sold	2,793	2,598	2,720
Bicycle Auctions	5	5	5
Miscellaneous Auctions	5	4	5
Number of Minority Businesses Contacted	0	90	110
Vendors Cataloged by Supply Division	0	40	100
Printed Forms Cataloged	0	300	700

RESOURCE SUMMARY	ACTUAL 1975-76	ESTIMATED 1976-77	ESTIMATED 1977-78
Automobile Auctions	370,433	312,000	337,000
Bicycle Auctions	14,735	20,000	20,000
Miscellaneous Auctions	75,934	83,000	88,000
Sale of Surplus Property	75,434	60,000	63,000
Other General Fund Revenue	(94,099)	(5,225)	(23,495)
General Fund Allocation	442,437	469,775	484,505

33 595 375

EXHIBIT 2 (continued)

PURCHASING

EXPENDITURE SUMMARY	ACTUAL 1975-76	ESTIMATED 1976-77	PROPOSED 1977-78
Administration	152,368	172,029	178,269
Sales and Auctions	50,929	52,111	47,029
Procurement	249,598	253,778	267,796
Total Expenditures	452,895	477,918	493,094
Less: Charges to Grants	10,458	8,143	8,589
General Fund Allocation	442,437	469,775	484,505

POSITION SUMMARY	CURRENT	PROPOSED
FULL TIME		
Total Worker-years	28.3	28.3
Less: Grant Worker-years	1.0	1.0
General Fund Worker-years	27.3	27.3
Number of Authorized Positions	32.0	32.0
Less: Grant Positions	1.0	1.0
General Fund Positions	31.0	31.0

PROGRAM COMMENTARY

Funds for FY 1977-78 are proposed to continue current Purchasing services. Funds are provided for additional transportation and supplies to support the Office of Minority Business Opportunity. CETA assistance will continue to be used to supplement minority business assistance and sales and auctions activities.

33 595 376

3. To complete renovation of the laboratory.

4. To begin the transfer of public health programs to the County.

Program indicators are measures of progress in reaching program objectives and accomplishing the work of the department. Examples of program indicators for the Health Department are:

	ACTUAL 1976-77	ESTIMATED 1977-78	ESTIMATED 1978-79
Child Health			
No. Clinic Visits	33,094	34,000	35,000
Cost Per Visit ($)	6.28	6.39	6.40
Tuberculosis Control			
No. Clinic Visits	13,182	13,300	13,500
Cost Per Visit ($)	15.91	16.00	16.00
Venereal Disease			
No. Clinic Visits	51,827	52,333	55,000
Cost Per Visit ($)	5.09	4.98	5.00
Laboratory			
Total Samples Examined	302,622	338,937	372,830
Avg. Cost/Sample ($)	1.09	1.10	1.00
Vital Statistics			
No. Certificates Issued	92,612	95,200	97,500
Cost Per Copy ($)	1.80	1.64	1.85

Performance indicators are monitored by department managers and reported quarterly to the city manager's office.

Financial Integrated Resource Management System (FIRMS)

The second major financial system is FIRMS, a comprehensive financial management system designed for the City of Dallas. It encompasses all aspects of financial management at each departmental level, integrating the functions of budgeting, accounting, and reporting with the measuring of performance against standards as established by city management. FIRMS provides the city controller a means of satisfying fiscal responsibilities through appropriation and fund control. It also supports operating management through effective cost accounting, work hour utilization analysis, and unit cost calculations.

FIRMS was originally designed in 1971 by the County of Sacramento. Subsequently, other government agencies have obtained the system and modified it substantially. The City obtained the FIRMS system from Pima County, Arizona and has refined the Pima version to meet the requirements of the City of Dallas.

On October 1, 1976, the City of Dallas began operating FIRMS. Dallas' accounting system is probably one of the most sophisticated of any large local governmental unit in the country.

Like many of the sophisticated corporate accounting systems now in use, FIRMS has a fully integrated payroll, receipt, disbursement, purchasing and budget capability. Automated equipment "reads" each transaction and an "explosion" routine posts all transactions to the proper accounts. An editing system screens invalid or improperly documented transactions for resubmission by the system operators. An on-line video system allows users instant update on current expenditures and remaining balances.

In addition to the usual line-item and organizational reporting capability, FIRM's also records transactions at the program, activity, and even task level; such capability allows for the identification of costs according to "cost centers" and "accountabilities centers".

A sample FIRMS report, "Expenditure Detail by Sub-Account", is reproduced in Exhibit 3.

This report represents a FIRMS detail expenditure report. This report is produced at mid-month and at the end of each month. The detail expenditure report is one of the more important reports produced by the system in that it provides department managers a detail of expenditures and encumbrance transactions against appropriations.

FIRMS is designed to produce a series of daily reports which serve primarily as balancing reports. The expenditure detail report is the only FIRMS report produced and distributed at mid-month. The system also produces a series of monthly reports, most of which, are sent to department managers for their review and use.

The series of monthly reports include the following reports:

1. Trial Balance (by fund)
2. Expenditure Detail (by organization)
3. Outstanding Encumbrances (by organization)
4. Revenue Detail (by organization)
5. Cash Deposits (by organization)
6. General Ledger Activity (by fund)
7. Book Cash Ledger

EXIBIT 3

FUND 100351 DPT 1215 UNT 1215 CITY CONTROLLER
REPORT I.D. 110J02

CITY OF DALLAS 1215 CITY CONTROLLER
EXPENDITURE DETAIL BY SUB-ACCOUNT
JUNE 01, 1978 THRU JUNE 30, 1978

DATE RUN 07/09/78

DESCRIPTION	ACCT CODE	DOCUMENT NUMBER	APPROPRIATION	EXPENDITURE	ENCUMBRANCE	UNENCUMBERED BALANCE	PERCENT EST	ACT	VAR
CONTINUANCE PAY CIVILIAN	1452			51.36		51.36-			
**	1000		526,102.00	410,563.53		115,538.47	75	78	3-
OFFICE SUPPLIES	2110		3,000.00	2,862.36	453.80	316.16-			
FRED L LAKE & GN22		FREDL177			14.90-				
FRED L LAKE & GN22		FREDL177		14.90					
N		H4C86901			.10-				
N		H4202101			139.76				
OFFICE SERVICE N		OFFIC172		118.54					
OFFICE SUPPLY GN035		OFFIC177		87.50					
OFFICE SUPPLY GN035		OFFIC177			87.50-				
*	2110		3,000.00	3,083.30	491.06	574.36-	75	119	44-
STAMP POSTAGE FUND LEVEL	2251		100.00			100.00			
METER POSTAGE FUND LEVEL	2252		10,000.00	7,221.72		2,778.27			
OFFICE SERVICE N		OFFIC172		1,113.56					
*	2252		10,000.00	8,335.29		1,664.71	75	83	8-
**	2000		13,100.00	11,418.59	491.06	1,190.35	75	91	16-
TEMP & CONTRACT PERS SERV	3010			3,000.00		3,000.00-			
PRINTING & PHOTO SERVICES	3030		4,265.80	4,547.78	253.00	534.98-			
OFFICE SERVICE N		OFFIC172		168.07					
*	3030		4,265.80	4,715.85	253.00	703.05-	75	116	41-
COMMUNICATIONS	3050		5,131.00	1,473.45		3,657.51			
PROFESSIONAL SERVICES	3070		148,195.00	88,386.00	59,809.00				
HASKINS & SELL GN78		HASKI159		17,673.00					
HASKINS & SELL GN78		HASKI159			17,673.00-				
*	3070		148,195.00	106,059.00	42,136.00		75	100	25-
REPAIR&MAINT SERV EQUIP	3110		300.00	153.70		146.30			
MEMBERSHIP DUES	3340		62.00	50.00		12.00			
TRAVEL MEETINGS EXP&TRAIN	3361		1,200.00	630.20		569.80			
REIMB-VEHICLE USE,PARKING	3363		300.00	58.05		241.95			
CONVENTION CEN AN17527		CONVE159		25.00					
*	3363		300.00	83.05		216.95	75	28	47
EQUIP & AUTOMOTIVE RENTAL	3410		1,224.00	510.00		714.00			
EQUIPMENT & AU N		EQUIP174		102.00					
*	3410		1,224.00	612.00		612.00	75	50	25

Prior to the implementation of this system, Dallas maintained manual general ledgers. At the close of the first year under FIRMS the annual financial report was published earlier than it had been in over 12 years.

Even with the best of information and budgeting systems, Dallas is becoming more dependent on forecasts of economic cycles. Absolute limits on property tax will accelerate the trend of cities being tied to economically sensitive sources of revenue and the necessity for timely, accurate and understandable financial reporting.

DEVELOPING LONG RANGE FINANCIAL PLANS AND REPORTING MECHANISMS

The major techniques used in Dallas for long-range planning are the Five Year Plan and the Financial Management Performance Criteria. Comparisons of actual performance to plans and performance criteria are reported to the city council, citizens and outside agencies through a variety of financial reports.

Five Year Plan

The long range financial planning program in Dallas is designed to expand the time frame in which fiscally related management decisions are made. The program is centered around an annual publication of the Five Year Plan. The plan projects all known costs and revenues five years into the future and analyzes the implications of the projections. With this technique, the fiscal impact of current operating decisions is directly visible to both management and council; problem areas and opportunities are identifiable with sufficient time to plan and implement an appropriate response. From these projections trends can be evaluated and adjustments made to avoid conditions which could lead to future fiscal problems. Projections also provide a foundation for assessing the long-term implications of current budgetary decisions.

This long range financial plan begins with a brief financial outlook . Future developments affecting the City of Dallas are examined and a summary and analysis of revenue and expenditure projections through five fiscal years is presented. The next two sections display revenue and expenditure projections in detail and highlight those major revenue sources or expenditure items which are expected to have a significant impact upon the city's fiscal future. Expenditure projections are based upon standarized assumptions. Revenue projections are derived using standard statistical methods and other technical considerations are discussed in detail in a concluding section of the report.

The revenue and expenditure estimates in the report are projections based upon the best available historical information as well as a series of assumptions about the future. Financial forecasting, however, is a dynamic process. As economic indicators change and more reliable information becomes available, projections must continually be revised to reflect this new information. The projections in the Long Range Financial Plan do not portray the future; they do, however, provide a foundation for viewing, discussing and preparing for the fiscal future of the City of Dallas.

Financial Management Performance Criteria

The five year projections are analyzed with respect to the specific policies and limits adopted by the city council. This analysis constitutes a continuous monitoring device and allows management to adjust performance to remain consistent with policy. The "City of Dallas Financial Performance Criteria" is a composite list of criteria adopted by the City Council on March 15, 1978.

Each of these criteria is based on widely accepted investment measures and standards. No one measure should be singled out as embodying the full wisdom of municipal finance; rather, compliance with the full range of criteria will ensure continued financial health and serve to protect our investment for future generations to enjoy. The criteria are reproduced fully in exhibit 4. These established criteria are compared regularly to actual performance.

Financial Reporting

Dallas has taken positive steps in the direction of more meaningful financial reporting. While most other local governmental entities continue to publish 300 to 400 page annual financial reports, Dallas' annual financial report runs approximately 80 pages, yet contains all the pertinent accounting, management and investment information that the larger, more cumbersome reports do. Not only has Dallas established the consolidated financial statement as an efficient reporting tool for local governmental units, Dallas was the first city in the country to publish a quarterly financial report.

EXHIBIT 4

CITY OF DALLAS FINANCIAL MANAGEMENT PERFORMANCE CRITERIA

Operating Programs

1. Current revenues will be sufficient to support current expenditures.
2. Debt will not be used for current expenses.
3. All retirement systems will be financed in a manner to systematically fund liabilities. The City will assure that sufficient funds are provided to pay current service plus interest on unfunded liabilities plus amortization of the unfunded liabilities over a programmed period.
4. Actuarial analysis will be performed on all retirement systems. Adjustments in benefits will be authorized only after meeting the test of actuarial soundness.
5. Each Utility of the City, including Water, Airport, Public Market and others that may be designated, will maintain revenues which support the full (direct and indirect) cost of the utility.
6. An Emergency Reserve shall be maintained in the General Fund at a level sufficient to provide for temporary financing of unforseen needs of an emergency nature, and to permit orderly adjustment to changes resulting from termination of revenue sources through actions of other governmental bodies.
7. Contingency Reserves shall be maintained at a level sufficient to provide for unanticipated expenditures of a non-recurring nature.

EXHIBIT 4 (continued)

Capital and Debt Management

8. Any capital project financed through the issuance of bonds shall be financed for a period not to exceed the expected useful life of the project.

9. The Net (non self-supporting) General Obligation debt of Dallas will not exceed 6% of the true market valuation (or 8% of the assessed valuation) of the taxable property of Dallas.

10. Total direct plus overlapping debt shall be managed so as to not exceed 10% of market valuation of taxable property of Dallas. All debt which causes total direct plus overlapping debt to exceed 8% of market valuation shall be carefully planned and co-ordinated with all overlapping jurisdictions.

11. Interest, operating, and/or maintenance expenses will be capitalized only for facilities of enterprise activities and will be strictly limited to those expenses incurred prior to actual operation of the facilities.

12. Average (weighted) General Obligation bond maturities shall be kept at or below 10 years.

13. Total General Obligation debt will be managed to remain below three times the total annual locally generated, non-enterprise, operating revenues.

14. Annual General Obligation debt service shall not exceed 20% of the total locally generated, non-enterprise, operating revenue.

15. Per Capita General Obligation debt will be managed to not exceed 10% of the latest authoriative computation of Dallas' percapita annual personal income.

EXHIBIT 4 (continued)

Accounting, Auditing and Financial Planning

16. The City will establish and maintain a high degree of accounting practice. Accounting systems will conform to accepted principles and standards of the Municipal Finance Officers Association and the National Committee on Governmental Accounting.

17. An annual audit will be performed by an independent public accounting firm with the subsequent issue of an official Annual Financial Statement.

18. Full disclosure will be provided in the annual financial statements and bond representations.

19. Revenues and expenditures will be projected annually for at least five years beyond the current budget projections.

20. Financial systems will be maintained to monitor expenditures, revenues, and performance of all municipal programs on an ongoing basis.

21. Operating expenditures will be programmed to include the cost of implementing service of the capital improvements, and future revenues necessary for these expenditures will be estimated and provided for prior to undertaking the capital improvement.

Dallas has also initiated an annual Performance Report modeled after the corporate annual report. The first Performance Report, published in January, 1978, is attached as exhibit 5. The report begins with a page of financial and performance highlights and continues with the Manager's Message, which describes the major accomplishments of the previous year. The "Operations Review" section reports significant financial, performance and productivity improvements in various city services during the preceding year.

The report then displays economic data developed by outside sources (eg: unemployment and cost of living statistics developed by the U. S. Department of Commerce and total value of construction data developed by Dun and Bradstreet building permit records). This information provides intercity economic comparisons. A statistical profile of Dallas is also included.

Financial information includes balance sheets for governmental funds and proprietary funds statement, a summary of changes in unappropriated fund balances, a summary statement of operations and changes in retained earnings, accompanying notes to financial information and a "Financial Review" section which posts financial highlights.

The Performance Report presents audited figures. The statement of the certified public accountants is included in the report.

This audited Performance Report represents the most advanced municipal financial reporting. It has already won two national awards and been praised by bond rating agencies and professional financial organizations.

Developing and adopting a sound financial management policy and reporting financial information in timely, accurate and understandable forms are critical components of fiscal responsibility. Efficient use of resources, however, requires people to use the systems. Insuring that qualified people take advantage of innovative opportunities means that responsibilities, opportunities and incentives for improvements must be increased.

INCREASING THE RESPONSIBILITIES, OPPORTUNITIES AND INCENTIVES FOR INNOVATION

Dallas has initiated several programs to strengthen employee skills, assess employee attitudes that affect performance, evaluate and reward performance and recognize and encourage productivity and performance improvements. These programs include the Dallas Performance Improvement Program, the employee opinion survey, the executive performance evaluation system, and Dallas Innovations.

Performance Improvement Program

Managers are encouraged to strengthen managerial skills through the 5-year Performance Improvement Program. Now in its second year, this training program involves managers from the executive to supervisory levels, and encompasses work simplification, job enrichment, management by objectives, participative work groups, team building and organizational development.

The city manager's office and all department heads serve as an executive committee to evaluate the program for scope and modifications which will improve or clarify its operation. A group of department heads assists in setting policies and objectives for the program, provide the means to measure effectiveness of the program and determine techniques to publicize accomplishments. Program coordination is achieved in each department. Assigned coordinators, from the departments' management ranks, are responsible for the overall aspects of their department's Performance Improvement Program. They collect, analyze, document, and report on achievements within their own organizations.

Personnel department plans the necessary resources to conduct training in-house through its Training Division and uses outside training assistance.

Each year a topic, such as work simplication, is presented by outside consultants to three levels.

Each presentation is designed for the specific interests and needs of the executive, division and supervisory levels of management.

Strengthening specific management skills is one way to supplement on-going training activities in the city and increase the professionalism of the work force. Another way to strengthen the work force is to monitor employees attitudes that affect performance.

Employee Survey

The purpose of the employee survey in Dallas is to assess employee job satisfaction, identify ways to improve it and thereby improve job performance.

During 1974 and early 1975 the city manager asked the city personnel department to develop a program to determine how city employees felt about their jobs.

Research on ways to determine these feelings resulted in the conclusion that WHY employees felt as they did was equally as important as WHAT they felt.

Further, one theory postulated that the values held by employees was a major factor influencing reasons why employees felt as they did.

Consequently a survey instrument was chosen which secured both responses to a set of questions and value profiles of the respondents. The value profiles are based on concepts developed by Clare W. Graves and extended to the work environment by Vincent A. Flowers. The employee survey is reproduced as exhibit 6.

Data from the 1975 survey permitted comparison between departments and to the private sector, where similar studies had been made.

The survey was repeated in 1977 permitting trends over the two-year period to be developed. The values profile was omitted from the 1977 survey since it is expected to change more slowly than the employee opinions.

Since results did differ from department to department, few generalizations can be safely made as to conclusions. The city manager has charged each department head to develop responses based on the survey results. These responses are part of the performance evaluation of each department head. For example, the building services department experimented in 1973 and 1974 with the use of ad hoc committees as a means of increasing productivity and job satisfaction. During this two year period substantial performance

EXHIBIT 6

EMPLOYEE OPINION SURVEY
CITY OF DALLAS

CITY OF DALLAS

KEY PUNCH ONLY	
1. ________	1
2. ________	1
3. ________	1

The work that people do for a living is important to them in many ways. The values, attitudes and general orientation of individuals determine an organization's success. This "Values for Working"© questionnaire has as its purpose the assessment of how City of Dallas employees see their work. It has been adapted from a nationwide survey conducted by Dr. Vincent S. Flowers, Dr. Charles L. Hughes, Dr. M. Scott Myers, and Susan S. Myers.

There are no right or wrong answers. What is important is the way in which you feel about your work. Because of his interest in your opinion, the City Manager is conducting this survey with the assistance of Dr. Vincent Flowers.

The survey replies will be held in the strictest confidence on an individual basis. The survey is completely anonymous. A general report of the findings will be forthcoming in the July issue of city/scene.

4. Sex ☐ Male 1 ☐ Female 2 5. Race ☐ White 1 ☐ Minority 2 6. Job Status ☐ Exempt 1 ☐ Nonexempt 2

7. Age ☐ 16-24 1 ☐ 25-30 2 ☐ 31-40 3 ☐ 41-50 4 ☐ Over 50 5

8. Length of City Employment ☐ Less than one year 1 ☐ 1-5 yrs. 2 ☐ 5-10 yrs. 3 ☐ Over 10 yrs. 4

9. Education ☐ Less than High School 1 ☐ H.S. Degree/ G.E.D. 2 ☐ Some College 3

☐ College Degree 4 ☐ Some Post-Graduate work 5 ☐ Post Graduate Degree 6

RETURN BY
INTERDEPARTMENTAL MAIL

TO: MR. GEORGE R. SCHRADER
CITY MANAGER

ROOM 210

CITY HALL

EXHIBIT 6

HOW TO ANSWER: After reading each statement, mark an X in one of the four agree or disagree boxes, corresponding to each statement, that best describes how you feel about the statement. Circle the ? only if you have no opinion, or the statement does not apply to you, or the statement is not clear, or you don't know.

	STRONGLY DISAGREE	DISAGREE	AGREE	STRONGLY AGREE	?
10. My work is satisfying to me.	1☐	2☐	3☐	4☐	5 ?
11. There is not enough cooperation between my work group and others we work with.	1☐	2☐	3☐	4☐	5 ?
12. There are opportunities in the City for those who want to get ahead.	1☐	2☐	3☐	4☐	5 ?
13. For the jobs in my area, working conditions are o.k.	1☐	2☐	3☐	4☐	5 ?
14. We don't get enough information about how well our work group is doing.	1☐	2☐	3☐	4☐	5 ?
15. I have confidence in the fairness of management.	1☐	2☐	3☐	4☐	5 ?
16. The City's retirement plan is o.k.	1☐	2☐	3☐	4☐	5 ?
17. I can be sure of a job with the City as long as I do good work.	1☐	2☐	3☐	4☐	5 ?
18. There are too many rules and procedures to follow.	1☐	2☐	3☐	4☐	5 ?
19. I have as much freedom as I need to do my job well.	1☐	2☐	3☐	4☐	5 ?
20. I feel free to tell my supervisor what I think.	1☐	2☐	3☐	4☐	5 ?
21. I am proud to work for the City.	1☐	2☐	3☐	4☐	5 ?
22. I am paid fairly for the kind of work I do.	1☐	2☐	3☐	4☐	5 ?
23. During the past six months I have looked for a job outside the City.	1☐	2☐	3☐	4☐	5 ?
24. Favoritism is a problem in my area.	1☐	2☐	3☐	4☐	5 ?
25. Most City employees I know are in jobs that make good use of their abilities.	1☐	2☐	3☐	4☐	5 ?
26. My job seems to be leading to the kind of future I want.	1☐	2☐	3☐	4☐	5 ?
27. The City is a better place to work than last year.	1☐	2☐	3☐	4☐	5 ?
28. I understand what is expected of me in my work.	1☐	2☐	3☐	4☐	5 ?
29. Compared with private industries, the City's fringe benefits are good.	1☐	2☐	3☐	4☐	5 ?

EXHIBIT 6

Each of the following questions, numbered 30 through 37, has six possible responses. Indicate to what extent you agree with some or all of the six responses by giving them a numerical value, the total of which will add up to a total of twelve points for each question. The more you agree with a particular response, the higher the number you should assign it. For example:

- **If you agree equally with all six responses, you should assign or give two points to each response, for a total of 12.**
- **If you agree with only one response, you should assign all 12 points to it.**
- **If you agree with several responses in differing degrees, you should assign a proportionate amount of points to each response with which you agree, for a total of 12.**

---

30. The City of Dallas has often rewarded employees for their loyalty. To me, being loyal means:

(1) supporting the goals of my supervisor and the City of Dallas as long as they are not in conflict with my principles. ____ 1
(2) sticking with my supervisor and the City of Dallas through good times and bad, and sometimes making personal sacrifices to keep my department strong. ____ 2
(3) giving up my freedom and doing as little as possible. ____ 3
(4) being at work every day and doing what I am told by my supervisor. ____ 4
(5) supporting my supervisor as long as he is concerned more with the needs of his people than with getting the job done. ____ 5
(6) supporting any supervisor or department as long as I have the opportunity to get ahead in the City organization. ____ 6

TOTAL 12

31. Every supervisor working for the City has both formal and informal rules. I think most rules are:

(1) necessary to keep employees from doing the wrong things and protect us from people who always want to break the rules. ____ 1
(2) made by the supervisor for the supervisor and often do not give the employee a chance. ____ 2
(3) necessary to preserve order in the department and employees who violate the rules should be told how important it is to follow the rules. ____ 3
(4) O.K. as guidelines, but sometimes you have to beat the system in order to get the job done and to get ahead. ____ 4
(5) useful only if they get all the people working together in friendship and harmony. ____ 5
(6) best when they are few, and effective if they succeed in putting the burden of responsibility on the employees. ____ 6

TOTAL 12

32. The kind of supervisors I think the City of Dallas should hire are ones who:

(1) get us working together as a team and who are more friendly people than bosses. ____ 1
(2) give me access to the information I need and let me do the job in my own way. ____ 2
(3) are tougher than nails but let me be tough, too. ____ 3
(4) know what they are supposed to do and are not always changing their mind, and see to it that everyone follows the rules. ____ 4
(5) tell us exactly what to do and how to do it, and encourages us by doing the job with us sometimes. ____ 5
(6) do not ask questions as long as I get the job done so we can both look good. ____ 6

TOTAL 12

33. All employees who work for the City of Dallas belong to one department or another. I think a good department is one where:

(1) employees are allowed to get ahead and achieve their career goals without anyone holding them back. ____ 1
(2) nobody can tell you what to do and where I am not forced to do somebody else's job. ____ 2
(3) the rules are well defined and members are rewarded for their loyal service and hard work. ____ 3
(4) the employees stick together and help each other when the going gets tough. ____ 4
(5) the needs of the employees are a little more important than the needs of the department. ____ 5
(6) the supervisor provides a framework for the employees to meet their personal needs while meeting the goals of the department. ____ 6

TOTAL 12

EXHIBIT 6

34. Having job freedom while working for the City of Dallas is important to many employees. Job freedom, for me, means:

(1) the opportunity to do challenging work, to be able to express myself openly, and the freedom to change jobs if I chose. ____ 1
(2) being in a position where my supervisor or the higher-ups in the City cannot push me around. ____ 2
(3) not having to worry about my job, sickness, paying bills, and other problems. ____ 3
(4) the opportunity to work where I want and have a steady secure job. ____ 4
(5) standing on my own two feet and having the opportunity to plan my own career without too much interference. ____ 5
(6) being friends with anyone without worrying about where they fit into the City organization. ____ 6

TOTAL 12

35. The information that I would like to hear from my supervisor is:

(1) that our department is doing well, my job is secure, and my work is appreciated. ____ 1
(2) that he is going to provide more freedom to achieve personal goals and is going to place less emphasis on hours of work or following the system. ____ 2
(3) that he is going to keep off my back for a while. ____ 3
(4) that he is going to place more emphasis on the people in our department and less on just getting the job done. ____ 4
(5) letting me know what is expected of me and that he cares about me. ____ 5
(6) that I have been promoted to a job that gives me more authority and responsibility. ____ 6

TOTAL 12

36. The money we receive from the City of Dallas is important to all of us. Money is important to me because it:

(1) is a measure of my success in my department and in my community. ____ 1
(2) helps me to save for a rainy day, to aid the less fortunate, and to have a decent standard of living. ____ 2
(3) lets me buy the things I want, like a sharp car and clothes, and makes me feel important. ____ 3
(4) provides me freedom and the opportunity to be myself - having money is not as important as what I do with it. ____ 4
(5) pays for groceries, house or rent payments, and other things I need to keep going. ____ 5
(6) enables me to enjoy many friendships and support worthwhile causes that help other people. ____ 6

TOTAL 12

37. The work that a person does for his living is important to him in many ways. In my own case:

(1) I believe in doing what I like to do, such as working with people toward a common goal, is more important than getting caught up in a materialistic rat race. ____ 1
(2 the kind of work I usually do is o.k. as long as it's a steady job and I have a good supervisor. ____ 2
(3) I prefer work of my own choosing that offers continuing challenge and requires imagination and initiative, even if the pay is low. ____ 3
(4) I don't like any kind of work that ties me down, but I'll do it if I have to in order to get some money, then I'll quit and do what I want until I have to get another job. ____ 4
(5) I am responsible for my own success, and I am always on the lookout for new opportunities which will lead to a more responsible position and greater financial reward. ____ 5
(6) I have worked hard for what I have, and think I deserve some good breaks. I believe others should realize it is their duty to be loyal to the City if they want to get ahead. ____ 6

TOTAL 12

Please complete this sentence:

If I were City Manager, I would ______________________________

____

____

improvements were made accompanied by a significant improvement in employee attitudes.

An employee survey is also planned for 1979.

In addition to the Performance Improvement Program and the employee survey, the City of Dallas has instituted an executive performance evaluation program to provide incentives and rewards for performance improvements.

<u>Gauges of Performance</u>

In 1973, the city manager first set specific "gauges of performance". These standards are developed, discussed and modified with department heads in January of each year. At the end of the year, department heads report progress on each area of emphasis and goal set. This year, for example, department heads will report on responses to the employee survey and budget performance. The 1977-78 Gauges of Performance is reproduced in Exhibit 7.

The performance evaluation system is the basis for salary increases for department directors. As such, it provides a valuable incentive and reward system for productivity improvements.

Productivity improvements in the City of Dallas have been encouraged and created with a variety of other methods as well:

* review and evaluation methods for measuring executive performance have been specifically oriented toward emphasizing accomplishments in improving productivity;
* interdepartmental task forces have been used to identify opportunities for improvements which transcend organizational boundaries;

EXHIBIT 7

EMPHASES

1977-78 GAUGES OF PERFORMANCE

I. Basic Emphases	
1. Programmatic response to Citizen Profile Results	Written Statement of Program
2. Programmatic response to Employee Opinion Results	Written Statement of Program
3. Effective Budget Management/Administrative Accuracy and Consistency in Financial Projections	
a. Effective Management of Service Charges	Complete Review & Appropriate Revision
b. Development of Enterprise Operating - Activity Financial Statements: Quarterly Frequency	
c. Better than Budget Operating Performance	2%
4. Progress in Personnel Management	
a. Affirmative Action: Upward Mobility b. Improvement in Safety Performance c. Reduction in Absenteeism/Overtime d. Training in Personnel Disciplinary Action	
5. Long Range Program Plans	
II. Special Emphases	
1. a. Research Effort b. New Entrepreneural Efforts c. Marketing Effort d. Use of Volunteers e. Elimination of Duplication f. Elimination of Unproductive Endeavors g. Contribution to Professional Journals h. Entry in Awards Competition	Establishment of Targets
2. Development of Recurring Economies: Reduction in Personnel/Vehicle/Space Units	Establishment of Quantity Targets
3. Development of Non-Recurring Economies	Establishment of Quantity Targets
4. Programmatic Affirmative Response to Results of Women's Survey	Written Statment
5. Management Talent Assessment & Development Program	Program
6. Programmatic Effort at Achieving Uniformity of Service Impact	Statement of Strategies
7. Job Holders Meetings	Program - Schedule
8. Conflict Management	

* funds have been made available for use of outside assistance by program managers for implementing improved management systems;
* technical assistance has been provided from central, in-house staff with both industrial engineering and organization development skills;
* reorganization has provided smaller, more homogenous departmental units with single or interrelated missions which provide better opportunities for managerial change and allow closer attention to previously neglected areas; and
* support services have been provided through centralized departments (i.e. building services, equipment services, data services) with experienced professional management.

With these tools, opportunities for substantial productivity gains have been exploited, with a central staff of minimum size, and a high ratio of productivity savings to investment.

Dallas Innovations is a program involving city personnel in identifying areas in which economies can be made without lessening the quality of performance. Even seemingly insignificant cost reductions, when multiplied by the scale of city operations, mean substantial savings. The elimination of waxing for resilient-type floors--as recommended by the industry trade association--began saving more than $45,000 annually. A plan to disassemble and rebuild landfill heavy equipment rather than to replace it after five years of service initiated annual cost reductions of $96,000 to $160,000. The productivity savings for the entire city for the fiscal year ending September 30, 1977, surpassed $2 million.

Dallas Innovations

In 1977-78, the Dallas Innovations program began to recognize these types of gains, and encourage departments to use methods found useful in other departments. Three types of innovations were identified: "productivity improvements", "performance improvements" and "long term projects".

Productivity improvements must 1) maintain the same or higher level of service, 2) begin during the current fiscal year, 3) produce savings (in equipment, space, personnel, or other resource) that can be expressed in dollar amounts, and 4) produce recurring savings. Recurring savings are those that will be realized in the current and future years. Recurring savings are contrasted with one-time cost savings.

Performance improvements are also projects or changes begun by department managers in the current fiscal year. These improvements either 1) produce a beneficial result that cannot be expressed in dollar amounts, or 2) produce one-time cost savings. Long term projects are improvements begun in a previous fiscal year that <u>continue</u> to have <u>new</u> beneficial impact in subsequent years. Long term projects may be either productivity or performance improvements.

In the first year of Dallas Innovations, 132 innovations were identified and over $2 in productivity (annualized cost) savings were documented for that current fiscal year alone. A sample page from the Dallas Innovations book is reproduced in Exhibit 8.

EXHIBIT 8

CITY OF DALLAS

DALLAS INNOVATIONS

PROJECT NAME: CUSTODIAL PERFORMANCE STANDARDS AND ORGANIZATION

DEPARTMENT(S): BUILDING SERVICES

IMPROVEMENT SUMMARY	PERSONNEL + OR -	OTHER RESOURCES	ANNUALIZED SAVINGS
Case study of City Hall to apply custodial performance standards and realign organization.	-29		$154,452

DESCRIPTION

PROBLEM ADDRESSED: To reduce custodial costs at City Hall by application of performance standards and realigning the organization.

WHEN INITIATED: 1971

WHO INVOLVED: Custodial management supervisor, Building Service Department was primarily involved.

INNOVATIONS PROPOSED: Municipal Building and Police/Courts Building were systematically surveyed/inventoried in detail. Standard work measurement units were applied to determine optimum work force. Individual tasks/work areas were reassigned and job duties written. Organization was adjusted to conform, shifts rearranged.

IMPACT: Immediate reduction of 29 employees at an annual savings of $154,452.

One of the other uses of Dallas Innovations in its first year was to document productivity savings for the City Council for use during budget sessions. The city manager proposed to "return" the two million dollars in savings to the citizens and employees. The manager proposed a property tax rate reduction for citizens and a higher city contribution foremployee health insurance for employees.

> As a reward to personnel for performance improvements this year, and as an incentive for further improvements next year, it is recommended that the first $1 million in productivity savings be shared with employees through a reduction in the employee's health insurance premium.
>
> Manager's Message
> 1977-78 Budget

The city council increased the amount of property tax rate reduction from 2.5¢ proposed by the manager to a 4.0¢ reduction. The council disagreed with the health insurance premium proposal, because it represented the first contribution to support employee dependent coverage. Although the council agreed with rewarding employees for productivity, they did not agree with the specific proposal. Instead, the council set aside $375,000 to be used for an alternate reward to be determined during the next fiscal year.

The next section of this report describes two of the productivity programs in the City of Dallas. These case examples highlight the process used in beginning a productivity program andthe results of the improvement programs.

CASE EXAMPLES

Two case examples illustrate how Dallas makes more efficient use of its resources: the Management Improvement Program in the Water Utilities department and the City Profile Survey. Both examples involve long-term implementation, are tied to on-going mangement systems of the city, and use outside consultants and in-house staff. The details of the examples highlight other similarities and some differences.

MANGEMENT IMPROVEMENT PROGRAM: DALLAS WATER UTILITIES DEPARTMENT*

Faced with rising costs and the need to increase productivity, the Dallas Water Utilities Department (DWUD) began in late 1972 an extensive analysis of its management structure and its operational methods with a view of enhancing cost effectiveness and improving the delivery of water and sewer services. The Department provides water services to the 844,000 citizens of Dallas, and to the citizens of 21 neighboring cities, as well as sanitary sewer services to Dallas and three other cities. In recent years DWUD has made considerable progress in automating selected activites and in using automated data processing equipment. The Department has also upgraded and expanded its water and sewer treatment facilities to keep pace with accelerating demands for water and sewer services. This stimulus of increasing demand, coupled with more stringent standards for water quality imposed by state and federal agencies, and the ever increasing need for recognition of environmental concerns

*This case example is an edited and updated version of "Management Improvements Cut Costs",I.M.Rice,Water and Wastes Engineering,May,1975 prompted the DWUD to take a new look at management methods to determine what opportunities existed for improvement.

Accordingly a decision was made in the fall of 1972 by the director, Dallas Water Utilities to undertake an indepth management analysis of the department. The objective was to determine if the DWUD organization and operations could be improved to provide equal or better service to customers at less cost. Cost reduction was not considered as the sole measure of success. Of at least equal importance were customer satisfaction and employee acceptance of the program.

Because of the size and complexity of the DWUD organization, it was the consensus of the department head and the city manager that an outside consultant--one thoroughly experienced in management studies--should be employed. It was the City's concept that the task should be completed in three phases: Phase I--Development of a study design: Phase II--Research and documentation of the present structure and methods of operation; and Phase III--Problem identification and solution development. Some general questions of interest were also suggested for inclusion in the study. For example: Considering the program objectives, are there tasks that may be eliminated or realigned? Is data processing being used in a cost effective manner? Can work be scheduled more effectively? Is the management structure effective and efficient? Would a system of work standards be cost effective?

After extensive evaluation and interview process, a local management consultant firm was selected. The city council approved an award of a contract to this firm at a cost not to exceed $66,000 for the study. One of the features in choosing the consultant firm was its proposed use of a combination of industrial and system engineers together with behavioral scientists on its study team. The industrial and systems engineers were to examine procedures, information flow, and computer systems in the field of maintenance operations of DWUD. The behavioral scientists were to examine mangement methods and to assist in implementation of any changes which were developed. Another key feature of the study methodology was active participation by personnel from DWUD and from the city manager's staff in making the study. It was planned that these personnel would continue to function in the management improvement area after the consultant's role was completed. The initial thrust after development of the study design (Phase I) was to conduct in-depth interview of division heads and other key personnel within the department that the survey teams could make an overview of the DWUD structure and operations (Phase II). Of particular concern was the determination of skills, capabilities, and viewpoints that existed within the management echelon of DWUD down to the level of second line supervisors. Interviews were also conducted with city personnel outside DWUD whose activities were interrelated with the department: for example, members of the personnel and purchasing departments. The engineering group made onsite observations of activities in all major areas of field operations of DWUD. These observations provided information on current levels of productivity as well as the effectiveness of methods then in use for scheduling and directing DWUD personnel and equipment. Records were also examined to determine the historical productivity which DWUD had been experiencing.

Analyzing the data, the study team prepared a list of the opportunities which they thought were available and indicated their opinion concerning the priority of these items. They were then discussed in detail with department management and agreement was reached concerning the action which should be taken (Phase III).

The study team concluded at the end of Phase I that DWUD had made state of the art advances in the development of its physical facilities, its technical capabilities, and its research activities and no significant changes were to be suggested in these areas. The team identified several management methods and systems, such as career development and training, to which more effort should be applied. The greatest opportunity in terms of economic benefits were revealed to be opportunities for improved productivity in the two labor intensive areas--the commercial division which included accounting, meter reading, and customer service, and field operations of the wastewater collection and water distribution divisions. Also recommended was a detailed study of the facilities maintenance activities of DWUD to determine the requirements for any modification to the degree of centralization of maintenance effort then in effect.

The basic skills needed to solve most of the problem areas already existed within the DWUD organization. There were two possible ways to implement the study's recommendations: addressing the problem as a normal staff function, or creating an ad hoc organization. There were two principal objections to the first alternative--the limited staff capability, meaning that the study process would have to be a long,drawn-out affair and that DWUD could not bring its full capability to bear because it would fail to use the considerable know-how inherent among the line supervisors. Therefore, it was decided to use the normal staff organization to examine the management improvements in the commercial division but to implement the recommended changes on a department-wide basis through the medium of a task force comprised of senior managers. This group was designated the Implementation Task Force (ITF). It is made up of two members each from the engineering, field operations, and business areas. The ITF is chaired by an assistant director and administrative support is provided from the program planning and management services division to which the industrial engineers are assigned. The ITF was given the responsibility for planning and supervising the work of implementing the various recommendations developed by the study. To assist the ITF, subordinate task forces were set up to provide detailed direction and guidance for implementing recommendations.

To date four subordinate task forces have been established and two have completed their missions. Two more task forces are being established and DWUD expects to set up five more. The task forces and their areas of interest are:

* Metering Activities Task Force--to develop ways and means of integrating departmental metering activities and responsibilities and design an optimum organization to handle these tasks.

* District Pilot Study Task Force--using a selected district operation as a test area, develop and implement improved work methods and standards, an activity costing system, an effective district organization, and improved means in scheduling work for subsequent use in the department.
* Maintenance Task Force--to define, develop and implement the most cost effective approach for performing the plant maintenance function that will satisfy operating division requirements.
* Project Management Task Force--to develop and implement a system to provide budget information by project element, measure performance versus budget by responsible managers, accumulate data to forecast financial needs, and establish a means of measuring productivity in engineering and construction. Use of a computer-based system was to be considered.
* Activity Costing and Performance Evaluation Task Force--to develop and implement an activity costing system throughout the department, productivity standards and a structure for reporting periodic performances, and determine productivity targets for each activity, using as a guide the findings and recommendations of the District Pilot Study Task Force.
* Data Processing Task Force--to identify potential data processing applications and benefits to be derived therefrom and the resources required, define systems information requirements, objectives and goals, and develop ways and means of determining cost effectiveness of departmental information handling methods.

Each subordinate task force prepares a detailed work plan listing the various implementation steps and the time for accomplishment. The ITF meets regularly on a monthly basis to monitor progress of the implementation plan by the subordinate task forces.

The Metering Activites Task Force was one of the first to get underway and to complete its mission. It was chaired by the manager of the departmental commercial division and had seven other members three of whom were supervisors having long experience in the Water Department and three others were newer employees who had showed aptitude for this type of work or needed an introduction to management in their career development. In addition, an industrial engineeer from the city manager's office also served on this task force. The findings and recommendations of this task force led the department to streamline a widely dispersed metering function into an effective, integrated metering division, which controls and directs all metering activities to include meter reading, repairs and inspections.

Service technicians and inspectors previously two different functional categories in different sections of the department, were cross trained so one person would be able to inspect the meter and make necessary repairs on site. Through the use of this one person, one-trip concept the total number of miles driven to perform the functions of meter inspection and repair was reduced by two hundred and fifty thousand miles per year.

The new streamlined organization will cost an estimated $165,000 per year less to perform the same functions and response and control will be improved.

A detailed six-month examination of the commercial division was conducted as a staff function. Flow charts were constructed to represent the steps taken to perform each activity and to show the interrelationship of individual activities in the overall process. Procedures were standardized and all processes were examined in search of methods improvements, work simplication, work duplication and possible automation. Historical work volume levels were compiled and a detailed log kept of the volume of work being done currently. A forecast of predicted work loads was then prepared. A reasonable performance level was established for each activity by time studies and by self-timing of the individuals who were actually doing the work. No predetermined time standards were used. The projected work hours required by each section were determined using projected daily volume requirements and job standards for each activity. A staff scheduling model was constructed to determine when and how the work should be completed to maximize the performance of the division and meet the requirements of related divisions in order to enhance the efficiency of the entire organization. In sections where it was found that there were excess personnel, actual staffing levels were allowed to decrease gradually by attrition to the level determined by the staffing model. No employee's job security was endangered by this program. Employees flexibility charts were constructed to determine the number of employees who were trained to handle each activity. A program of cross-training was then undertaken to secure adequate coverage on each activity during periods of unusual absence. Complete documentation of the tasks required to accomplish each activity was prepared and updated as procedural changes coccurred. A reporting system was set up to monitor the performance in each area and to evaluate labor cost on an ongoing basis. Using these reports, all levels of management are immediately aware of the effects of changes in work load, staffing, or procedures and are in a position to correct problems before they become severe. This gives the supervisor a yardstick to measure the performance of his employees and gives upper management insight into the effectiveness of individual supervisors. Innovations in information flow, accounting and recording procedures, and processing accounts receivable have resulted in this sytem identifying an annual savings of $90,000 within this one division. It is interesting to note that the staff report estimated a potential savings of $86,000.

Following the organization of the Metering Activities Task Force, the ITF activated the District Pilot Study Task Force. This group, working under the direction of the manager of the water purification division, is comprised of two young but experienced supervisors, a supervisor experienced in commercial operations, and a combination of industrial engineers coming from the departmental staff and the supporting private consultanting firm. The detailed study began with interviews between industrial engineers and the first line foremen in a pilot district, working under policy guidelines established by the task force. Job tickets were reviewed.

job categories were discussed, problem areas indicated and an initial plan of attack was thereby established. After this familiarization period, the industrial engineers went throughout the district with the foremen, visiting almost all of the crews to view examples of the job types and to discuss the jobs in detail with the workers onsite. From these discussions and compilations of the historical information available from the job tickets, the areas with the greatest potential impact in terms of resource savings (material, workhours and equipment utilization) were identified.

Three of the areas of major potential impact were: fire hydrant maintenance; repair of street cuts by concrete patching; and backhoe use. Investigation of methods improvements in these areas was greatly aided through the use of a time-lapse photometry data system. With this camera system, the industrial engineers were able to review methods then being employed by the fire hydrant maintenance crews and the concrete patching crews. Crew organizations were restructured.

The concrete patching operation, for example, employed one crew to remove excess dirt and material from a jobsite, an additional crew to saw the cut, and a third crew to break out the concrete and prepare the cut for paving. This approach necessitated three separate trips to the location with inherent scheduling problems, time delays in completing the repair, and excessive vehicle mileage.

The study demonstrated that one crew could handle all functions with one trip if the proper equipment adjustments were made.

Each crew is now equipped with a dump truck, skid steer loader, pavement saw, and hydraulic pavement breaking equipment. The result is a savings of over $100,000 annually, improved response time, and minimization of citizen inconvenience.

The management improvement study produced three general changes:

* The structural organization of supervisors and management of field resources were changed to combine functions and to assign crews with their work areas to geographic areas in a more effective relationship.
* The structure of second line supervisors was redesigned to provide more appropriate concentration of the mangement effort and to emphasize more effective utilization in scheduling work crews
* Improved methods of scheduling crews were developed and installed. Total estimated savings effected by the District Pilot Study Task Force exceeded an annual $186,000

Beneficial results of the changes included reduction of travel time, decrease in number of supervisors, better access by supervisors to their crews, better balancing of work load among crews and an increased capability to provide specialized functional skills and equipment where appropriate.

CITY PROFILE SURVEY*

Since 1974, Dallas has conducted an annual citizen attitude survey. Dallas calls this project its City Profile. Three features of the City Profile set it apart from more traditional citizen attitude surveys:

* The survey is conducted annually. This allows the city to measure public assessment of city services regularly and to look for recurring trends or changing attitudes.
* The survey is completed before adoption of the proposed city budget so that the data can be used by the city council in discussing budget recommendations.
* The city uses the same set of core questions every year. This reduces the risk of artificial changes in citizen attitudes which might result from different questions or differently worded questions.

Dallas' purpose in surveying its residents is simple and straight forward--city officials want to expand their citizen participation program by learning on a regular basis how satisfied the public is with basic public services. Specifically, the city wants a system for building citizen evaluation of public services into the annual budget process. That way, decisions to increase or decrease spending for basic public services are based in part on citizen assessment of those services. The City Profile plays two other roles in Dallas. City department heads use the City Profile to determine whether operational changes have produced their intended results and to gather statistical information about the city and its residents.

---

* This case example is an edited version of "701" Planning and Management, Dallas, Texas: City Profile Survey, By Charles Schwabe, International City Management Association, Washington, D.C. 1978.

Dallas began measuring citizen satisfaction with public services in 1973. Funds to develop the City Profile came from a grant from the U. S. Department of Housing and Urban Development, "701" Comprehensive Planning Assistance Program. Dallas' city manager first suggested that the City Profile could be used in both developing and adopting the annual budget. The city council approved the program and directed the city manager to begin implementation.

Dallas completed four steps in developing the City Profile. They were:

- determing WHY the city wanted to survey its residents;
- writing the survey questions;
- developing a statistically sound sample;
- field testing the questionnaire

In the first step, Dallas city officials felt it was very important to determine WHY the city wanted to conduct a citizen survey before beginning any actual survey work. During its initial research, Dallas discovered that cities have conducted surveys for a number of reasons--some useful and some not. Some cities have wanted to determine whether the climate was right for a specific bond issue. (Not a very good reason for an attitude survey, according to both Dallas city officials and professional market research firms). Other cities have used surveys to find out if citizens were aware of specific city services. Still other cities have used surveys to find out if citizens wanted a proposed new public service. Dallas decided to survey citizens to determine how satisfied citizens were with basic public services.

These services included:

* Police Protection
* Park and Recreation Facilities
* Fire Protection
* Garbage Collection
* Sidewalks
* Street Cleaning
* Neighborhood Traffic Signs and Signals
* Street Maintenance and Repairs
* Beautification with Trees, Flowers, Shrubs on Public Land
* Library Services
* Consumer Protection and Education
* Control of Stray Animals
* Control and Elimination of Run Down Buildings
* Water Services
* Control of Air Pollution
* Regulation of Utility Companies

Beyond assessing citizen attitudes, the city also was interested in collecting physical and socio-economic information. For example, interviewers complete an evaluation of housing and neighborhood appearance as part of the survey.

Once the decision to do the survey was made, the second step was to write the questions. City officials reviewed other city attitude surveys. At the same time, Dallas' Department of Management Services asked each department and elected official to prepare possible questions. From these two sources, more than 700 potential questions, about seven times the number needed, were compiled.

Then the city contracted with the University of Texas at Arlington for help in preparing a usable questionnaire. The University worked with the city in three ways:

* developing unbiased questions
* wording the questions so that the information they asked for was what the city was looking for
* organizing the questions into a usable survey instrument.

The next step was to develop a sample--the number of households that the city wanted to interview. For the 1974 survey, Dallas included 3,781 households in the sample. This figure was chosen after the city determined the types of analysis and evaluation it wanted to complete.

City staff wanted to use the data to compare one neighborhood's assessment of city services with other nieghborhood's assessments.In order for such detailed comparisons to be statistically sound, it was determined that one percent of the city's households would have to be included in the survey. However, the city does not consistently use a one per cent sample. During odd number years, such as 1977, only 800 households were included in the sample. The sample size was reduced because city staff used the data only for city wide assessment of public services, rather than inter-neighborhood comparisons.

As a final step in developing the City Profile, Dallas contracted with a local market research firm to both field test the questionnaire and actually administer the survey. The market research firm field tested the survey by administering the questionnaire to 100 randomly selected households.

Dallas used this private market research firm to actually conduct the field interviews for a number of reasons.

* Residents were more inclined to discuss city services with an independent contractor than a city employee.
* The private firm had individuals specially trained in asking questions and recording responses.
* Dallas found the survey's credibility is directly related to the time it takes to complete the total process--the longer it takes, the less credible the results. The private firm could administer the survey, verify the responses, and prepare the key punched computer cards in far less time than the city could using its own personnel.

The market research firm used 40 interviewers to administer the questionnaire to 3,134 households during May and June 1974. All interviews were conducted in person. Each interview involved three steps:

* completing the Exterior Housing Evaluation section
* completing a defined follow-up procedure if no one was at home at the selected household.
* recording the individual's responses to the 43 questions contained in the questionnaire

Interviewers began each interview by completing the Exterior Housing Evaluation. In this section, the interviewer rated the overall appearance of the housing unit and the neighborhood. Roofs, privately maintained lawns and shrubs, porches and front entryways, the condition of doors and windows, and the existence of plumbing facilities and electricity were evaluated by the interviewer. Next, the interviewer administered the survey. Special care was taken to include the opinions of residents not home during the traditional working hours.

The market research firm performed quality control checks on the data before it was delivered to the city. After all questionnaires were completed and translated into key-punched computer cards, the firm's job was largely finished. Dallas' Department of Data Services used these key punched cards to prepare computer reports. These reports recorded the total response for each question and broke the response into demographic categories. The Management Services Department used this information to analyze question responses, and year to year changes in attitude.

Writing the final report was the last step in implementing the City Profile. In this report, city staff listed the overall responses to all 43 questions. In addition, the report contained a summary of major findings and brief narrative analyses of key survey questions. The City Manager reviewed the report, and sent it to the city council for acceptance. Once accepted, the report was distributed to department heads.

Probably the highlight of each year's final report is the city-wide answers to three key questions:

1. How satisfied are residents with each of the 16 public services included in the City Profile?
2. Would city residents be in favor of the city spending more

or less on these city services?

3. Would city residents favor paying more or less taxes for these services?

Dallas has completed the City Profile process every year since 1974. During that time some changes have taken place in the survey process. These changes have been made based on Dallas' experience with the City Profile.

Although the same questions are used every year to evaluate basic public services, additional blocks of questions can be inserted in the questionnaire to focus on a specific service.

Another variable in the annual survey is sample size. Large samples are used only in even numbered years. Sample size varies for two reasons. First the city uses data collected during small sample years for city-wide analysis, rather than neighborhood-to-neighborhood comparisons. Second, small samples cost less. Dallas spent about $50,000 during 1974 to develop the City Profile. A large portion of these funds were used to initially develop the City Profile. A large portion of these funds were used to initially develop the questionnaire, statistical sample and an operating procedure. Additional costs were staff time, computer usage, consultant fees, and the contract with the market research firm. During large sample years, the City Profile costs $30,000 to operate. This figure drops to $12,000 in small sample years. As a general rule of thumb, city staff estimate that each completed interview costs $10-$12. This figure represents the city's direct costs in administering the survey, key punching the survey's raw data and verifying the raw data. Other costs to be considered are the staff time required to analyze the data and prepare the final report, and data processing costs.

City officials anticipate additional changes for future surveys. Presently, the City Profile addresses and gathers information primarily from the residential community. Therefore, it is impossible to determine accurately how other community segments, such as the business, industrial and institutional communities, evaluate city services. Additional surveys may be directed toward these segments of the city.

Elected and appointed Dallas officials are involved at different levels with the City Profile process. Generally:

* Elected officials use the City Profile's results in shaping public policy.
* The city manager uses the survey to support budget recommendations.
* Other city departments use the survey to collect statistical, demographic, and housing assessment information.

Elected officials, of course, are not directly involved in the day-to-day operation of the City Profile. Their involvement at the operational level is limited to submitting potential questions for the questionnaire. But their most important job is to use the information produced by the City Profile to make decisions and set city policies. For example, the survey showed a higher citizen demand for street lighting in neighborhoods than on major thoroughfares. Elected officials decided to reduce lighting along major thoroughfares and increase lighting in neighborhoods. Every other thoroughfare street light was turned off. In addition, some additional street lighting construction was deferred. The city was able to save $100,000 in operating costs, and the next year's survey showed a marked increase in citizen satisfaction with neighborhood street lighting.

The city manager's primary goal in developing the survey is to build a citizen evaluation component into the annual budget process. The city manager regularly uses survey results to determine what service increases or decreases should be included in the proposed budget. For example, in his 1976 budget message the city manager wrote:

> "Responses are provided in the proposed 1976-1977 service program to the three most critical service concerns identified by the City Profile Survey:
>
> - Increased street maintenance as well as a significantly expanded street resurfacing effort
> - Improved and more humane animal care program.
> - Analysis of utility rate actions and representation of the interest of Dallas citizens before the new Texas Public Utilities Commission..."

The city manager also uses the City Profile to find out whether changes in operations produced the intended results. For example, the 1974 City Profile showed that 39 percent of the people calling city hall did not receive a satisfactory response to their question or complaint. To address this problem, the city manager met with key department heads during a staff retreat to map out a strategy. The 1975 survey demonstrated that the strategy had failed--unsatisfactory responses jumped to 42 percent. So in 1976, the city manager tried a different approach. In those departments with direct citizen contact, any increase in the department head's annual salary would be based in part on a decrease in unsatisfactory question and complaint handling. In 1976, the percentage of unsatisfied responses dropped to 35 percent.

For example, The Department of Housing and Urban Rehabilitation has used survey results to assist in preparing annual applications for community development block grant funding. Data collected through the questionnaire's Exterior Housing Evaluation was used to identify target neighborhoods for neighborhood preservation and low cost home improvement loan programs. The department also used survey data to meet the citizen participation requirements of the community development program.

The Management Services Department used the survey to compare citizen satisfaction with city services over an extended period of time. For example, public satisfaction with street lighting was compared over a four-year period and street lighting policies were changed in response to these attitudes.

The department also measured the changes from one year to the next for specified public service areas. In the 1977 City Profile, the department found that satisfaction with police protection, consumer protection and education, control of stray animals, and air pollution control all decreased more than three percent since 1976.

ANALYSIS OF CASE EXAMPLES

There are several lessons to be learned from these case examples. Perhaps the most important lesson is that improvements are possible--and they take many forms. The second major lesson is that there is no magic in productivity and performance improvement. Both are hard work; both cost money, take time and require people.

Both examples illustrate the long-term nature of improvements. Both programs were begun several years ago and are still going on. The need for a multi-year outlook and commitment is evident in these examples. Long-term planning horizons are necessary because of the complex and dynamic environment. Complexity means it takes time to analyze, implement and produce the beneficial results.. In addition, the environment is dynamic, so conditions change and the process must begin again. There is a need to re-study, re-measure re-think and re-do.

Process

There are also similarities in the change process. Both examples began with an intensive "project", the introduction of new methods. The "project phase" is a time of intensive study and analysis. Outside consultants are used--in careful cooperation with city staff--to develop a plan for change.

The management improvement program hired a consulting firm; the city profile used both university consultants and a polling firm.

Since city staff had worked with the consultants throughout the project phase, the staff could continue the improvements after consultants had left. It is important that city staff feel--and indeed, are--responsible for the improvement programs. Consultant proposals that are never implemented are wasted. Consultants in these examples helped design a new process with city staff, collected data and provided different perspectives to analyze the data. In both cases, city staff either participated in the recommendation (management improvement program), or were totally responsible for the recommendation (City Profile Survey).

After the initial "project" phase, the "long-term implementation"phase begins. Long-term implementation is the responsibility of city staff, eventhough consultants may be called in from time to time. For example, a polling firm is hired each year to actually conduct the city profile survey, but the city staff has the year-to-year responsibility for the project. In the management improvement program, the Implementation Task Force, is responsible for identifying new areas of improvement and overseeing their implementation.

Many people approach productivity or performance improvements as a one-time cost savings. Many people view improvements as a one-time project, or a series of unconnected one-time projects. The Dallas experience is that the "project" phase is only the beginning. It is a necessary time of intensive effort and analysis and often is improved with outside consultants. Its main function, however, is to give city staff new ideas,tools and incentives to begin a long-term improvement strategy.

Resource

The improvement process requires time--and many other resources. Both case examples illustrate the use of technology: the time-lapse photometry used in the improvement program and the data processing technology used in the city profile project. Both examples also showed the use of research tools: statistical analysis in the city profile survey and scheduling models and flow charts in the management improvement program.

The use of various technologies implies the use of another resource: skilled people. Consultants were hired to add special skills; city staff used their professional and on-the-job skills. Both examples involve training. In the management improvement program, cross-training of employees enabled groups of employees to learn each others skills. In both examples, city staff learned from the initial project phase how to improve thier own analyses and implement further improvements.

The Dallas experience is that resources must be committed to improvement programs. Time, skilled personnel, money and technology are critical factors for the success of any improvmeent program.

Incentives

To keep skilled people committed to improvement, there must be incentives.

The incentives for the use of the City Profile Survey are: 1) the relationship to the budget process, 2) the relationship to performance evaluation 3) the usefulness of the information and

4) the ability to measure progress. The city manager uses the information gathered from the profile survey to justify budget recommendations to the city council. This use gives the profile survey added visability and importance. It also links the survey to resource allocation, which provides the money, people and other resources to act on the survey results.

In addition, department directors are held responsible for responding to results. Their salary increase is based in part on their improving services citizens identify as needing improvement. Accountability is a powerful incentive.

The third major incentive for the use of the survey results is that the information collected is helpful to managers. The Exterior Housing Evaluation, for example, provides information on the condition of housing that cannot be obtained in any other way. City-wide evaluation of city services is also unavailable from any other sources.

The final incentive for using the city profile is that progress can be measured over time. There is a sense of satisfaction in seeing ratings for city services improve over the years.

The incentives for the management improvement program in the Water Utilities Department are similiar. Managers and employees alike derive a sense of satisfaction from seeing work methods and performance improve. The department head's salary increase is linked to budget performance. The department is recognized for improvements through Dallas Innovations and discussions with the management team.

Another important incentive described in the management improvement program is job security. At the beginning of the project phase, employees were assured that they would not lose their jobs. Reductions in the number of people needed to do a job were accomplished through attrition and reassignment, not lay offs.

Incentives are important, and they are almost impossible without top level management support. Implied in this discussion of incentives is the ability to grant them. That ability begins with authority from the city council, support of the city manager, and committment of the department director. In both examples, the city council authorized the improvement programs and were shown beneficial results. In both projects the city manager supported the projects and used available systems (eg: budget, performance evaluation) to highlight, encourage, monitor and reward improvements. In both projects, department directors are responsible for improvements and recognized for beneficial results. The lesson of the Dallas experience is that incentives are varied and critical to the success of any improvement.

Another major lesson of the case examples is that change in one area of the organization produces change in others. Productivity and performance improvements will result in changes in the way decisions are made and in the structure of the organization.

In the management improvement program in the water department for example, improvements depended on participation of various employees in describing and analyzing tasks, as well as recommending improvements. Ad hoc committees and task forces that cross traditional hierarchical boundaries were and are being used to continue improvements. These are examples of "participatory management", "temporary organizations" and "flattened organizations" discussed in literature on management of the future.

In the City Profile Survey, citizens assessments and opinions are involved in the decision-making process in a way they had not been before.

Changes in methods produce changes in decision-making processes and in organization. The lesson from this experience is to prepare for spin-off effects. It is difficult to isolate change in an environment of interrelationships. Managers must anticipate and respond to changes in decision-making and organization if improvements are to continue.

Summary

The two case examples presented are very different types of improvements. One is focused on a department-wide change involving management practices; the other is essentially a research tool with various publications in various parts of the total city organization. Yet these two improvements rely on very similar ingredients for their success: Long-term planning horizon, adequate resources, incentives and the ability to absorb and manage change.

CONCLUSION

WHERE DO WE GO FROM HERE?

It is an unusual time for cities. Just as cities emerged from the social turbulence of the 1960's, they were faced with the financial crises of the early 1970's. Now that cities are getting their financial houses in order and talk of renaissance begins, tax revenues are being frozen or reduced. The conflicting demands on cities create an unusual and challenging environment for cities.

Dallas, for example, is experiencing economic prosperity on the one hand and economic austerity on the other. The local economy is strong. Industry and commerce are thriving here. During fiscal 1976-77, economic indicators for the area surpassed those of the preceding year in every instance.

The Standard Metropolitan Statistical Area (SMSA) gained more than 40,000 jobs and forty-eight new firms. Manufacturing activity increased by almost 10,000 jobs.

Unemployment statistics for Dallas indicate a rate of 3.9% compared to a national average of 7.0%.

Housing starts in the past year were the third highest in the city's history. Single and multi-family permits were up more than 60%; the value of contract awards was up 23%. The market for these new dwellings was apparent in the housing occupancy figure: a remarkably high 95%.

The city government's performance matches that of the private sector. The budget is balanced, reserves are provided, capital plant expansion continues, services levels are constant or increasing, and ad valorem tax rate is decreasing. The total tax burden in Dallas compares very favorably with other parts of the country.

Even in these fortunate circumstances, Dallas is pressed to reduce spending,increase productivity and reduce taxing.

These pressures are countered by employee demands for higher wages and more and better benefits. Citizen demand for quality city services continues, as does the necessity for steady capital investment. Balancing these demands is a serious and difficult job.

The obstacles to success are many. Public officials can no longer be satisfied with the efficient use of resources; what is needed is the wise use of resources. Among the obstacles to overcome are:

* The complexity of issues
* Conflicting and increasing demands
* Fear of change
* Temptation to substitute short-range "solutions" for long term strategies
* Inertia of bureaucratic organizations
* Industry standards and traditions
* Limited resources
* Lack of accountability, skills, control, incentives and standards.
* Changing environment and conditions

In the face of these powerful forces, the challenge of government is still acceptable and success is still possible.

Today's challenges are:

1. Re-think and re-define the scope of government.

Cities now provide a wide range of services, including many that are mandated by state and federal governments. Cities must review the necessity of services, the appropriate levels of services and the appropriate providers of the services. Many of the services cities perform could and should be performed by the private sector or other levels of government.

2. Clarify the roles of local governments.

Cities, countries and special districts tax many of the same resources and serve many of the same people. Duplication of services wastes resources. Incentives must be provided to clarify intergovernmental relationships.

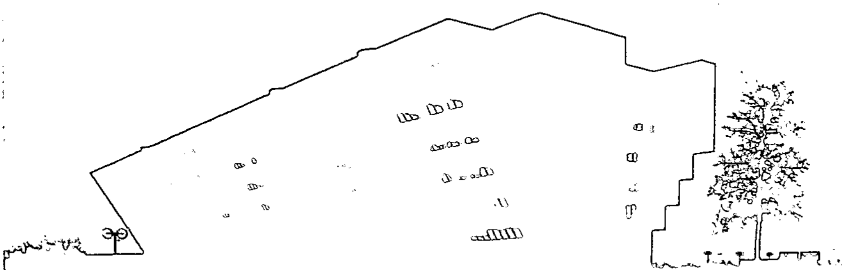
3. Develop skills for financial management

Cities councils need to understand municipal finance to make better decisions. Citizens need to know the financial implications of their demands.

4. Manage from the future

Long-term planning, ability to measure and assess impact and anticipating and managing change are critical management skills.

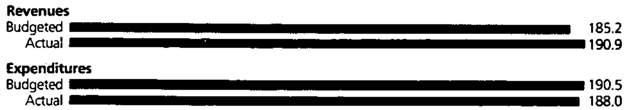
Tax revolt is a powerful force that can be used to reshape government. The obstacles and challenges are many. The Dallas experience suggests, however, that much is already being done to make better use of resources.



City of Dallas 1977 Performance Report

Financial Data

General Fund Operating Results (Cash Basis) — Year Ending 9/30/77
(millions of dollars)

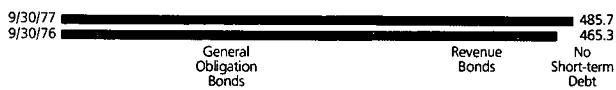


Emergency Reserve
(millions of dollars)

Earned Interest
(millions of dollars)

Total Equity
(millions of dollars)

Total Bonded Debt — Principal Only
(millions of dollars)



Bond Ratings — Moody's (GO) AAA; Standard & Poor's (GO) Aa

Dallas Offers . . .

- Emergency police service that reaches the scene of a reported crime in an average of six minutes from the time of the call.
- A reduction in the serious crime index of 8.9%.
- Emergency fire service that reaches the scene of a fire in less than six minutes from the time of the call.
- Average response time of less than five minutes for paramedic teams; emergency medical care by paramedic teams working with twenty-six of the city's forty hospitals.
- Adequate water supplies for home and industry beyond year 2000.
- Advanced wastewater treatment facilities assure effluent quality exceeding existing and anticipated national standards to the year 1984, and with planned treatment capacity to the year 1985.
- Low-cost, in-city solid waste disposal capacity to meet long-term planning needs beyond the year 2085.
- Adequate natural gas reserves for more than ten years at current rate of consumption; no residential curtailment in service.
- A reserve of 49% in electrical energy capacity; increases in capacity planned to accommodate needs through 1985.
- Diversification of energy sources so that by 1983 more than 75% of electrical energy may be generated by low-cost, near-by lignite coal and nuclear fuel.
- A rating of third in the nation for clean air by the American Medical Association.
- Fourteen institutions of higher learning; degree-granting capabilities include PhD and MD; postgraduate research opportunities also available.

Manager's Message

The challenge of city government in the seventies is to combine fiscal responsibility, quality services, and the ability to merge the creative energies of the public and private sectors. Dallas is meeting the challenge.

For the second consecutive year, the city's financial condition permitted a *decrease* in the ad valorem tax rate. Not only is Dallas' annual budget balanced, but revenues were higher and costs were lower, resulting in general fund performance at $8.2 million better than budgeted, for the fiscal year ended September 30, 1977. In addition:

- ▶ Productivity savings surpassed $2 million dollars.
- ▶ $5 million dollars was added to the cash Emergency Reserve, enabling it to reach its target level five years ahead of schedule.
- ▶ Interest earned on temporarily idle funds increased $1.3 million, up 9%.
- ▶ The year's lowest bank cash level was $265 million, which was $50 million above the low point last year.
- ▶ Capital plant expansion continued at the $40 million level.

The fiscal soundness of the municipal corporation also characterizes the private sector. Industry and commerce are thriving here. During fiscal 1976-77, economic indicators for the area surpassed those of the preceding year in every instance. The Standard Metropolitan Statistical Area (SMSA) gained more than 40,000 jobs and forty-eight new firms. Manufacturing activity increased by almost 10,000 jobs.

Unemployment statistics for Dallas indicate a rate of 3.9%, compared to a national average of 7.0%.

Housing starts in the past year were the third highest in the city's history. Single and multi-family permits were up more than 60%; the value of contract awards was up 23%. The market for these new dwellings was apparent in the housing occupancy figure: a remarkably high 95%.

Another kind of business activity saw more than 400,000 buyers come to the Dallas Market Center. The growing numbers of these buyers caused the Apparel Mart to add two additional floors, its third expansion in recent years.

The economy is but one evidence of Dallas' positive circumstance. Dallas is in a period which most aptly can be described as a renaissance — a coming together of spirit, effort, and ideas that promise to bring far-reaching achievements.

The symbol of this burgeoning spirit is the new City Hall, a striking and functional structure whose beauty and presence adds vigor to downtown Dallas and exemplifies a commitment to excellence in public architecture.

The spirit of the new building is mirrored in the professionalism and energy of the work force. The 5-year Performance Improvement Program, now in its second year, is a training plan to strengthen management skills and to infuse an entrepreneurial orientation throughout the organization.

A related program, Dallas Innovations, involves city personnel in identifying areas in which economies can be made without lessening the quality of performance. Even seemingly insignificant cost reductions, when multiplied by the scale of city operations, mean substantial savings. The elimination of waxing for resilient-type floors — as recommended by the industry trade association — began saving more than $45,000 annually. A plan to disassemble and rebuild landfill heavy equipment rather than to replace it after five years of service initiated annual cost reductions of $96,000 to $160,000.

Performance means more than cost savings; it means meeting needs. For the fourth consecutive year the city conducted a market analysis among its residents to determine their sense of needs and assessments of current operations. Once again respondents gave improved performance ratings for most city services. Singled out especially were the areas of fire, library, and water services, all gaining better than 90% approval.

The city's challenge, however, goes beyond fiscal responsibility and service delivery. Our challenge is to participate fully in the spirit of renaissance present in the city.

Public/private ventures evidence a spirit of common interest. Thanks-Giving Square illustrates the benefits of such participation. The multi-level facility combines a surface park with subsurface pedestrian walkways and a truck terminal. Completed in the past year, the project calls special attention to our heritage. Its pleasant expanse of grass, gardens, and fountains is enhanced by a chapel, bell tower, and Hall of Thanksgiving. The Square encourages meditation as well as celebration.

Another example of merging public and private energies is an inspired plan to revive the colorful buildings of the downtown warehouse district, while refurbishing streets and other public improvements.

The spark of merging energies is seen most spectacularly in a co-development called ReUnion at the western edge of the central business district. The $75 million first stage, already nearing completion, will include an ultra-modern, 1,000 room hotel; a 50-story tower with observation deck and revolving restaurant; restoration of the old Union Terminal railroad station to a transportation center and site of unique shops; offices; restaurants; and ten acres of green space.

These public/private commitments are not confined to brick and mortar projects. They are evident in a loan consortium program in which the city guarantees loans of participating banks for funding home repairs; they are seen in the efforts of city employees and citizen volunteers who work side by side in such places as the Public Library and Action Center.

A renaissance also implies a cultural awakening, and indeed the enthusiasm of the public and private sectors has already resulted in groundbreaking for a new central research library and planning for new arts facilities. Even though the province for the arts lies largely outside the authority of local government, the city and a number of arts organizations have combined efforts in planning a long-range, fresh approach for maximizing cultural impact. One important result may be the creation of a comprehensive arts district just north of the central business district in which six major art and cultural entities will be located.

The newest and perhaps most significant vista for Dallas is its emergence as an international city. If the railroad and Love Field projected us into the regional and then national picture, the regional airport places us directly in the international scene. It may be surprising to learn that Dallas has had for some time more international bank deposits than all other Texas banks combined.

International impact is apparent in many ways. Cultural exchanges with Japan add a new dimension to the long tradition of trade missions. Direct flights to London have been authorized, and soon the Concorde may be arriving regularly. Thirty consulates are already located here, more than in any other inland city. Increased activity at the World Trade Center prompted by such ties has resulted in plans to double the building's height to fourteen floors. Efforts are now focused on the creation of a Foreign Trade Zone for the tax-free movement of goods and establishing this area as an official U.S. customs district.

The year ahead holds plans for a downtown special events center. This rectangular building, scheduled for completion by 1980, will house an oval-shaped arena for a variety of performances and for indoor sports events.

Also underway are plans for a center to enrich the lives of handicapped citizens through recreation and other services.

All these projects and developments make this a time of celebration for Dallas. It is not a celebration of final achievement, for there are still many problems. These problems require forceful responses if present momentum is to be maintained. What is needed is a continued investment of energy, money, and heart — an investment of ourselves. The cause for celebration in Dallas is that spirit of dedication. Such a spirit gives added belief in renaissance.

Very truly yours,

George R. Schrader
City Manager

Dallas Mayor Robert S. Folsom and George R. Schrader

Operations Review

Providing services for the nation's eighth largest city is a complex job. Last year's operating budget of $307 million reflects that complexity. It includes police, fire, water, parks, street and sanitation services, as well as over 40 less conventional programs such as consumer affairs, human development, and environmental health.

Dallas' council-manager form of government is modeled after the private sector, with the city council providing policy leadership and the city manager providing professional administration.

GOVERNMENT OPERATIONS

The emphasis in this aspect of municipal activity is delivering quality services in the efficient, responsive, and equitable manner desired by the public. Police and fire protection, street and sanitation services, parks, libraries, traffic control, emergency medical services, and street lighting are some of these operations.

Police Services Modernized

One of the first concerns of any citizen is to have a safe environment for living. In Dallas the index crime rate — that is, serious crime — has declined each month for fifteen months. A crime prevention activity begun this past year was an automated analysis to detect patterns in criminal activity called Real Time Pattern Detection. Among other things, the program permits the accumulation and summary of residential burglary data within an hour and a half. Under the manual system, several days of work were required to obtain the same information.

A program called Automatic Vehicle Monitoring, expanded last year, electronically tracks each police vehicle at all times. This monitoring permits further reductions in response times and improved officer safety.

Firefighting Improvements

Fire protection was significantly improved this past year by installing a computer-assisted dispatch system. The dispatch time for calls was cut in half, down to less than two minutes. The time taken from dispatch until the equipment and personnel arrive on the scene of the fire averaged 4.20 minutes last year.

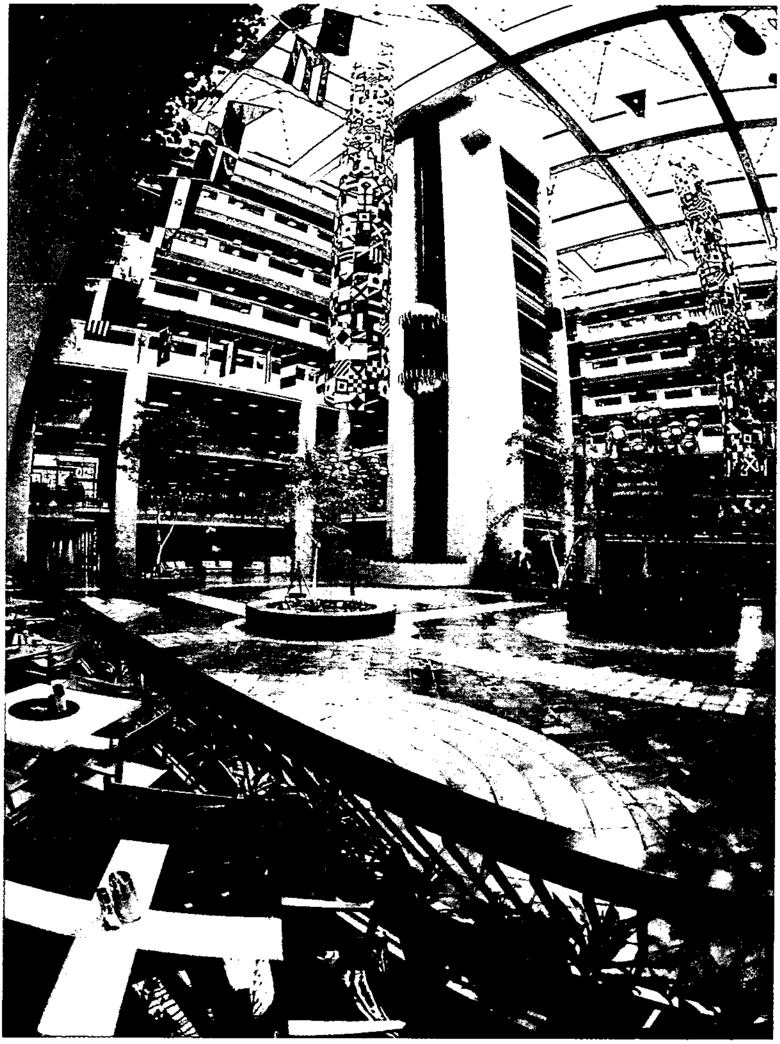
Redistricting of fire stations and reallocation of fire apparatus during the past fiscal year further improved service and response time. Modernization of radio fire alarm boxes saved $120,000 in maintenance costs and technically skilled personnel. The city's newest fire station cuts costs through reduced utility bills. The station uses solar energy for year round heating and cooling.

Dallas' newest fire station is heated and cooled by solar energy gathered by roof-top panels.

High school students, studying aeronautics from a real airplane, benefit from the Dallas Independent School District's multiple approaches to learning.

The proud figure of Big Tex looms over the Midway at the annual State Fair of Texas, the biggest exposition of its kind in the world.

The nations of the world come together under one spectacular roof in Dallas in the stunning World Trade Center.



Emergency Medical Services at High Level

The amublances, operated by paramedic teams, are equipped with biomedical telemetry equipment which sends data on a patient's vital signs to monitoring devices in the hospital emergency room. This equipment enables remote diagnosis and supervision by a physician, while a paramedic provides emergency treatment en route to the hospital. In the past year this service was enhanced through the addition of "Thumper" units which utilize the latest medical technology for resuscitation. Dallas' Emergency Medical Services have attracted international interest. Medical and city officials from England, Germany, Africa, Egypt, Canada, Brazil, and numerous other locations have come here to see it in operation.

Street Preventive Maintenance Improved with Computer System

A computerized inventory of the condition of every block in the city is maintained and updated annually. These precise descriptions permit optimum use of street repair funds by scheduling preventive maintenance for streets, sidewalks, and curbs in the areas of greatest need.

Severe Weather Response System Improved

Another unique feature of Dallas' streets program is an emergency response system in which radar facsimile equipment tracks approaching storms and automatically initiates emergency procedures when indicators reach specified levels. The notice facilitates prompt and efficient responses for locations prone to high water inconvenience or difficulty under conditions of sleet or snow. During this past fiscal year the program was improved through the installation of a high water sensor system which monitors levels at specified locations and frees the workers normally stationed at these points for more critical tasks.

Cultural Activities Broadened

The Dallas Public Library System serves as a major resource in North Texas and has the most recent technological devices for gathering information on practically any subject. During the past year the development of a long range plan for public library services marked the city's most organized effort to date for planned expansion. The city opened one new branch library this past year, and two more are being designed. These facilities brought the system close to its goal of positioning a library within two and a half miles of every home.

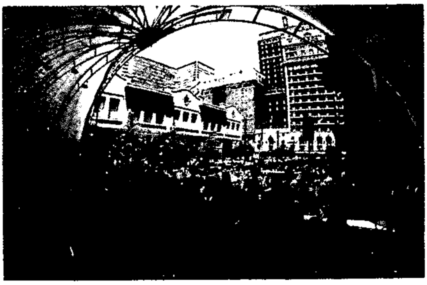
The cultural opportunities offered in many of the city's 262 parks continued to expand this past year. One of the most popular events was the city's sponsorship of free concerts by the Dallas Symphony Orchestra. Eleven park concerts and four downtown noon concerts attracted a combined audience last season of more than 50,000, an increase of 10,000 from the previous year.

ENTERPRISE OPERATIONS

Enterprise operations put the city in an entrepreneurial position; all revenues generated bring relief for the taxpayer.

Convention Center Strengthened

Dallas' Convention Center is one of the primary reasons that the city is second only to Chicago in the number of conventions to be held between July 1977 and December 1978, and that it ranks third in that period for estimated attendance. Convention activity



A free symphony concert enlivens a noon hour for shoppers and workers in downtown.

Graceful homes of years long passed are being restored to their original splendor in the historic Swiss Avenue area.

generated over $286 million in economic activity in the city during the past fiscal year, and for the forthcoming year that amount should reach $325.5 million. The Convention Center itself, in addition to its attractiveness to large national and international conventions, provides a centrally located facility for the recreational, entertainment, and cultural activities in Dallas.

Leadership in Aviation

Dallas Love Field continues to expand and improve its facilities, and it now ranks eighth in the nation as a corporate and business aviation center. Its in-city location is especially advantageous for business air service. In 1977 more than $3 million in private capital was invested for refurbishing facilities at the site. Steady growth continued, with aircraft movements increasing 10% over the previous year and passenger enplanements increasing 35% over the previous year.

The area's facility for commercial flights, Dallas/Fort Worth Regional Airport, illustrates what can be achieved in partnership by two cities. The airport is already one of the busiest anywhere, standing fifth in the world in air passenger boardings and fourth in the United States.

Water Resources — Ample Supply, High Quality

Current system capacity for treating and delivering potable water is 500 million gallons per day — a satisfactory margin above the peak day demand of 384 million gallons experienced in 1977. To assure that water quality continues to meet or exceed applicable state and federal standards, the city has completed and has in operation a $1 million pilot plant for conducting research on improved water treatment techniques.

Dallas is also a leader in efforts to enhance the quality of wastewater being returned to lakes and streams. The new $38 million Central Wastewater Treatment Plant is the first large advanced wastewater treatment plant in the southwest, and its design reflects the results of research conducted at the city's Water Reclamation Research Center. The Research Center has been operated in association with Texas A & M University.

Technological changes, crew scheduling, and other productivity improvements achieved an annual savings of $1.45 million during the past year.

Farmer's Market Highly Active

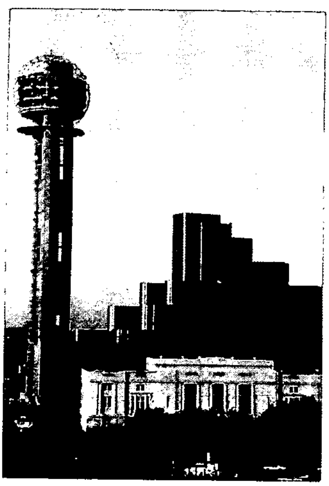
Some 1,000 families regularly bring vegetables and fruits to sell at the Farmer's Market, which is one of the city's most fascinating enterprise operations. Last year more than four million shoppers purchased $19 million in farm products. The Market is a hub of activity — one may also find flowers, crafts, or entertainment attractions there.

Its popularity has brought an increase in market revenues of 138% in the past five years, an increase of 14% during the past fiscal year. As a consequence, a master plan for expansion is underway.

The Market, too, has attracted international attention. Delegations from Saigon, Hong Kong, and other foreign cities have flown to Dallas to inspect it.

In Conclusion

These activities constitute hardly more than a sketch of the progress in the multitude of large and small operations involved in serving the people of Dallas. Whatever the job, though, the overriding objective is the same: to enhance the quality of life in Dallas.



The ReUnion project's striking blend of old and new is seen in the contrast between the Old Terminal Building and the contemporary hotel, towering revolving restaurant and observation area.

Unemployment Rate Lowest In Nation

Ranking Of 10 Most Populous SMSA'S (percent)

SMSA	RANK	1976	1975
Dallas-Fort Worth	1	4.6	5.3
Washington D. C.	2	5.2	5.5
Chicago	3	6.7	7.2
Philadelphia	4	8.8	8.5
Los Angeles-Long Beach	5	8.8	9.7
Boston	6	9.0	10.6
Detroit	7	9.1	13.1
Nassau-Suffolk	8	9.8	7.4
San Francisco-Oakland	9	10.3	11.0
New York	10	10.4	10.2

Source: U.S. Department of Commerce

Cost Of Living Comparison Lowest In Nation

Family Of Four With Intermediate Income
Ranking of 10 Most Populous SMSA's (Annual Budget in Dollars)

SMSA	RANK	1976	1975
Dallas-Fort Worth	1	14,699	13,924
Los Angeles-Long Beach	2	16,016	15,186
Detroit	3	16,514	15,701
Chicago	4	16,516	15,712
Philadelphia	5	16,836	15,689
Washington, D. C.	6	16,950	15,890
San Francisco-Oakland	7	17,200	16,415
New York	8	18,866	17,493
Boston	9	19,384	18,090
Nassau-Suffolk	10	N.A.	N.A.

Source: U. S. Department of Commerce

Statistical Profile Of Steady Growth

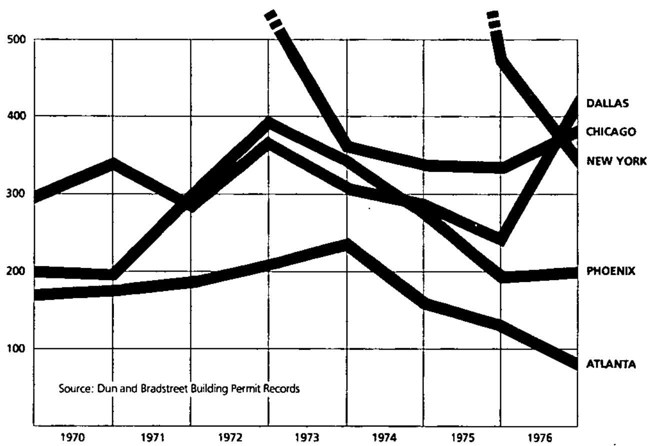
City of Dallas

	1976	1970	1960
Population	872,000	844,401	679,684
Per Capita Income	$ 5,626	$ 3,697	$ 2,782
Housing Units	348,174	303,233	231,270
Land Area — square miles	365	296	277
Park Acreage	*43,313	15,800	7,988
Park Sites	250	168	118
Number of Lakes	5	5	2
Miles of Streets	2,982	2,632	2,383
Number of Public Branch Libraries	17	12	5
Total Electric Connections	251,980	246,606	216,774
Airline Passengers Enplaned	7,986,094	5,225,083	1,387,517
Convention Attendance	1,250,000	695,000	595,000
Civilian Labor Force	421,995	386,139	297,162
Employment	400,995	374,209	287,440
Unemployment	21,000	11,930	9,722
Number of Manufacturing Businesses	1,946	1,768	1,488
Number of Service Businesses	10,168	8,277	4,982
Number of Retail Businesses	9,576	8,575	6,438
Number of Wholesale Businesses	3,690	3,261	2,620
Number of Banks	59	42	26
Retail Sales (in thousands)	$3,544,645	$2,541,628	$1,244,176

*Includes Lake Ray Hubbard — 22,560 acres

Upward Trend In Total Value Of Construction

Valuation of new residential, non-residential, repairs, alterations and additions (in millions)



Summary Combined Financial Information
Governmental Funds and Account Groups
Summary Balance Sheet
September 30, 1977 and 1976
(in thousands of dollars)

	1977	1976
Assets and other debits		
Current assets		
Cash and certificates of deposit	**$ 41,030**	$ 33,969
Cash and investments restricted for debt service	**18,014**	16,366
Cash and certificates of deposit held for capital projects	**68,012**	54,869
Other current assets	**47,621**	24,379
Total current assets	**174,677**	129,583
Non-current assets		
Unrestricted	**3,073**	2,877
Restricted (principally trust fund investments)	**5,735**	5,889
	8,808	8,766
Fixed assets (net of depreciation)	**457,963**	429,648
Amounts required for debt retirement	**303,494**	293,923
	$944,942	$861,920
Liabilities, invested capital and equity		
Current liabilities		
General obligation bonds	**$ 23,293**	$ 22,028
Other current liabilities	**21,408**	7,300
Total current liabilities	**44,701**	29,328
Non-current liabilities		
General obligation bonds	**280,201**	271,895
Other non-current liabilities	**1,569**	1,998
	281,770	273,893
Total liabilities	**326,471**	303,221
Investment in general fixed assets	**457,963**	429,648
Equity		
Fund balance		
Appropriated	**112,548**	94,128
Unappropriated (restricted and unrestricted)	**47,960**	34,923
Total equity	**160,508**	129,051
	$944,942	$861,920

See Accompanying Notes

Summary Combined Financial Information
Governmental Funds And Account Groups
Summary Statement Of Changes In Unappropriated Fund Balances

Years ended September 30, 1977 and 1976
(in thousands of dollars)

	1977	1976
Balance beginning of year as previously reported	**$ 34,923**	$ 54,591
Restatements	**—**	4,241
Balance beginning of year as restated	**34,923**	58,832
Revenue and transfers		
Taxes	**182,769**	165,789
Federal and state grants	**49,326**	36,133
Bond sales	**32,000**	21,950
Other	**40,059**	40,197
Transfers from other funds	**43,054**	21,872
	347,208	285,941
Expenditures and transfers		
Personal services	**139,413**	131,659
Other	**129,325**	119,430
Transfers to other funds	**47,013**	25,912
	315,751	277,001
Excess of revenue and transfers over expenditures and transfers	**31,457**	8,940
Increase in appropriated fund balance	**(18,420)**	(32,849)
Balance end of year	**$ 47,960**	$ 34,923

See Accompanying Notes

Summary Combined Financial Information
Proprietary Funds
Summary Balance Sheet
September 30, 1977 and 1976
(in thousands of dollars)

	1977	1976
Assets		
Current assets		
Cash and certificates of deposit	$ 16,569	$ 11,018
Cash and investments restricted for debt service	6,033	6,243
Other current assets	21,047	16,607
Total current assets	43,649	33,868
Non-current assets		
Restricted (principally for construction and debt service)	99,953	72,159
Fixed assets (net of depreciation)	580,767	568,620
Other assets	415	628
	$724,784	$675,275
Liabilities and equity		
Current liabilities		
Other current liabilities	$ 18,611	$ 11,525
Payable from restricted assets		
Current maturities — revenue bonds	12,965	14,080
Other	3,141	3,016
Total current liabilities	34,717	28,621
Non-current liabilities		
Revenue bonds	169,285	157,350
Other non-current liabilities	21,009	20,289
	190,294	177,639
Total liabilities	225,011	206,260
Equity — contributed	197,445	187,183
Retained earnings		
Appropriated	67,374	39,887
Unappropriated	234,954	241,945
Total equity	499,773	469,015
	$724,784	$675,275

See Accompanying Notes

Summary Combined Financial Information
Proprietary Funds
Summary Statement Of Operations And Changes In Unappropriated Retained Earnings

Years ended September 30, 1977 and 1976
(in thousands of dollars)

	1977	1976
Balance beginning of year as previously reported	**$ 241,945**	$ 244,648
Restatements	**—**	(35)
Balance beginning of year as restated	**241,945**	$ 244,613
Revenue		
Operating revenues	**101,101**	83,350
Taxes	**2,365**	2,009
Federal and state grants	**3,197**	2,222
Operating subsidy	**4,535**	4,481
Other	**11,591**	11,958
	122,789	104,020
Expenditures		
Personal services	**42,991**	37,629
Other	**60,300**	54,885
	103,291	92,514
Income before cumulative effect of change in accounting method	**19,498**	11,506
Cumulative effect on prior years of change in method of accounting for operating subsidies	**—**	5,972
Net Income	**19,498**	17,478
Increase in appropriated retained earnings and other adjustments	**(26,489)**	(20,146)
Balance end of year	**$ 234,954**	$ 241,945

See Accompanying Notes

Notes To Summary Combined Financial Information

Years Ended September 30, 1977 and 1976

Note 1 — Summary Financial Reporting

Interest in the development of summary financial reports for local governmental units has become widespread. In endeavoring to be responsive to the needs of the users of its financial statements, the City of Dallas supports this growing interest through the accompanying presentation of summary financial information.

Traditional governmental financial reports present the financial statements of each fund within the governmental unit. While we concur that the investment community and certain others continue to require this level of information, we believe that the traditional statements should be supplemented by a more readable and condensed financial presentation similar to the consolidated statements of a private corporation.

The City of Dallas complies with the traditional reporting concept and includes financial statements prepared in accordance with generally accepted accounting principles in its Annual Financial Report.

Note 2 — Governmental and Proprietary Funds

City of Dallas funds and account groups classified as Governmental are:

General Fund	General Obligation Debt Service Fund	Capital Project Funds
Park Fund	Revenue Sharing Funds	General Fixed Assets Account Group
Community Development Fund	Trust & Agency Funds	General Long Term Debt Account Group

City of Dallas funds classified as Proprietary Funds are:

Surtran	Water Utilities	Airport Revenue
Transportation Terminals	Convention Center	Internal Service Funds
Public Transit	Municipal Radio	

The amounts presented in the accompanying summary combined financial information represent the totals of the governmental funds and account groups and of the proprietary funds financial statements. Certain financial statement captions have been combined and interfund transactions and balances have not been eliminated.

The financial statements and notes to financial statements contained in the City of Dallas Annual Financial Reports for the fiscal years ended September 30, 1977 and 1976 should be referred to for a description of the City's significant accounting policies and other disclosures required by generally accepted accounting principles. Summary financial information is also presented in the Annual Financial Reports as a supplement to the traditional statements.

Report of Certified Public Accountants

The City Council
City of Dallas, Texas

We have examined the separate financial statements of the funds and account groups of the City of Dallas, Texas at September 30, 1977 and for the year then ended listed in the Table of Contents on page 13 of the City's 1977 Annual Financial Report, and have issued our report thereon dated January 10, 1978. We previously made a similar examination of the financial statements for the prior year. Our reports on the financial statements of certain funds contained qualifications for the effects of insufficient provisions for pension expense and for consistency as a result of changes, with which we concurred, in methods of accounting.

We have also reviewed, as to compilation only, the accompanying summary combined financial information of the governmental funds and account groups and of the proprietary funds of the City of Dallas, Texas at September 30, 1977 and 1976 and for the years then ended. This information, which has been compiled and summarized on the basis described in Note 2, from the statements referred to in the preceding paragraph, does not present financial position and results of operations in conformity with generally accepted accounting principles. In our opinion, the summary financial information referred to above has been compiled on the basis described in Note 2.

January 10, 1978
Dallas, Texas

Arthur Young & Company

Financial Review

The City of Dallas improved its already strong financial position by stressing quality financial management of city services. Expenditures were contained and revenues increased, making general government performance $8.2 million better than budgeted.

The property tax rate of $1.39 per $100 valuation in effect for fiscal year 1976-77 represented a decrease from the previous year's rate of $1.395. Late in the year, the rate was further reduced to $1.35 for 1977-78.

Financial highlights include:

- *Emergency Reserve* — This cash reserve was established in 1975 to provide an added margin of safety for emergencies. At the time of its inception, plans specified a contribution of $1 million annually, until achieving a balance of $10 million. Strong budget performance made it possible to increase the Reserve by $5 million to a total of $9 million at September 30, 1977.
- *Treasury Management* — The City Treasurer is selected for a two year term, based on competitive bids, to invest the city's cash reserves. A new treasurer contract was completed during 1976-77 which provides an incentive for efficient cash management by providing increased interest rates for longer term cash deposits.
- *Earned Interest* — Interest earned for all temporarily idle funds during 1977 is $1.3 million (9%) greater than 1976.
- *Total Equity Balances* — Total equity balances at September 30, 1977 increased over September 30, 1976 by $60.7 million (10%).
- *Sales Tax Receipts* — Sales tax receipts for 1977 increased $8.1 million (23%) over 1976.
- *Short-term Debt* — Current revenues support current operations; there is no short-term debt.
- *Net General Long Term Debt* — Net general long term debt declined as a percentage of the tax roll assessed value from 1974 through 1978, to a current 3.4%.
- *Annual Debt Service Expenditures* — Annual debt service expenditures for general obligation bonded debt at September 30, 1977 is 13.4% of total governmental funds expenditures. This percentage is 1.6% less than the year ended September 30, 1976 and represents the smallest percentage for several years.
- *Actuarial analysis* — Actuarial analysis is underway to permit systematic funding of retirement program liabilities.
- *General accounting systems* — General accounting systems conform to accepted principles and standards of Municipal Finance Officers Association and National Committee on Governmental Accounting; a fixed assets accounting system is being developed.

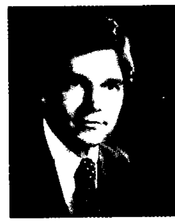
Those services not supported by means of tax revenues which posted exceptional earnings include:

- *Aviation* — Dallas' two wholly owned aviation facilities, Love Field and Redbird Airport, exhibited strong financial performance for the year ended September 30, 1977. Net income increased 9.5% over the previous year.
- *Water Utilities* — Due primarily to a rate adjustment in January of 1977, operating revenues increased by $13.2 million to $60.4 million. This increase resulted in net income of $18.5 million and a coverage of maximum debt requirements of 2.1, adequately above the required level of 1.5.
- *Convention Center* — Operating revenues from Convention Center events increased 17.8% to a total of $1.8 million. This result, together with an increase in hotel-motel tax proceeds, made possible a reduction in the general fund support by $219,000 to $814,000.

Dallas City Council

Robert S. Folsom
Mayor
Place 11

William E. Cothrum
Deputy Mayor Pro Tem
Place 5



William M. Blackburn
Mayor Pro Tem
Place 9

Don Hicks
Place 1

William F. "Bill" Nicol
Place 2

John N. Leedom
Place 3

Richard F. Smith
Place 4

Juanita Craft
Place 6

John A. Walton, D.O.
Place 7

Lucy Patterson
Place 8

Steve Bartlett
Place 10

STATEMENT OF WILLIAM V. DONALDSON, CITY MANAGER, CINCINNATI, OHIO

Mr. DONALDSON. Mr. Chairman, members of the subcommittee, thank you for having me. I was, however, a little surprised to find out that you did not have a holiday in Washington today, considering Pete Rose's performance last night. In Cincinnati we take that very seriously.

I think, you know that we have really overestimated and overtalked the idea of taxpayers' revolt. And the truth of the matter is that the taxpayers are really just smarter than we are and that they have figured out that our cities are getting smaller and that probably as they get smaller, we need less resources and we need to really plan to start dealing with smaller cities.

It is interesting to note that the Academy for the Study of Contemporary Problems in Columbus has found that the kind of characteristics of the cities of the Midwest and the Northeast—cities like my city—declining populations, or a rise in the number of citizens who for one reason or another are dependent on Government, on job loss, industrial job base moving away or going out of business, that those characteristics are now starting to spread to other parts of the country, the Southwest and the West, and that the sort of thing that we did in Cincinnati 2 years ago—applies to other cities.

We began a program to reduce the number of full-time city employees in our city. We have reduced that number from about 9,200 now to about 7,200. It seems to me that the first thing we really need to do in our cities, if we are going to make any sense of the decline and make any sense of getting smaller and having limited resources is develop some sort of a long-range plan that really says we are going to limit the growth of city revenues to maybe half or a third of the rate of inflation.

And once that kind of plan has been developed, to stick with it. There are all kinds of things we can do to make that plan work. For instance, we can reduce the level of some services.

In our city, a good example was that we cut off carrying out garbage. We just now pick it up at the curb. And it was really surprising how few people cared whether we carried out their garbage or not. We thought it was terribly important and that the citizens demanded that of us.

It turns out most of them really don't give a damn whether we did or not.

The second thing you can do is you can stop doing some things; for instance, we find our city is a city that is very strong on neighborhoods; we have some 44 organized neighborhoods, and we found that almost all of them wanted us to come clean up their neighborhoods, to pick up the trash in the street.

It wasn't people from Mars that throw all that stuff on the street. It is people that live in the neighborhoods, and we found that when we stopped picking up and when we said that we expected the people who live in the neighborhoods to take some part in keeping the neighborhoods clean, that they did that very nicely.

33-595 O - 78 - 23

We found in areas such as recreation that it was very easy to find all kinds of citizens who would volunteer to run recreation programs and probably do it more effectively and more satisfactorily than our people did it.

We have also found that the encouragement of self-help—involved real citizens involvement. I think somehow we have managed at least in our city to give people the idea that what citizen participation is not about is coming in and yelling at the Federal Government or the city government to do something for them.

The truth of the matter is that when you start to judge people's desires to have something done by how much they're willing to do about it themselves, you start to get some real changes.

I thought I would just mention a number of things that seem to me to work very well and tie into that idea of some kind of a long-range plan for reduction. And again, I would really emphasize that, we have a great way in government of thinking, well, the taxpayers don't like us this year, but they will forget about economy. You know, something grand will happen, and in a couple of years from now, why somebody will lay some more money on us.

Our city government is a good example of a government that felt that way. We have lost almost 100,000 people in our population in the last 20 years. We have lost some 3,500 manufacturing jobs. We have had a general reduction in our economic level, and each few years—why, our city government came to a crisis in being able to finance itself.

And instead of developing a long-range plan for cost reduction, we would just stop that year paving streets or we would stop buying firehose, with the idea that maybe another year from now things would change, and we could get all of that money back.

It seems to me that it is really important that we realize that the decline and the getting smaller and the limitation of resources that our governments have is something that is going to be with us for a very, very long time, and unless we are really willing to plan to deal with that, that we are going to find ouselves just constantly in the kinds of troubles we are now.

There is no magic and there is no way somebody is going to lay on the gold that gets us out of this.

Some of the suggestions that we have found that work very well is one, make your employees a partner in starting to deal with reductions. I think it is very interesting that Mr. Wurf has pointed out on a number of occasions that it is really not the employee unions that have fouled up the cities. It is the rotten management that has made poor use of these employees.

What we have done—there is a group in our highway maintenance division that plows snow and patches streets. Planning to do all these kinds of things with the union and with the management—they have managed to increase their productivity by a measurable 10 percent.

What is interesting, however, is that when asked, one employee said, we think we are working hard, but we think we could work harder if you did a better job of managing, if you did a better job of getting equipment onto the jobs and planning your work.

The second thing is a very difficult thing for local government to do and that is really the substitution of capital for labor. It is a lot easier in government to pay somebody's salary forever and a day than it is to get $100,000 to buy a new machine.

And we have had real attempts in this last year by changing our specifications and spending a great deal of money on the type of refuse equipment that we use. We have managed to reduce overtime by almost $200,000 this year.

A third thing it seems to me is important is to start to get some kind of measurement about how citizens perceive the services cities deliver. One of our difficulties is that we are the only garbage company and fire department and police department in town, and the result of that is that nobody can choose anyone else. We found that it has been very helpful to do citizen attitude surveys so that they start to talk about what they perceive the quality of the services and what they perceive to be the changes.

It is interesting that despite the fact that we reduced our work force by 2,500 people that our last attitude survey count, 15 percent of the people thought we were doing more than we were a year ago. Fifteen percent thought we were doing less, and the rest thought we were doing the same, which makes me wonder about some of the things we were doing.

It seems to me the next thing is to ask for help from the business community. The business community is not particularly helpful in helping you set long range policies. That is really the job of the politician, the job of the people I work for.

But what they are superhelpful in doing is helping you with techniques and helping you with ways of doing things. We have used the business community in our city for things ranging from writing performance specifications for garbage trucks to developing an internal auditing system so we have some idea what we're doing with our money.

We in Ohio were saddled with probably the most archaic and stupid State financial laws that you can imagine that put us on a cash basis, and it is pretty hard to plan, and they have helped us to do that.

The next thing is to provide some kind of incentives. You know, it is no wonder we get in trouble when we pay the fire chief that has the most firemen the most money.

Basically in our city governments the people that can get the biggest budget for their division or department get the highest salaries. And that is sort of inclined to get you into trouble. What we have really found is that a system that allows us to vary salaries—and we have an awful lot of trouble doing this—we have a very difficult civil service system, which has become sort of a triumph of technique over purpose. And we have had trouble making a performance pay system. But we found that that is really quite useful.

The last point again I would emphasize is: Make use of citizen volunteers. We find that our professional people sometimes resent that and that it is difficult to get them to understand that not only will citizen volunteers reduce municipal costs, but it will do a great deal to make people partners in what you are doing in city council and to reduce the kind of adversary relationship that we sometimes get into with our citizens.

Thank you, Mr. Chairman.

Chairman Reuss. Thank you, Mr. Donaldson.

Now, from Savannah, Ga., Mr. Mendonsa.

STATEMENT OF ARTHUR A. MENDONSA, CITY MANAGER, SAVANNAH, GA.

Mr. MENDONSA. We have been asked to address the question of how local governments can make more efficient use of limited resources. And before I turn to this question, I would like to respond to several comments which were made at the hearing on Tuesday.

A suggestion was made that the wages of local government employees be cut as a means of achieving or reducing governmental costs. This certainly would be a reasonable proposal, if it was done in the private industry, if it was done in the Federal Government, if it was done in the State government, and in all other sectors of our economy.

But until it is, local government employees, like other employees, still must buy food, pay for housing, pay the same high taxes as other workers, suffer the cost of inflation and otherwise survive.

Perhaps there is something that some of you do not know. There are still many local government employees who are paid less than the minimum wage. There are still local government employees who are neither under social security or under pension programs. It is conditions such as these that have brought about public employee unions, and it is the continuation of these conditions that is helping to make public employee unions the fastest growing unions in the Nation.

A suggestion was made that the private sector was more efficient than the public sector. In some localities for some services, this may be true, but this is not universally true. In my city, for example, it costs the city $42 per household per year to collect garbage from the backyard twice a week.

In the unincorporated part of our community just outside our city, the private collectors are charging $96 per household per year. Now, if they are more efficient, then they are certainly gouging the consumer.

It was suggested that revenue sharing should be abolished, apparently on the assumption that local governments are not able to use these funds efficiently. I would respond that local governments, particularly municipal governments, are the most responsible and responsive of the three levels of governments. Dollar for dollar they make more efficient use of their tax dollars than either the States or the Federal Government. The reason is simple:

It is at the local level that government really meets the people. There is an immediate and effective feedback from the taxpayers when things go wrong. The response is equally prompt.

I might also add that many of the costs that we are burdened with at the local level are not self-imposed. They are imposed by Federal and State mandates and environmental protection, on prevailing wages, on minimum wages, on unemployment taxes, to mention just a few.

They are imposed by inflation, particularly in the energy field. Revenue sharing was sought to help offset these costs. Dollar for dollar, the local citizens have received more benefits from this program than perhaps any other grant-in-aid program.

It has helped to hold down local tax increases. It has paid for needed capital improvements. It has helped to offset rising costs. A significant factor in the benefits obtained is that much of the revenue-sharing money is not wasted, complying with Federal redtape in using these funds, a situation that does not exist for other Federal grant programs.

Returning to the question of this session, the municipal governments of this Nation are very much concerned about the question how they can make efficient use of limited resources.

Because of this concern, many have instituted productivity improvement programs, which are increasing efficiency and improving the effectiveness of their service operations. In the efficiency area, they are using industrial engineering and analytical techniques to restructure operating procedures and redistribute work loads to improve efficiency. These efforts have cut employees from the payroll and have reduced costs. In my city, for example, we have a full-time productivity improvement staff that has in the past 12 months produced operating savings of more than $400,000 annually. Many other municipalities can report similar results.

Municipalities are also directing attention to the matter of effectiveness. This is an issue that has received too little attention at all levels of government. One result has been that we now have programs operating for which there is no clear definition of the results they are expected to produce, and without this definition, there is no way to evaluate performance.

Moreover, because the objectives are not clearly stated, the problems they are intended to address are poorly understood; it is virtually impossible to design effective programs. Some of our Federal urban programs fall into this category. One at times has a disconcerting feeling that some of the programs can best be described as solutions in search of a problem.

They appear to be designed on the shotgun principle that if birdshot is fired into a large enough flock of ducks often enough, one is bound to kill a duck. This may be an appropriate way to shoot ducks, but it is a costly and inefficient way to design programs to meet urban problems. One does not have to search too diligently to find examples.

Federal housing programs directed to low and moderate income housing consumers, manpower programs directed to the hardcore unemployed and to the youth unemployment, LEAA grants directed to crime reduction: Each is directed to a particular problem. Unfortunately they are not effective in correcting the problems to which they are directed. The housing needs of low and moderate income housing consumers are not being met. The problems of the hardcore unemployed are not being solved. The crime problem has not been reduced through LEAA programs.

The effectiveness issue is a concern of local government. We have operated service programs without giving much thought to the effectiveness of these programs in different parts of our community. We are now beginning to do this.

We are finding that there are significant differences between neighborhoods in terms of the services they need and in terms of the impacts of our service programs. We find that they usually work well in the economically advantaged neighborhood, first, because the people of these neighborhoods can afford to supplement these efforts through the private sector; and second, because they have a much lower level of exposure to conditions which are detrimental to their health, safety, and well-being than the citizens of the economically disadvantaged neighborhoods.

We found this to be true in Savannah. The economically disadvantaged neighborhoods when compared to the advantaged neighborhoods had more litter in the streets and on vacant lots and had a very high incidence of substandard houses, mostly tenant occupied.

They had a greater exposure to crime and a greater exposure to fire incidents, had fewer recreational opportunities and had more unpaved streets and more substandard paving on the paved streets and on down through the list of conditions which have a direct effect on the quality of living environment.

On the basis of this information we have revised our service programs to these neighborhoods to attack more effectively these conditions which are detrimental to the well-being of these citizens. In addition, we have targeted all of our community development block grant moneys to these neighborhoods.

We call our program the responsive public services program. It is well named, for what it is doing is tailor-making programs to address the particular needs of each neighborhood, and more to the point, is placing priorities where they belong, not only for capital expenditures and operating expenses, but also to insure that the programs which we are operating in these neighborhoods are at levels that will produce the intended results. Other local governments are pursuing similar programs. The goal is to make their services responsive to the public needs. More to the point, their goal is to insure that the tax dollars we do have are used not only efficiently, but are used effectively in serving the needs of our citizens.

Thank you.

[Mr. Mendonsa's prepared statement follows:]

LIMITED RESOURCES AND EQUITY IN PUBLIC SERVICES

Arthur A. Mendonsa
City Manager
Savannah, Georgia

Municipal governments exist to provide those services deemed necessary to protect and promote the public health, safety, convenience and social and economic welfare. Decisions concerning the kinds, quantity and distribution of services that will be provided are made on the basis of local political considerations and by federal and state mandates.

Until the early 1960's, the range of services provided by municipal governments was usually limited to such functions as police and fire protection and public works activities. However, beginning in the sixties and continuing to the present, the kinds of services being provided have been expanding. Today, in addition to the traditional functions, municipalities are operating environmental protection programs, health and social services programs, economic development programs, housing programs and a variety of manpower programs. Some of these new programs have started as a result of local initiatives. Others have resulted from various state and federal mandates.

As the types and levels of services have expanded, the cost of operating municipal governments has increased. The increase has been accelerated by inflation, federal mandates on minimum wages, social security, unemployment insurance, various environmental protection programs, and by union demands for higher wages and expanded fringe benefits.

To meet these increased costs, municipalities have had to increase tax rates and develop new sources of revenue. For a time, local taxpayers accepted these tax increases. In recent years, however, this has changed. Today, taxpayers no longer quietly acquiesce when taxes are increased: they are vocal and aggressive in their opposition.

Increasingly, municipal governments are being placed in an untenable position. On the one hand, the public continues to demand and receive more and better services. On the other hand, the public is becoming less and less tolerant of tax increases needed to finance the expanding services.

This dilemma has forced municipal governments to seek ways to control costs without curtailing services. One of the most successful approaches has been to use industrial engineering techniques to re-design public service operating procedures in order to improve the productivity of these services. This has produced dramatic results. In Savannah, for example, we have a full-time productivity improvement staff. During the last twelve months, through the efforts of this staff, we have carried out changes in our operating methods which are producing savings of more than $450,000 annually.

But there is another side to the equation. It is one thing to make services more efficient. It is another thing entirely to ensure that these services adequately serve all parts of the community. This can be a difficult assignment. Within municipalities, there are great differences between neighborhoods in terms of needs and problems. Unless this fact is recognized, there can be great inequities in the benefits obtained in the different neighborhoods from services provided, and in the priorities established for service changes and public facility improvements to these neighborhoods.

The issue boils down to one of equity. This issue becomes critical when placed in the context of limited resources. When resources are limited, as they are in most municipalities, measures must be taken to ensure that these resources are allocated to service programs in a manner that will secure equitable distribution of services throughout the community.

To achieve this objective, each community must carefully analyse the service and facility needs of each neighborhood. It must rank each neighborhood in terms of the kinds and quantity of services and facilities needed and then design programs, within the limits of available resources, to ensure that neighborhoods having the greatest needs will receive the highest priority in making service and capital improvement allocations. This approach may present political problems, although to do otherwise may present even more difficult political problems. In the past, the people of neglected and deprived neighborhoods lacked political clout, and, therefore, received little or no attention from city government. Moreover, they did not have the culture of complaining to City Hall. If their housing was poor, their streets dirty, their neighborhoods deficient in recreational facilities, their drainage and water and sewer facilities inadequate, then "that was the way it was supposed to be." Now, however, the people of these neighborhoods, in many Cities, are developing political sophistication and are learning to call City Hall for assistance. Failure of City Hall to respond effectively can produce a voter response at election time.

How can opposition to such an approach be minimized from those neighborhoods that have always enjoyed good service? The neighborhood analysis suggested earlier can help. If an objective system is developed to measure the conditions in each neighborhood and if the findings of these measurements are made known to the public, it will help quiet the opposition. Further, if benefit standards for each service are established and followed so that people of all neighborhoods know what to expect from services, opposition will be muted.

Savannah has undertaken a program to analyse the service needs of each neighborhood. As a first step, the City was divided into neighborhoods. In each neighborhood, the following conditions were measured:

1. Crime, by specific types.
2. Fire incidents.
3. Proportion of housing units that are substandard.
4. Extent to which streets and property were littered with trash and debris.
5. Proportion of street block segments, properties and structures subject to recurring flooding.
6. Proportion of structures with water and sewer service deficiencies.
7. Proportion of streets that are unpaved or have deficient pavement.
8. Adequacy of recreational facilities.

As expected, there were marked differences between neighborhoods for each of the conditions studied. We found that neighborhoods differed in terms of crime and fire hazards. They differed in how clean they were. They differed in the condition of their housing and in the adequacy of their water and sewer facilities, and they differed in the condition of their streets and the adequacy of their drainage facilities.

The neighborhoods were classified as problem or non-problem neighborhoods by comparing them with the city averages for each of the conditions studied.

Neighborhoods that were in better condition than the City as a whole were classified as non-problem neighborhoods, those in worse condition as problem neighborhoods.

Once the problem neighborhoods were identified, the next step was to determine what levels and kinds of services would be needed to bring the neighborhoods up to an acceptable condition, and then to calculate the cost of providing these services. This was done.

The information obtained from the analysis has been used in two ways: First, it has been used in planning the City's annual program of work. For example, as a result of thisprogram, the City has instituted an intensified fire-prevention inspection program in the neighborhoods with above average fire occurances, it has instituted a litter-control program in the high-litter neighborhoods and it has instituted a concentrated crime prevention program in high-crime neighborhoods. Second, the City used the findings of this program to develop its multi-year community development program.
With block-grant funds, the City has paved streets, made water and sewer improvements, provided housing assistance, made drainage improvements and recreational facility improvements in the problem neighborhoods. It should be noted that none of

Savannah's block grant funds have been applied to those neighborhoods which the study program classified as non-problem neighborhoods.

The significance of Savannah's Responsive Public Services Program, when viewed in the context of scarce resources, is three-fold: First, this program, for the first time in Savannah's history, undertook to identify those conditions in each neighborhood that are affected by the City's public services program and to determine the level of services needed for the particular neighborhood to address these conditions. This is a significant change in terms of service management because it puts the emphasis on designing services to meet the specific needs of a particular neighborhood rather than on the basis of generalized community-wide need.

Second, the program has demonstrated that care must be used in designing public services to ensure they are designed to meet the particular needs of each neighborhood; otherwise, there can be great differences in the benefits each neighborhood will receive from these services. This means that municipal policymakers must carefully consider what level of benefit will be acceptable and then assign resources in a way to ensure that such benefits are obtained for all neighborhoods. This is not always done. The tendency, in times of scarce resources, is to maintain service levels in those neighborhoods without serious problems at much higher levels than actually needed because it has always been done this way, even though such practices clearly penalize the problem neighborhoods.

Third, this program has provided the City with an objective system for establishing priorities for capital expenditures to pave streets, improve drainage, improve housing, improve recreational facilities and up-grade water and sewer facilities. Controversy over these issues has virtually disappeared since the program was instituted. Further, it has provided a basis for establishing priorities to up-grade public services.

As the financial resources of municipalities continue to grow more scarce, it will become essential that ways be found to use these resources in a manner that will effectively and equitably serve all the citizens of the community. A program such as Savannah's Responsive Public Services program can provide a means of accomplishing this. Such a program can help make the management of public service production and delivery more responsible, and it can enable municipalities to make more effective use of their limited resources for capital improvements and operations by providing an objective mechanism for establishing priorities.

Presentation before the Sub-Committee on the City, Committee on Banking, Finance and Urban Affairs of the Ninety-Fifth Congress Washington, D.C., July 26, 1978

Mr. PATTISON [presiding]. Thank you, Mr. Mendonsa. We will next hear from Donald Wasserman.

STATEMENT OF DONALD S. WASSERMAN, DIRECTOR OF RESEARCH, AMERICAN FEDERATION OF STATE, COUNTY, AND MUNICIPAL EMPLOYEES (AFSCME)

Mr. WASSERMAN. Thank you, Mr. Chairman.

Summarizing the initial section of our statement, we think it is proper that the subcommittee looks at the broad aspects of financial problems in the cities. Certainly it is not a one-dimensional problem.

For example, productivity, in the full sense of the word, must exist in a healthy economy. Instead we have had a recession in the mid-seventies and currently an unyielding inflation.

We also address the necessity of reasonable and equitable revenue raising mechanisms by State and local government. Most State and local governments fall far short here.

Most importantly, we address the Federal role in State and local government financing. Here we are particularly interested in the manner in which this money is directed.

For example, Mr. Chairman, as early as 1972, when President Wurf testified on general revenue sharing, he said about State governments that—general revenue sharing for State governments ought to be conditioned on the degree of progressivity in State taxing programs. His statement maintained that States without a progressive income tax, relying instead on regressive property and sales taxes, should not receive grants under revenue sharing. This, of course, would affect the local governments within those States.

AFSCME holds now, as it did then, that while revenue sharing is extremely important and, indeed, a very essential program, the Federal Government should not be in the business of supplementing the revenues of States which continue to raise taxes from those citizens least able to pay and, thus, adding further to the distress of those areas within a State which are most in need of adequate public services and economic growth strategies.

We are aware of the chairman's concern over the plight of American cities and the desperate need for a rational national urban program. I think a part of such a program must include answers to some of the questions raised during these 2 days.

We think the Federal Government has other roles to play. And, frankly, we are a little puzzled as to how the administration is interpreting the role. It seems to us that one single Federal agency, the National Center for Productivity and Quality of Working Life, has been serving as the lead agency in convincing local governments to examine their entire scope of operations and to determine what functions may be done better or less expensively. It has pleaded and cajoled, it has flattered and embarassed both cities and employee organizations into self-examination.

The Center was beginning to make progress, at least in its working with the public sector. People were beginning to listen. Productivity projects were being initiated. The concept of productivity was beginning to take on specific meanings in many cities. The word productivity, in fact, was losing some of its mystique in local government.

Now we learn that the center is being dismantled and that several of its functions may be parceled out to a variety of Federal agencies. We are not clear as to what activities will be assigned to the Office of Budget and Management, the Department of Labor, the Department of Commerce, the Civil Service Commission, and perhaps even the Federal Mediation and Conciliation Service.

Frankly, we fear that an assignment of bits and pieces of the center into a host of ongoing offices and bureaus in existing agencies has two very distinct disadvantages.

One, accountability will be lost. The buck will not stop since the finger always can be pointed somewhere else. Perhaps even more importantly, this decision will result in blurring an important focal point. Acting as the point agency in Government productivity concerns is perhaps the most useful function of the Center.

If indeed productivity is the combination of effective and efficient delivery of services, it seems to us that it must be a way of thinking. It simply does not lend itself to the kind of fragmentation that I sense is about to take place.

Our union, too, has a substantial stake in the survival and viability of local government. As a matter of fact, more than 50 percent of our 1 million members work for municipal government alone, and perhaps two-thirds work for all of local government.

We have a substantial stake in the public's perception of public employees. And, let's face it, that perception is not always positive. In part, however, public perception is forged on a number of misconceptions. One misconception is that State and local government employees earn more than their counterparts in private industry. Direct comparisons between wages in the public and private sectors are not always easy to achieve.

For many years we have requested the Department of Labor's Bureau of Labor Statistics to collect and publish the same kinds of earnings data for State and local governments that it collects for virtually all major and minor private industries. While BLS has expanded its program slightly, there are still huge gaps that make direct comparison difficult. This, too, is an area where the Federal Government can assist State and local governments to make decisions on a more factual basis by collecting the necessary data that is not now collected—but that is collected for virtually every private industry.

Nevertheless, on an annual basis, the Bureau of Economic Analysis of the U.S. Department of Commerce does publish earnings data for the U.S. work force by major industry group. Recently released information showed that 1977 average wages for all State and local government employees, including managerial, administrative, professional, and so forth, was $12,230 per year. The average wage for noneducational State and local governmental employees was $11,721 per year. The average employee in all U.S. industries earned $12,320 per year, or about $10 per week more than noneducational State and local governmental employees.

Comparable average earnings for other unionized industries were:

Mining, over $17,350; construction, over $14,650; manufacturing, almost $14,000; durable goods manufacturing, almost $15,000; automobile manufacturing, almost $20,000; transportation, $16,000; communications, over $16,500.

Earnings in State and local government are even less than in nondurable manufacturing.

Another misconception is that fringe benefits in the public sector far outstrip those paid by private industry. According to the U.S. Conference of Mayor's Labor Management Relations Service, fringe benefits as a percentage of pay for hours worked in 1975 amounted to 41 percent for general employees in U.S. cities. A comparable U.S. Chamber of Commerce employee benefits study showed, in the same year, 1975, that on the same basis of comparison, that is, percentage of pay for straight time hours worked, average fringe benefits in the private sector of the Nation came to 52 percent.

Translating this into dollars, cities paid $3,392 or 41 percent. Private industry paid $4,672 or 52 percent of pay for hours worked.

There is only one conclusion. Private sector employees earn more than city employees and have a more lucrative fringe benefit package, both in absolute dollar amounts and proportionally to earnings.

Employment in city government has suffered. As a matter of fact, there was an absolute decline between 1975 and 1976. And if it were not for the Comprehensive Employment and Training Act, many large cities would have undergone a decimation of their work force.

Our union has supported CETA from its inception, and has long supported federally funded public service employment programs. But let's be candid. Let's admit that when the Government acts as the employer of last resort, jobs—not productivity—is the major concern. Let's be honest enough to say right up front that there may be a conflict between the Government as the employer of last resort and increased productivity of the public work force.

And let's acknowledge that national public policy correctly opts for jobs at this time.

I am not suggesting that we throw up our hands. I am suggesting that the question of productivity in city government is a multidimensional problem. Within this framework we have encouraged the formation of local labor management committees where we can. And some of these committees have dealt exclusively with productivity and the quality of working life. We have attempted to improve the art of labor management relations in the public sector so that critical decisions can be based more on fact than emotion.

We have joined with public interest groups and public management in demanding that Federal agencies be more responsive to the data and information needs of local governments that now employ almost 9 million American workers.

Thank you, Mr. Chairman.

[Mr. Wasserman's prepared statement on behalf of the American Federation of State, County, and Municipal Employees (AFSCME) follows:]

TESTIMONY OF DONALD S. WASSERMAN

DIRECTOR OF RESEARCH AND COLLECTIVE BARGAINING SERVICES

AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES

BEFORE THE

SUBCOMMITTEE ON THE CITY
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES

JULY 26, 1978

The American Federation of State, County and Municipal Employees is pleased to have this opportunity to participate in this panel on "How Can Local Governments Make More Efficient Use of Their Limited Resources?" This question is posed within the framework of the Subcommittee's Hearings "Proposition 13: Prelude to Fiscal Crisis or New Opportunities." These issues are of particular concern to our union: more than one-half of our one million members work for municipal governments. Over two-thirds work for local governments.

The broad nature of the Subcommittee's Hearings these two days indicate an appreciation of the broad scope of the problems facing local government, their tax payers and employees. AFSCME, too, has grappled with these problems for some time. For more than six years we have been emphasizing the need for substantial and meaningful tax reform at both the state and local government level. We have warned that tax payers were getting fed up with unfair, unreasonable and regressive tax systems.

Now Proposition 13 is a fact of life and state and local governments around the nation are faced with similar propositions or other tax or spending limitations. For the information of the Subcommittee I have attached to my testimony a copy of AFSCME's 1978 policy statement on State and Local Government Tax Reform. It is substantially similar to other policy statements we have issued since 1972. Unfortunately tax reform seems to be as far off now as it did then.

It should be stated for the record though, that while tax payers are rebelling against unfair local taxes they are not rebelling against local services. Several surveys, even in this post Proposition 13 era, reveal that tax payers want and in fact demand services from their local governments.

It is also important to note that we believe the Federal Government should play a key role in encouraging state and local government to be more effective and efficient -- in short more productive -- in the way services are delivered. When we -- AFSCME -- talk about productivity we mean both people and systems -- and we also mean climate. People: the men and women who raise the revenue and those who spend it; those who set the policies and those who carry them out; the people who design the sanitation routes and the people who collect the trash. All are responsible and each must be held accountable. Elected leaders set policy. Managers design and administer. Employees deliver services.

But productivity can only exist in a healthy climate. It starts with a strong economy and a fair, adequate and reliable system of raising revenue. The responsibility of nationally elected leadership starts with establishing a firm economy, hardly a description of today's economy. The responsibility of locally elected leadership begins with decisions on which services to provide in what quantity and quality and how to pay for them. Local government productivity efforts run afoul in a faltering national economy with disgraceful state and local tax systems. Recession brings dramatic declines in sales tax projections. Inflation in some areas has driven property taxes through the roof and taxpayer resentment has virtually traumatized many public officials.

When we look for breakdowns in the system, we must first look at the root causes -- look at the top of the hierarchy. Otherwise adjustments at the bottom are likely to be little more than cosmetic. Mistakes made at the start cannot be undone at the finish. This is not said to absolve workers of responsibility. In no way should they be exempt from efforts to increase productivity or from accountability. Incompetence and malingering should not be tolerated at any level of the work force. A fair day's work for a fair day's pay should be the order of the day at all levels. But when elected officials or managers drop the ball workers should not be charged with the error.

The Federal Government should play a role in the manner in which state and local governments are financed. For example, as early as 1972 AFSCME President Jerry Wurf testified that general revenue sharing for state governments ought to be conditioned on the degree of progressivity in state taxing programs. At that time our statement maintained that states without a progressive income tax, relying instead on more regressive property and sales taxes for their revenues, should not receive grants under revenue sharing. AFSCME holds as we did in 1972, that while revenue sharing is an important, indeed essential program, the Federal Government should not be in the business of supplementing the revenues of states which continue to raise taxes from those citizens least able to pay, and thus adding further to the distress of those areas within a state which are most in need of adequate public services and economic growth strategies.

Mr. Chairman, we are aware of your continuing concern of the plight of urban American cities and the desperate need for a national urban program. Part of that program must include answers to some of the questions raised in these hearings. It seems to us that survival of the cities certainly depends as well on how and to what degree cities are able to improve the effectiveness and efficiency of the delivery of services to their tax payers. But even here, Mr. Chairman, we believe the Federal Government has an important role to play. And frankly, we are puzzled as to how the Administration is interpreting that role.

A single federal agency, the National Center for Productivity and Quality of Working Life, has been serving as the lead agency in convincing local governments to examine their entire scope of operations to determine what functions may be done better or less expensively. It has pleaded, cajoled, flattered and embarrassed both cities and employee organizations into self-examination. The Center was actually making progress, at least in its working with the public sector. People were beginning to listen. Productivity projects were being initiated. The concept of productivity is beginning to take on specific meaning in many cities. The word "productivity" is losing some of its mystique. Now we learn that the Center is being dismantled and that several of its functions may be parcelled out to a variety of federal agencies. We are not clear as to what activities will be assigned to the Office of Budget and Management, Department of Labor, Department of Commerce, Civil Service Commission, and Federal Mediation and Conciliation Service. Frankly, we fear that a submerging of bits and pieces of the Center into a host of ongoing Offices and Bureaus in other Departments has two disadvantages. Accountability will be lost. The buck will not stop since the finger can always be pointed elsewhere. Perhaps even more importantly, this decision will result in blurring the focal point. Acting as the "point" agency in government productivity is perhaps the most useful function of the Center. If productivity is the combination of effective and efficient delivery of services, it must be a way of thinking. It simple does not lend itself to the kind of fragmentation that I sense is about to take place.

For its part AFSCME has repeatedly stated its willingness and desire to assist in making local government more productive. Our International President Jerry Wurf has repeatedly challenged local government to join with AFSCME in raising the performance level of local governments -- from the elected officials and department heads through rank and file employees. We have said that we are prepared to bargain, negotiate, discuss or consult with local government management on all aspects of the effective and efficient delivery of services, including the productivity of its employees -- our members. Unfortunately, local governments generally respond to this challenge only when battling a severe crisis as in the case of New York City, or when an impending crisis looms as in the case of several other cities. There are instances, however, where we have been able to work out productivity arrangements with a number of local governments. These arrangements are not altruistic.

We too have a substantial stake in the survival and viability of local government. We too have a substantial stake in the public's perception of public employees. And, let's face it -- that perception is not always positive. In part, however, public perception is forged on a number of misconceptions.

One misconception is that state and local government employees earn more than their counterparts in private industry. Direct comparisons between wages in the public and private sectors are not easy to achieve. For many years we have requested the Department of Labor's Bureau of Labor Statistics to collect and publish the same kind of earnings data for state and local governments that it collects for virtually all major private industries. While BLS has expanded its program slightly in this direction, there are still huge gaps that make direct comparison difficult. Nevertheless, on an annual basis the Bureau of Economic Analysis of the U.S. Department of Commerce does publish annual earnings data for the U.S. work force, by industry group. Recently released information shows that 1977 average wages for all state and local government employees -- including managerial and professional employees -- was $12,230 per year. The average wage for non-educational state and local government employees was $11,721 per year. The average employee in all U.S. industries earned $12,239 per year, or about $10 per week more. 1977 comparable average earnings for other unionized industries were:

Federal Government	$14,291
Mining	17,352
Construction	14,664
Manufacturing	13,892
Durable Goods Manufacturing	14,766
Automobile Manufacturing	19,811
Transportation	15,999
Communications	16,684
Electric and Gas Utilities	16,743

These figures show state and local government employees earning substantially less than manufacturing employees and even less than non-durable manufacturing employees who earn $12,592.

Another misconception is that fringe benefits in the public sector far outstrip those paid by private industry. According to the Labor-Management Relations Service of the U.S. Conference of Mayors, fringe benefits, as a percentage of pay for hours worked in 1975, amounted to 41% for general employees in U.S. cities. A Chamber of Commerce Employee Benefits Study showed that average fringe benefits for private industry employees in the United States amounted to 35.4% of total payroll costs in 1975. The Chamber reported, however, that when fringe benefits were calculated on the basis of a percentage of pay for hours worked, they amounted to 44.2%. Additionally, the Chamber reported that when fringes were calculated on the basis of percentage of straight-time pay for hours worked they came to 51.8%. It is this 51.8% that is comparable to the U.S. City average of 41%. Using an identical basis for measurement, fringe benefits as a percentage of straight time pay for hours worked, the 1975 cost to private industry employers was almost 52% compared with a cost of 41% for public (city) employees. Said another way, the actual dollar fringe benefit expenditure per year in U.S. cities was $3,392 (or 41% of pay for hours worked of $8,273). In private industry this expenditure was $4,672 (or 51.8% of pay for hours worked of $9,021). There is only one conclusion. Private sector employees earn more than city employees and have a more lucrative fringe benefit package, both in absolute dollar amounts and proportionally to earnings.

A third misconception is that rigid union seniority requirements prohibit management from promoting good deserving employees. I suppose that somewhere among our union's 4,000 collective bargaining agreements there may exist one that requires promoting the senior employee regardless of ability, but I have yet to see it. Overwhelmingly promotions in local government are based on qualifications and ability, with a measure of concern for tenure. What union contracts should insist on -- and generally do -- is that management make its decision in an objective and reliable fashion. Management should be held accountable and be able to justify by-passing experienced employees. Most union agreements insist on no more than this simple procedure.

Our union, in fact, has indicated a willingness to cooperate in removing rigidities that have become part of civil service systems over a period of years. We support independent examination to evaluate the impact of civil service systems on productivity.

A fourth misconception is that a public job is equivalent to a lifetime sinecure. Apparently even substantial lay offs of public employees in most major U.S. cities have done little to bury this myth. The truth is that municipal employment actually declined between 1975 and 1976, the latest data available. If it were not for the Comprehensive Employment and Training Act many large cities would have undergone a decimation of their work force.

Our union has supported CETA from its inception and has long supported federally funded public service employment programs. But let's be candid. Let's admit that when the government acts as the employer of last resort, jobs -- not productivity -- is the major concern. Let's be honest enough to say right up front that there may be a conflict between the government as the employer of last resort and increased productivity of the public work force. And let's acknowledge that national policy currently opts for jobs -- and properly should do so.

Mr. Chairman, I am not suggesting that we throw up our hands because of these problems. Rather, I am saying let's understand the real dimension of the problem and let's see how each of us can have some input without either demanding or expecting miracles. Given the current fiscal and revenue raising mess, the nation's unabating inflation, the organizational and structural mistakes of local government, the inadequate quality of some public management, the frequently contradictory regulations, guidelines and signals from Washington, let us recognize that arrangements made between employers and employee organizations can indeed improve the functioning of local government but they will not solve some of today's most pressing problems facing local governments.

Within this framework AFSCME has encouraged the formation of local labor-management committees to review ongoing problems, especially those that hinder effective delivery of service. Some of the Committees deal exclusively with productivity and quality of working life concerns.

We have attempted to improve the art of labor-management relations in the public service so that critical decisions can be made based more on facts than on emotion.

We have joined with public interest groups and public management in demanding that federal agencies be more responsive to the data and informative needs of local governments that employ almost nine million workers.

Last year AFSCME established a Public Service Advisory Board to assist and advise the Union in setting our national policy objectives in a host of critical areas. This Board is independent of the union and is made up of 20 men and women from government, academia, public interest groups, and private business. It brings together some of our society's most prominent opinion leaders and experts on local government issues. It makes an important contribution to the efforts of AFSCME's membership, leadership and staff to stay informed and participate intelligently in important national and local debates. Currently a sub-committee of this group is reviewing the feasibility of doing a thorough study of state and local government productivity. AFSCME encourages such a study.

Twenty-Third International Convention

JUNE 26 - JUNE 30, 1978

LAS VEGAS, NEVADA

RESOLUTION No. 108

STATE AND LOCAL TAX REFORM

WHEREAS:

State and local government has been one of the most rapidly growing sectors of the economy in the last twenty years. There are several reasons for this growth. The post-war increase in population increased demands for "people oriented" services such as education, health and welfare -- services which are largely provided by state and local jurisdictions. At the same time, in order to assure high quality services, it was necessary to increase the wages and salaries of state and local employees, who were seriously underpaid relative to the rest of the economy's wage earners. In addition, states and localities are inherently more vulnerable to inflation than are either the federal or private sectors. Because state-local services are more "people oriented" (e.g., schooling, health services, welfare) they are more labor intensive than the rest of the economy's output. As a result, state and local jurisdictions are less able to adopt technological changes which dampen the inflationary impact of rising costs.

WHEREAS:

Since economic growth responsiveness of state-local tax structures has not been sufficient to provide all the needed revenues, both state and local government are forced to raise existing tax rates and bases, adopt new taxes or cut the scope and quality of public services.

WHEREAS:

Committee Assignment ____________ Committee Recommendation ____________ Convention Action ____________

As state-local jurisdictions have played a larger role in the economy, it has become increasingly important to rely on tax systems which are both equitable and automatically responsive to economic growth. This need, in turn, argues for the necessity of an ongoing program of state-local tax structure reform.

WHEREAS:

This need for reform is largely concerned with two issues. First, the burden of state and local taxes tends to fall more heavily on the poor. Second, most state and local tax structures are not adequately responsive to economic growth.

WHEREAS:

In order to achieve more equitable and growth responsive tax systems, reform is needed with respect to the three most important state and local government revenue sources: the income tax, the general sales tax and the property tax.

INCOME TAXES

WHEREAS:

The personal income tax is not only the most equitable mechanism for raising tax dollars, it is usually the only progressive tax which is used by state and local governments. As such, it is critical that personal income taxes be used more intensively in order to offset the regressivity of the other state and local taxes.

WHEREAS:

There has been some progress on this front in recent years. Since 1961, 11 states have adopted the income tax, bringing the total number of broad-based income tax states to 41. But these new adoptions are by no means enough. Income taxes account for only a meager 10 percent of all state-local revenues. Moreover, many income taxes are not progressive. Several state income taxes (e.g., Pennsylvania, Indiana, Illinois) have proportional rather than graduated rates; and, even some states which have nominal graduated tax brackets have designed those rates to "top off" at relatively low incomes.

WHEREAS:

Income tax regressivity is particularly severe at the local level where these taxes usually have no exemptions or standard deductions and which are levied only on wages and salaries. As a result, most local income taxes are no more than payroll taxes in disguise.

WHEREAS:

The use of the progressive personal income tax is the most convenient vehicle for reducing the tax burden on low income taxpayers. It also has the ability to generate new tax revenues automatically during periods of economic growth. Such automatic growth responsiveness is desirable in order to help governments to meet the inevitably rising costs of providing public services to a growing population.

GENERAL SALES TAXES

WHEREAS:

General consumer sales taxes provide the major source of state tax revenues -- 30.6 percent of all collections in 1977. Unfortunately, sales taxes are also the primary source of the overall regressivity of the state tax system. This is because low income families spend a larger proportion of their total incomes than do higher income families.

WHEREAS:

This regressivity can be severe, but it can be offset either by exempting necessities from the sales tax base or by adopting a tax credit for sales taxes paid.

WHEREAS:

The exemption of certain "necessities" -- such as food -- from the sales tax base is the most politically popular form of sales tax relief. However, the benefit of a food exemption is much less than that of a system of tax credits and rebates. Although the impact of a food exemption is mildly progressive, much of the benefit goes to wealthy individuals, who spend large absolute sums of money on food items -- and do not require such tax relief on equity grounds.

WHEREAS:

A system of tax credits and rebates is a more efficient and equitable mechanism for offsetting the impact of a general sales tax. Such credits, geared to state income tax returns, have taken a variety of forms. They can range from a flat dollar amount for each family member to a variable credit based on the level of family income.

WHEREAS:

The most progressive form of a sales tax credit is the "variable vanishing type." Under this system the size of the tax credit is related directly to family size and is inversely proportional to income. Thus, the larger the number of dependents, the larger the credit; the higher the income, the smaller the credit. Of the eight states (plus the District of Columbia) which have implemented sales tax credit plans, those in Hawaii, New Mexico and Vermont best illustrate this concept.

PROPERTY TAXES

WHEREAS:

Reform of the current system of property taxation has aroused a good deal of interest because of two interrelated circumstances: the problem of financing public education among communities with different levels of wealth, and the unfair burden that the property tax imposes on certain groups of citizens -- the classic case being the elderly person living on a fixed income.

WHEREAS:

The property tax has come under increased criticism from a wide range of public officials as well as from the general public. However, this criticism often fails to recognize that the property tax is potentially one of the most progressive revenue-raisers in state and local finance. In fact, the property tax is the only major tax in the United States which is levied directly on accumulated wealth and unrealized capital gains income. Because of the many special tax preferences in the IRS Code, a large number of very wealthy people have little taxable income. A soundly structured, fairly administered property tax, on the other hand, would be a progressive loophole-free source of income.

WHEREAS:

Since property taxes finance such a large portion of public education, reform in the method of school financing deserves high priority. In order to compensate for differences in property values among school districts within the same state, a program of statewide funding must be adopted to finance public education. A major ingredient of statewide funding would be proceeds from a graduated, statewide property tax. These could be distributed to each school district as a flat per capita grant for each public school student. If a school district chose to spend more than the amount of its grants, it could augment this figure by adopting a local sales or income tax. However, the amount of revenue generated for education by either of these local taxes must not be dependent on the wealth of the community. To achieve fairness in the yield for such supplemental taxes, the state should adopt a "power equalizer" formula. This would ensure that the same tax effort in a poor community would yield the same number of tax dollars as it would in a wealthy community. The funds required for this "leveling up" process would come out of general state revenues.

WHEREAS:

Even with statewide, graduated rates the property tax would still place a heavy burden on low-income families and on elderly people living on fixed incomes. One effective mechanism for dealing with this problem is the "circuit-breaker" which is now used in some form in 25 states. This device provides a uniform system of tax credits or rebates on property tax liability for those with low incomes, especially elderly citizens. Homeowners below a certain income level -- say $10,000 -- would be exempted from a portion of their property tax liability. Property tax liability would be gradually removed at lower rates of income. Thus, income level is what "breaks" the property tax "circuit."

WHEREAS:

Further, renters could be included in a "circuit-breaker" system by fixing a specific percentage of rent payments as representative of property tax payments -- 15 or 20 percent, for example. This is done on the presumption that landlords are able to "pass on" to their tenants a major portion of property taxes. A property tax credit or rebate for renters should also be tied to income so that the benefits would be targeted to the low income family.

THEREFORE BE IT RESOLVED:

(1) AFSCME urges state and local governments to achieve more equitable and responsive tax systems by:

a. Relying more heavily on progressive personal and corporate income taxes for financing the growing demand for public services.

b. Adopting tax credits which are variable and inversely related to taxpayer incomes to offset the regressive effects of sales taxes.

c. Adopting a "circuit-breaker" system to provide property tax relief for low and middle income homeowners and renters.

(2) AFSCME urges state governments to assume a greater role in public school financing by:

a. Increasing the reliance for funding on progressive taxes, including adoption of statewide property taxes with graduated rates or large exemptions from the assessed valuation of property.

b. Adopting a system of "piggybacked" taxes with a "power equalizer" formula which would assure the same yield from the same tax effort in poor and wealthy communities.

(3) AFSCME urges the federal government to expand its use of grant-in-aid programs to include incentives for state restructuring of regressive tax systems.

(4) Local governments must transform their payroll type "income"

taxes to conform with the federal income tax base and include a graduated rate structure.

SUBMITTED BY: International Executive Board

Chairman REUSS [presiding]. Thank you very much, Mr. Wasserman.

If such is the consensus here, we will withhold the second panel consisting of the private sector's specialists and start our questioning of those who have already spoken.

If there is no objection to that, let me start out. Let's take Dallas and Cincinnati, respectively.

The population of the city of Dallas is——

Ms. CATES. It is about 950,000.

Chairman REUSS. The county's name and population is——

Ms. CATES. Dallas County, and Dallas County has about a million and a half.

Chairman REUSS. And Cincinnati?

Mr. DONALDSON. We are in a metropolitan area of about a million and a half, and a county of about a million, and a city popultion of about 400,000.

Chairman REUSS. And while we are at it, Savannah?

Mr. MENDONSA. The city is 150,000. The county is about 200,000. The metropolitan area about 235,000.

Chairman REUSS. What can be said about further forms of consolidation between large urban cities like yours and their surrounding counties? It seems to me that if one arrived here from Mars, one would not really set it up that way. You have got county cops patrolling the big highways, and city cops patrolling little highways, and various, and bizarre arrangements about who pays for the library and museum.

And you have certainly got an awful lot of legislators, some who work for the county and some for the city, who would probably do better if they were paid and worked for one. You have a problem, of course, if you start shuffling the two together. Then minority groups, particularly black people, who have suddenly established a foothold, feel they are being diluted.

You have lots of problems, but what about economy and efficiency and saving a buck?

Mr. DONALDSON. There is no doubt about it. In our county there are 46 governmental agencies. If you go to a meeting of the Hamilton County Firemen's Association it is a cast of thousands. Unfortunately, the Federal Government's policy of extending freeways at no cost, of extending sewer and water lines, the utility's policy of using our ratepayers to pay the cost of extension to the suburban areas—they have really not made much incentive for the suburban areas to become part of the central city.

We have added to that problem white flight from the city that probably is not very keen about being part of us any more. And, finally, we have reached the point where our minorities have some say in our city government. That complicates that problem even further. It is also complicated because in our city we tend to be Democrats, and in our county we tend to be Republicans.

So I think the likelihood of any kind of self-developed consolidation is not very high. On the other hand, there are a whole series of services that really are countywide, and that, for one reason or another, the city of Cincinnati has taken on. And probably because we were largest first and we were there the longest time, and we have been able to do things.

Like, for years we ran the Hamilton County Municipal Courts, and we have now managed to find a way of going to the legislature and handing that turkey back to the county government.

We are now in the process of trying to stick them with running the correctional institutions. We have gone through the process of working with them on water and sewer and on transit.

I think that there is some real future in taking specific activities and metropolitanizing those. I think it is very unlikely that we'll ever have less than 100,000 fire chiefs, though.

Chairman REUSS. Incrementalism has been going on for a long time. And it is still quite incremental, I regret to say.

If farseeing changes by some political legerdemain could be made, would you see the opportunity for visible savings for the taxpayers?

Mr. DONALDSON. I think not only savings for the taxpayers, but particularly some share of the cost that the central city is paying. The fact that we are the refuge for those people who need Government assistance does not mean that the problem of the poor, the people that, for instance, we run some 12 health clinics—there are no health clinics in the county. And I assume if you get sick in the county and you're poor, you move to the city. Well, it would seem to me reasonable to expect that the population of the county would help pay those kinds of costs.

Unfortunately, the tax rates are relatively high in the suburban areas because they don't have facilities. So they are in the process of taxing themsleves to build schools and to build other parks and things like that.

But, certainly, nobody ever felt that it was rational. And our problems are compounded by the fact that our overall metropolitan area is in three States.

Chairman REUSS. Could I ask unanimous consent to proceed for another minute or two? I don't think you need to go into the same detail, but is what Mr. Donaldson has said about Cincinnati—does it have its analog in Dallas?

Ms. CATES. Yes. I think there are possibilities for State legislation to provide incentives for services to be either county or city, so that we are both not in criminal justice, we are both not in transportation, we are both not in health.

There are things that the Federal regulations can do. For example, encouraging low-income housing in the suburban districts by certain types of guidelines. We have certainly tried in Dallas to spread more of that type of service into the suburban jurisdictions.

Those kinds of strategies can provide us with additional clout in the suburban cities with incentives to do that type of activity.

Chairman REUSS. Again, without going into too great a detail—Savannah may be different, but would you say some of these lessons apply to your own city?

Mr. MENDONSA. A couple of comments. No. 1, that we should be able to accomplish consolidation. It is very likely that the cost of Government would go down. In fact, it would go up because we would have to raise the level of services that are needed in the suburban areas. So that I think that has to be faced. It is, however, possible that the cost to the people who now live within the city will go down because they are helping to subsidize the people in the unincorporated areas and those people will begin to pay their fair share of the cost.

Point No. 2, however, it is very unlikely we will have consolidation because the legislation under which we attempted it called for a double majority. The people inside the city approved it, 3 to 1. The people outside the city turned it down, 2 to 1. And overall it passed 2 to 1. But, unfortunately, they had the veto in the unincorporated areas.

So unless we can change State laws to recognize the realities of these problems, we will not have many more consolidations in this Nation.

Chairman REUSS. I think you are all three right in your politics. I will conclude with my intrusion on the time of my colleagues by saying that I often question the wisdom of the Federal Government paying the States $2 billion a year plus in unrestricted general revenue sharing to give them more time not to do anything about the condition of their principalities and powers in the cities and counties.

Representative Pattison is recognized.

Representative PATTISON. The notion of self-help fee for service, where that is appropriate, is very attractive to me and has been for a long time. We have a city in my district that did a very unusual thing. It may not be unusual on a nationwide basis, but it is for our part of the country. The downtown merchants were quite interested in doing some facade work in the downtown area. However, they recognized that if they just got the Government to do it, there would be understandable complaints from the rest of the city, for even though it would benefit the whole city, it did benefit those merchants in particular.

So they worked out a formula whereby they created a special benefit district and assessed themselves within that district and worked out a one-third their share, one-third community development funds and one-third city in general revenues or something of that nature. And I think that goes along with the notion of fees for garbage service and things of that nature.

And so I am glad to see that we are progressing along those lines and perhaps that is one of the bright rays of proposition 13 and what is known as the taxpayers' revolt.

I am particularly concerned about the problem of leadership and of competence at the local level. I have been in local government and have observed local government in a variety of settings from very small cities to relatively large urban areas.

I do not mean competence and leadership only on the government level, but on the private level also. I see a remarkable lack of leadership, historically, at the level of the people who are in the neighborhoods and at the level of the people who are merchants in the cities, sort, of a noncaring attitude about the rest of one's neighbors. Everybody wants more parking, but nobody is willing to give. And they all tell their own employees not to park in front of the store, but they all park down in front of somebody else's store, and that's OK.

And so they clog the streets with their own cars and don't work out arrangements so that people who are coming to shop can find convenient parking.

They sweep their stores out in the morning and leave it on the street because that is the city's job.

If a tree dies in front of their property, just let it go, without watering it or without replacing it because that is somebody else's job. And fill up the alleys with boxes and whatever, packing crates and the rest of it because once it is outside the store, it is not their problem.

It seems to me that there is a real problem—that without the leadership that you get from local people we are not going to get very far no matter what we do.

What can you do about getting that leadership? Is there any magic solution to that?

I am not sure who I should address.

Mr. MENDONSA. I think we should let the elected official address that issue.

Ms. LAMPHERE. I spoke briefly in my comments about——

Representative PATTISON. Unfortunately, I was not here.

Ms. LAMPHERE [continuing]. About early efforts we have made to use marketing tools and techniques in public sector decisionmaking. And you can change public attitudes through marketing techniques, through public service announcements that begin to get through to people.

Don't let your dog run unchained and don't litter in the streets because in the end, it is going to cost you money. And don't leave the junk on the sidewalk because pretty soon, you'll get a special assessment.

Believe it or not, particularly in those things you speak about, the nuisance things that are extremely costly and people do turn their backs on, we have really marked up some scores in changing attitudes and changing behavior.

It is a new field, a new effort in the public sector. But I think it has tremendous potential. We have to concentrate on that. There is no reason why these techniques in this field of expertise is restricted to private sector activities.

It works well in other ways. There are other things but that is a subtle little turn. We have begun to market neighborhoods, market city living through posters and what have you, saying the city is where the action is, and believe it or not, people are coming back into the cities.

So we can change a certain course of events. We need to have as many tools in our kit bag as everyone else does, and we are beginning to awaken to that and I think collect some of them.

Representative PATTISON. Mr. Donaldson, would you like to comment on that?

Mr. DONALDSON. I might just add a little bit.

I suspect the first thing is to tell people the truth. If they think you are going to do it and they can be unpleasant and they will yell at you loud enough, why, they won't do it.

And the truth of the matter is if you sit down and say, look, if you want that thing done, you have to do it. And we in the city government are here to help you do it and we are here to show you and we are here to give you the benefit of any knowledge that we have. But really, you have to participate in doing the thing.

And in our city, we went through the period of time of encouraging citizen participation, and that amounted to having 47 neighborhoods all come and yell at the city council.

Well, of course the city council is very, very smart and they figured out a way to get them off their back was to play them against each other. So they ended up going away being perturbed at the city government and being perturbed at each other, and, you know, not getting anything. Somehow or another the idea was if you could just be unpleasant enough and you could just be persistent enough, and if you could just be around long enough, the city government would come pick up your garbage or chop your tree down or build you a parking lot.

What has happened now is that the city council and the neighborhood leadership have really taken a position of saying, we are going to judge your interests in an issue by what you're personally willing to do about it.

I think that we constantly use the excuse, the reason we do all of these things is somebody wants us to do them. The citizens demand it. That has got to be one of the grander lies of all times. Like a lot of my friends who wanted me to run for office. You know, it isn't true.

It just seems to me they are being honest and saying, look, we have limited resources and you live here. I think that Cincinnati has an advantage that I have never seen in any other city that I have worked for, and that is a tremendous pride and a sense of place and a sense that Cincinnati, I think, if you asked most people from our area where they come from, none of them would say Ohio; they would all say Cincinnati.

I think that is that kind of pride and that kind of sense.

It is interesting to note that most of our business people fly a city flag and even in our suburban areas, the suburban schools all claim they are in Cincinnati, even though they are not. I think it is that sense of kind of pride and caring about the community and it is really there if you ask people. Citizens are really very bright and are much more likely to face up to reality than I think we who are insulated by the public trough are.

Representative PATTISON. Thank you. I think that my time has expired.

Chairman REUSS. Thank you. Representative Kelly.

Representative KELLY. Mr. Chairman, I think that I understood correctly when the Chair said that he lamented the fact that we have revenue sharing because it gives them, referring to the cities, more time to do something about their act. And that is not good because they should have done something about their act earlier.

Mr. Chairman, I don't know whether to be pleased at your conversion or piqued at your plagiarism because that was exactly the argument that I used when we were dealing with the New York bailout and the chairman did not accept that logic then. But I am glad to see that he recognizes the logic with regard to revenue sharing.

In this whole discussion about proposition 13 and the cities, I don't hear any discussion from the people who are dealing with the problems about what the Nation or the Congress or you intend to do about such things as illegal strikes, where the cities have laws that say the municipal workers cannot strike. And yet, city after city, they do strike and they do prevail. Nobody gets fired when all the smoke clears. The taxpayers just put another rock in their pack and the people are not fired, nobody is prosecuted, and the city just goes on as normal.

And even in the case of the labor unions, there is a little bit of nonsense too, because so many of the pension funds are not properly financed. And somewhere down the road it would seem as though there is going to have to be a reckoning. Along with the proposition if we don't pay the pensions, are there going to be riots in the streets?

It would seem to me logically, there are going to be riots in the streets when there is no money to pay the pensions.

Then there is this whole question of a growing ominous cloud of regional competition where the North Central and the Northeastern cities have abused their taxpayers and abused their economies and driven their industries out of their areas. Now they are calling on the Federal Government to bail them out. They are plaguing this city like locusts. They are just milking the Federal cow and draining money into these regional areas. Can't we all know that sooner or later, the south or the west and the developing and growing areas that have tried to conduct their affairs in a responsible fashion are going to tire of the imbalance that is going to come from the regional competition?

I don't hear you people saying anything about that. I am listening for the conversation that I think is meaningful and I am not hearing it. I think it is all very learned and I think I am impressed with all of the credentials and the buzz words and all of that.

But the things that I am speaking of seem to me to be the gut issues and the damage that local governments through taxing policies are doing to industry and impacting on industry in the form of direct taxes and utility costs. And this is part of why we have the regional problem of the Northeast and North Central part of the country.

This is what those industrialists say is the reason why they are leaving.

What I would like to do is have some comment from you people on these subjects that I have raised. The big war, the big issue, is just in the development stage and the irritation of proposition 13 is just an indication—it is not really the bottom line.

Mr. DONALDSON. Mr. Chairman, I am not really sure that that was a question.

Representative KELLY. It was a subject matter. If you would like some help about developing a question Mr. Donaldson, I will be glad to assist you.

Can you find a question in all of that?

Mr. DONALDSON. As I say, I have never thought of myself as a locust before, but the truth of the matter is it was in California, which is a part of the country that doesn't have some of the relocation problems and doesn't have some of the problems of obsolescence where the taxpayers really rose up.

Representative KELLY. Well, do you think that a fire has caused the relocation problem or do you think that was a mismanagement problem?

Mr. DONALDSON. I think it has a lot to do with the changes in our national economy.

For instance, in our city, we found that only 23 percent of the job loss that we have had has been because people moved somewhere else. The rest of it is because a lot of the kinds of industries that we have, we in the United States are really no longer competitive and that those industries—for instance, the machine tool industry—is a very strong part of our local economy and that the Germans and Japanese are in that area.

I was going to say that I have been very fortunate. This is the first time that I have ever worked in what I perceive as the Eastern part of the United States. I served as a manager in California and Arizona and in Washington. And it seems to me that at least to some degree, it was the Federal Government's subsidy of reclamation projects, the Federal Government's subsidy of highways, and some of those things that made some of that movement occur.

Representative KELLY. Well, can I ask you, do you think that it is the tax burden, the utility cost burden, the mismanagement burden that is imposed on our industry and has robbed that industry of the ability to invest capital in new machinery and new technology, and has placed the United States at the bottom of the list of industrialized countries that invest in their own capital, that maybe this had something to do with the fact that we have an industry that is not as competitive as it used to be?

And isn't there a direct relationship, isn't the management of the city part of that scenario?

Mr. DONALDSON. There certainly may be some truth in that. But, for instance, the State of Ohio ranks some 48th or 49th in total taxes imposed. We are very, very low. We are lower than most of the States that are held up as grand examples.

So that I am not sure that it is really that tax policy. It may have to do with reinvestment, things like that, that I'm really not an expert on, sir.

But it seems to me that the real difficulty that we are dealing with is areas that have old plants and old buildings. And, you know, unfortunately, in America we have sort of retained the idea, you throw away things that are old and you go move and build something else.

We have received Federal policies that kind of encourage that. In my earlier remarks, the thing I really tried to point out is that, that really, the rate of growth of our country has slowed down. The population growth has slowed down and we need to plan to deal with that. And we need to do it.

I certainly do agree with you that pitting one section of the country against another or pitting one kind of city, old central city or suburban city against each other is a mistake. It is really a problem we need to work together with.

But, certainly, a lot of the burdens that have been imposed on local government are really national burdens. Certainly the problem that probably is our most critical problem right now is that we have a whole class of citizens who did all of the things that were right. They worked all their lives, they saved money, they participated in pension plans, they did all of the things that are really what good Americans do, and they retired and inflation has now made them poor people. It has now driven them on to kinds of assistance that, for instance, our city government provides.

I think it is really unreasonable to think that the people of the declining city of Cincinnati should be paying the cost, for instance, for health care for some of those people or paying the cost of some of the other things that are necessary to do for those people. And, certainly, one of the problems is that we need to look at some of the costs that are imposed on local government and say, look, those really aren't local costs. They really ought to be spread on a broader basis.

I think maybe that that is one of the things that the national Congress hopes to do in providing revenue sharing and other assistance.

Representative KELLY. Mr. Chairman, I would just like to suggest that businesses don't move because their buildings are old; they move because they can make more money some place else. And that has a ring of more realism to me. But perhaps the witness disagrees.

Mr. DONALDSON. The point is that for instance, industries are now organizing on a horizontal rather than on a vertical basis. And a lot of the industries that we have, their buildings were built during the early part of this century and they are buildings that are three and four and five stories high and it is more efficient for them now to be organized on a one-story building.

Unfortunately, our city built up around them. It costs money to tear down the buildings. The advantages that we should have had because we have a water system and a sewer system and a street system and public systems have really been kind of offset because those kinds of systems have been provided at taxpayer's expense, where you can go out and you can level out a cornfield and build that building.

Representative KELLY. And install your own and still make more money.

Mr. DONALDSON. And have the Government pay for it.

Representative KELLY. Thank you, Mr. Chairman.

Chairman REUSS. Thank you, Mr. Kelly. Representative Oakar?

Representative OAKAR. Thank you, Mr. Chairman.

I want to ask a question directed at anyone who would like to respond.

I have been very concerned and I support these programs very specifically, but I have been very concerned about the fact that the Federal Government has really impacted cities with multimillion dollar kinds of grants. CETA is a good example. You mentioned that. The community development block grant moneys, all of which have a very viable, important purpose.

And it has been my experience while serving local government that when it comes down to the local level, in various studies that we have done and GAO has done, that CETA, for example, is just a national disgrace in terms of the number of people who are hardcore unemployed but who are not being served.

The administrative costs far outweigh the actual earnings of employees and then many times these people can't get jobs after all of that great training and local government has put the police and firemen, et cetera, on the payroll when they should not have and so on.

So those kinds of funds are not always used for what they were intended. My question is, based on my position, do I continue to vote for these kinds of programs that I know have a good end result or could have, ideally speaking, or do we overregulate and not make block grant money, for example, as flexible as it is? What do we do to insure that administrators in cities are answerable to the people? As you know, my own city of Cleveland is being asked some hard questions by the people in Cleveland as to whether we want to continue with the administration and so forth. And lots of people signed a petition to call back the administration.

So the discontent is real, but I don't think it is the only thing that is going on in Cleveland. It is a catalyst for what is happening, I think, throughout the country because that money is not really impacted—it has not really impacted cities in the manner that it should.

So how do we insure, I guess following up on Ned's question, that local administrators really use that money creatively and well and with the best intentions? Do we do it by more regulations or do you just scrap these programs?

Mr. MENDONSA. I would like to comment and I am sure that there are others that would like to comment. But No. 1, under the community development block grant program, communities have far more flexibility to establish priorities and to define their problems and to develop their programs to address these problems than they do under CETA.

Now, CETA is a little confusing in terms of what it is intended to accomplish. If it is designed, as I mentioned earlier, to deal with the high unemployment during the cycles of unemployment, then it does that at least reasonably well. But if it is designed to deal with hardcore unemployment, these people who are chonically unemployed, who cannot really get to work and the youth, then it is not really working very well.

I mean you can put them to work—as soon as the moneys run out, they are unemployed again. They are not trained and the program that we are required to operate under, however, is subject to a great many guidelines and standards which are imposed by the Federal Government, not by the local communities.

If you would give us a block grant and say, look, here is $1 million or $2 million or $4 million, you design a program to deal with the hardcore unemployment, you have the flexibility to decide what will work and what will not work.

I am egotistical enough to think that our local communities would do a better job of dealing with that issue than we are able to do now because there are Federal limitations on what we can do.

Representative OAKAR. I would really be afraid to open that CETA program any more because I think it has been tremendously abused. It was my experience in just researching some of these cases on my own—and I don't think Cleveland is any different from other urban areas because the national average in terms of abuse for CETA was very similar to what it was in Cleveland.

So we just mirrored what was happening nationally in terms of finding jobs and having a productive program. But it is my experience that there were some jobs out there, but that the CETA administrators really didn't bother too much to get these people on a gainful payroll.

Mr. DONALDSON. I think that probably all of you at one time or another time read "Wind in the Willows," and you will recall there was a toad in there that had a new enthusiasm every week.

Well, one of the problems in dealing with programs like CETA is that every time we turn around, the Feds have a new enthusiasm. And you know, you are never really sure in the long run what the funding is going to be. There is always some kind of crisis during the summer whether there's going to be any more money or not. And if you look at the structure of that kind of a program, it is pretty hard to develop any long-term strategies for dealing with the problem that is a long-term problem—the hardcore unemployed.

You know, we're not going to wave a wand over all of those people and suddenly make them employable. Undoubtedly, there are cities that have abused anything. Undoubtedly, there are people in Congress that abuse things. But there are a lot of cities that have done very well, and it seems to me that it might be helpful to look at the cities that have done well and, in effect, give somebody a bonus for doing well and saying, look, you know, we will really give you some time.

Representative OAKAR. Is that your recommendation on how to change the law? Cities that use it well get a bonus?

Mr. DONALDSON. What if you just set up some goals and said, look, here is the goal. We want you to do that. You know, the kind of thing that is maddening, for instance, we had a 7.2-percent unemployment rate in our city, and somehow, over the weekend, the Department of Labor changed the way they figured that. And miraculously, probably the greatest thing that the present administration has accomplished, they dropped that unemployment rate from Friday to Monday to 6.2 percent.

Now, you know, that is very difficult to try to plan or do anything with a program that operates on that kind of stupid irrationality. I think that that is some of the difficulty we get in in trying to meet the goals and trying to meet the general ideas that you want to establish.

Representative OAKAR. Can I ask you a question about encouraging capital investment that will improve productivity and reduce long-term costs, which is one of your points, I think, Mr. Donaldson.

I really welcome the response you gave to my colleague who just left, because, being from a northern city and knowing that our industries are old and we have been crushed a la Youngstown, and so forth, by the import problem that the Government has not really faced head on and which has resulted in the loss of many, many jobs with the dumping of cheaply priced foreign goods that goes on with many of our older industries, I wonder, what do you do to encourage capital investment in cities?

Mr. DONALDSON. One of the interesting things is that really very few cities know very much about how their local economy works. We just finished a study of 1,500 industrial employers in our metropolitan area, and we found the single reason that people either did not expand in our area or left our area was not tax policy, was not Government regulation, was not even the hot summer weather. It turned out that it really was that we did not have enough skilled people, and it seems to me that imaginatively dealing with that problem of providing skilled employees—and you know, there is some reason to think that industry may very well follow people rather than the other way around—and that with the CETA program, that you could really do something about that, but that demands a kind of partnership and a long-term commitment.

You know, if you are really going to start to do something about that, it is not going to work next year. There is not going to be a miracle next year. It is going to take 4 and 5 and 6 years to do that.

Representative OAKAR. Just one quick question: do you think tax abatement should be an incentive for those older industries to stay?

Mr. DONALDSON. We find that it is reasonably effective in doing that. Unfortunately, it is often hard to judge, since everybody else gives tax abatements or tax credits. And so that, in effect, it becomes sort of a competitive sort of an edge.

For instance, one of the big projects that is going on in our area now is in Clermont County, which is the new Ford plant. That is there on a tax abatement. So, we find ourselves in our city having people come to us and say, "Why, if they can get it, why can't we?" And we end up doing it.

I think that is a difficult kind of an issue.

Representative OAKAR. Well, I had a lot more questions, but my time has expired.

Chairman REUSS. We will return Representative Hanley?

Representative HANLEY. Thank you, Mr. Chairman.

With regard to the subject of consolidation of political subdivisions, would it be reasonable to assume that if the obstacles could be eliminated, far greater efficiencies could be effected? Is it reasonable to assume that all of you would subscribe to that probability?

Mr. MENDONSA. Yes.

Representative HANLEY. Well, that is encouraging. That has been one of my pet peeves. I have seen in my own home community, where we have a city hall and its dynasty, and a few blocks away a county office and its dynasty, serving essentially the same set of taxpayers. Now, some years ago, there was a good reason for that division, because you had two distinctly separate set of citizens. You had the rural folks, and then you had the city dweller. But time has produced some changes, and now we have really an interdependent body of citizens who, unfortunately, have to underwrite the cost of maintaining two distinct governmental operations.

And beyond the administrative part of it, we think of—well, again, in my own community, there are 19 towns, each one of them with a police department, and you have the county sheriff, and you have the city police department; and beyond that, you even have the constables. Essentially, everybody is serving the same set of taxpayers. I do not wish to oversimplify the ability to effect this type of consolidation and recognition of all of the kings out there with their respective dynasties, who would probably fight hard to prevail. But I think with a proper program of education that the taxpayers would rather easily understand the merit associated with consolidation or metropolitanization, if you can call it that.

I recall back in our first go around with revenue sharing, I suggested to the then-chairman of the Ways and Means Committee, Wilbur Mills, that perhaps built into revenue sharing might be a requirement whereas States and communities who demonstrated that they were moving in the direction of walking away from that obsolete concept. I am delighted with your reaction or your response to my question. That is certainly heartening to me. I would hope that this subcommittee, through the hearing process and the field hearings that are intended, can develop a highly decent case for this type of consolidation.

Ms. Lamphere, you related to overregulation. I wonder if you might expand upon that, citing several instances where you feel that overregulation prevails.

Ms. LAMPHERE. I would be happy to.

But I would also like to add a footnote to your previous comment, and that is that some of the consolidation also has to take place at the Federal level, and there is, in fact, legislation that has been introduced to deal with this.

But I would simply state that in 1975—and that is now several years ago—grant programs were offered by 74 bureaus within 28 Federal agencies and departments of the Federal Government. There is still entirely too many categorical grants in the Federal system. In my city alone, at one time there were over 1,400 separate Federal grant programs in the city with no interrelationship between any of them. So, there is a great deal that should be done.

One example, however, that addresses itself to your question is: Every single bit of major legislation carries with it a number of requirements. Some of the common ones, across-the-board requirements, are in for components that deal with citizen participation, access to information, equal opportunity, planning, environmental quality, occupational standards. Those exist in almost every single bit of legislation that you deal with.

There is a separate mechanism required to comply for local governments to comply with each and every one of those requirements. It should be possible to certify local governments' plans of compliance for one program and say that certification carries to all.

Representative HANLEY. If the lady will yield. I find myself in agreement with what you say, and I do not believe that there is a member sitting up here who would disagree.

We recently instituted here in the Congress the sunset provision, as you know, which, once that program has lived for 5 years, we take a look at it, make sure that there is not a duplicative effort on the part of another agency or whatever.

That was a heartening and encouraging innovation in the Congress, and I would hope that we could deal more heavily in eliminating the type of problem or alleviating—hopefully, eliminating, but at minimum alleviating—the type of problem that you alluded to.

Ms. LAMPHERE. But I think we have to develop a higher level of trust as well, because if you are going to have a partnership, one of the essential elements is trust. Ask us what you will in the way of performance standards, comprehensive planning, and so on. But then trust us, once you have signed off on it, to carry through on the programs.

This, too, then, will mean that, once certified, a city remains certified as having an adequate EEO program and things of that nature, adequate environmental checkoff system, adequate vocational guidelines and objectives.

But this carries with it, then, greater delegation of responsibility closer to the scene of action, which is in the communities.

I could mention other things that I think should be done. We always have a problem with funding. If there were a way of providing, facilitating greater use of funding of a single plan or program with more than one source of Federal funds, if State and local governments could be assured at least a year in advance of the funding level that was going to flow from the Federal Government.

We cannot plan if our future is so uncertain, so there are a number of things of that nature that we would all be happy to provide.

Representative HANLEY. Thank you, Ms. Lamphere. I am advised that my time has expired.

Chairman REUSS. If it is agreeable with everyone, I would now like to call upon the second panel, that consists of two members, and hear them, and then resume questioning, asking the existing witnesses to remain because we have not finished with them.

Is there any objection to that?

[No response.]

Chairman REUSS. If not, Mr. Fosler, would you proceed?

STATEMENT OF R. SCOTT FOSLER, DIRECTOR OF GOVERNMENT STUDIES, COMMITTEE FOR ECONOMIC DEVELOPMENT

Mr. FOSLER. Thank you very much. Mr. Chairman and members of the subcommittee.

I am with the Committee for Economic Development, which is an organization of 200 corporate executives who over the years have taken an interest in the question of how to improve the productivity and efficiency, and the management of city, county, and State government.

I am going to be addressing the question of how businesses can provide assistance to local governments for the purpose of improving management. But before getting into that question, I would like to provide a little bit of context, given all of the talk that we have had in the last year or so about the growing interest in developing public-private cooperation and relationships to strengthen the ability of government to deal with problems at the local level.

There are a number of different ways in which public-private relationships can be improved in order to meet public needs. Let me just list a few: contracting public services to private business; shifting some responsibility from the public sector to the private sector; coordinating public and private capital spending and service operations; developing hybrid organizations that include the better characteristics of both government and the private sector; private research and development to improve government performance; economic development which is compatible with improved public service operation. And there are others.

All of these have pros and cons and each has special problems. But I think it is important to note that there are a variety of ways in which the public sector and the private sector can interact for the purpose of improving public services and dealing with problems at the local level.

Let me also note that the dichotomy between government and business, or between the public sector and the private sector, is somewhat less than precise. There is still a tendency to assume that business is efficient and government is inefficient; that business is a fairly homogenous set and that government is a fairly homogeneous set. The facts, however, are otherwise.

Government has grown in size and diversity to the point, where there exist all manner of government organizations. Some are well-managed by highly skilled, highly trained, highly capable people, who would compare in every respect with the best managers in the private sector. On the other hand, there are private sector organizations which are not particularly well run. There are, moreover, a wide variety of organizations called businesses, ranging from the local candy store to the multinational corporation. It is important to take some care in talking about the distinction between government and business, and what one can do for the other.

All of those things said, however, I think that it is possible to state with some confidence that there are things that business can assist government with at the local level for the purpose of improving management, in order that efficiency and productivity can be increased.

It is important to distinguish between the characteristics that are common to both business and government, from those that are not common to the two, so that we can be more discriminating in determining what business really can provide to government and what it can't provide to government. Certainly business organizations and government organizations are the same in the sense that they are organizations of people. In many cases they tend to be quite large organizations. They are complicated organizations. And by and large, they employ the same types of people with the same educational backgrounds, coming from the same kind of culture and having the same kinds of desires.

All of these things would suggest that there are ways in which you would run both a business and a government which are probably the same.

At the same time, there are important differences. The goals of government are politically determined, whereas in business by and large they are determined by the market. In government you don't have the same precision of measuring performance as you do in the private sector. And, as Camille Cates noted, in government it is more difficult to tie the revenue source to the actual service production, and that is one of the advantages of the so-called bottom line of the profit and loss statement that the private sector has. Government decisionmakers tend to have a shorter time horizon, geared toward elections, whereas business men are better able to gear problem-solving toward problems. And even though the nature of the work force is the same in business and government the structure of employment is different.

In government, employees are also to some extent the employers, in the sense that they elect the local officials, who then become their employers. This relationship clearly has an impact in the public sector.

What has been the experience with business assistance to Government to improve management over the years? It goes back a long way, perhaps back to the last century, when Woodrow Wilson attempted to make the distinction between policy and political determinations on the one hand, and the administration of public services on the other. It was suggested that there was no Democratic or Republican way to administer public services, but there was only a good businesslike way to do it. While that idea has often been simplistically presented, and while there are not clear distinctions between "policy" and "administration" it is, I think, possible to identify Government activities which are, or should be, nonpolitical. And it is here where business can be most helpful.

There are a number of examples, and successful examples, where business has helped Government improve management in recent years. Because Ed Belanger from Niagara Falls was not able to be here today, I was asked to talk about what happened in Niagara Falls with the experience that the business community had there in working with local government.

You have a copy of Mr. Belanger's testimony, which I think is quite good. He notes that in 1975, the city of Niagara Falls was facing a deficit in its budget of some $5.8 million. The city itself, the business community there, was clearly upset. The community had economic problems. The city was not well managed. They had financial problems. And the business community wanted to do something.

So they approached the city government and they asked what could be done. And with some outside assistance, which I will refer back to in just a second, they organized local business and formed what they call the city management advisory board. The board worked directly with the city government, providing technical assistance from business over a period of initially about 6 months. And during that period, they were able to turn the fiscal situation of the city completely around. By the end of 1976, they had turned their projected deficit of $1 million into a surplus of $748,000.

And I might mention that in the course of that assistance, they involved the entire community in the effort. People in the community bought short-term notes in order to stave off a bankruptcy which was imminent at the time, and they were literally able to turn the situation around.

I won't go into the details of all of the things that were accomplished in Niagara Falls because those are well laid out in Mr. Belanger's testimony, and I have mentioned some in mine as well. Briefly, they addressed such areas as departmental reorganization, financial procedures, budgeting and planning, procurement, energy management, and the like. And they found that not only did they have success in terms of the technical improvements, but they had a remarkable success in forging a greater sense of trust and cooperation between the private and the public sectors.

Let me also mention something else that is interesting with regard to this project, which has been noted as a success in recent articles in the Harvard Business Review, in Public Management magazine, and a few weeks ago, in the Washington Post. A number of years ago, the National Center for Productivity began developing ideas on how to improve productivity in local government. A little bit later, the Committee for Economic Development, the organization of businessmen that I work for, took an interest in the notion of how to improve State and local productivity, because they were concerned about the rapid growth of the State and local government sector that is depicted on the charts that you have here, and that we are all concerned about here today. CED depended heavily on the information that had been prepared by the National Center for Productivity. We solicited the advice of a lot of the people that you have here on this panel today. We had a business-Government cooperative effort of our own at the national level.

One of our CED trustees, William Wendell, at the time was the president of the Carborundum Corp. in Niagara Falls. He was familiar with CED's work on Government productivity, and asked me to come to Niagara Falls and to give the business and Government leaders there some idea of how the business community and the public sector might work together to deal with the financial crisis they confronted.

I think it's an interesting example, both because it shows what business can do at the local level to help Government and also because I think it demonstrates the positive results that came from the care and attention that has been given to this question over the past several years by the Federal Government through the National Center for Productivity, by professional managers such as the people that you have here today, by public employee unions, such as The American Federation of State, County, and Municipal Employees which was involved in that effort, and by business through such organizations as the Committee for Economic Development.

What kind of generalizations can we make about what business really can do to help improve Government management? I think Bill Donaldson hit the nail on the head when he said that getting the business people involved as businessmen in setting policy and dealing with difficult political questions is not a particularly good idea. In fact, there have been some problems where that has happened. Where business can be most helpful is in assisting to improve Government operations that are most similar to business operations.

In the case of New York City, the Economic Development Council of New York, an organization of business executives which has been quite effective in bringing business expertise to bear on Government problems, found that when they dealt with such things as how to improve the court case backlog, they were highly successful because they were taking business expertise and transferring it to Government where it made sense. Where they dealt with such political questions as establishing the criteria for top school officials, for example, they found that they tended to be at odds with some of the community people who did not think that professional qualifications alone were sufficient in determining who was going to run the school system.

The same was the case with the Greater Hartford Process, a massive business assistance program. There were problems when the business community got into the questions of determining policy and resolving political questions. There was greater success when they helped to carry out projects whose goals were set through the regular political process.

I would suggest there are four areas where business expertise can be useful. One is in developing and improving the administrative components of Government, such as finance, accounting, auditing, personnel management, and the like; and here again, with sensitivity to the distinctions I mentioned before between the public and private sector.

Second, in the development and use of analytic techniques such as systems analysis, cost effectiveness analysis, and some of the more sophisticated notions which in effect develop commonsense and rational problem-solving to a high art.

Third, in line operations experience, where the operations of Government are similar to line operations in business—such things as food services, motor pool operations, building and maintenance, refuse collection, transportation, paper processing, streetlighting, cleaning and laundering—and the list goes on. Where there is first hand experience in the private sector as to how those things are done, there is no reason why that substantive expertise cannot be applied in the public sector as well.

And fourth, management know-how. An intangible, perhaps. The tasks of management, by and large, tend to be fairly well defined: Setting goals, planning, identifying alternatives, allocating resources, motivating people, coordinating, control, evaluation, and the like. But the contexts in which they are carried out in business and Government are quite different. The styles, the personal styles of management that are used, are also quite different. But still, I think it is fair to say that sensitive managers, capable managers in the private sector, with appropriate adaptation to the differences in the public sector, can be effective in the political context of government.

You may have seen the article in the New York Times recently by Felix Rohatyn, an investment banker, who became the chairman of the Municipal Assistance Corp., the so-called Big MAC in New York City. He noted some of the awakenings that he had when he got involved in the political world of New York. He had been in a business which is always thought of as being very hard and tough minded, and he became involved in the politics of New York State and New York City as a part of his public position. In the Times article he characterizes politics as "probably the cruelest form of activity known to man short of war and cannibalism. The ruthlessness of political relationships, the callous disregard for a minimal level of human kindness have to be seen to be believed."

Now, that was his conclusion based on his experience. And perhaps it would be different elsewhere. But many businessmen, I think, are not aware of the problems that public officials deal with and elected officials deal with, in identifying the ways in which they can provide genuine assistance to local governments, and in determining ways in which they can transfer the experience that they have. Increasingly, they are learning that they're going to have to be sensitive to the real differences between business and government; that they're going to have to work on a genuinely cooperative basis rather than on a condescending basis, which has so often been the case in the past, to pursue what they clearly understand increasingly as their joint purpose. That is to keep down the cost of government by improving efficiency and productivity, and to increase the effectiveness of government to be able to deal with the range of problems in a local community which clearly affect the business climate and the future of business.

Thank you, Mr. Chairman.

[Mr. Fosler's prepared statement follows:]

Statement before the

Subcommittee on the City

of the

House Committee on Banking, Finance and Urban Affairs

by

R. Scott Fosler
Director of Government Studies
Committee for Economic Development

July 26, 1978

"Business Assistance to Local Government"

Mr. Chairman and distinguished members of the Subcommittee:

My name is R. Scott Fosler. I am Director of Government Studies of the Committee for Economic Development (CED), an organization of 200 business executives and educators. I appreciate the opportunity to appear here today to testify on the concerns of your Subcommittee for improving the effectiveness and efficiency of local government.

Over the past year there has been growing support for "public-private cooperation" to solve such social ills as unemployment, inflation, and central city economic deterioration. Recognition of the potential benefits of having government and business working together stems from a combination of factors. Government is widely perceived as having reached a limit in its ability to solve problems. Economic competition among regions has caused adversary groups in cities to recognize that they have a common interest in preserving the local economic base. Government increasingly has recognized its need for better management, which, it is believed, the private sector can supply. And there is a growing recognition that the fragmentation of institutions and individuals in American society needs to be checked and a reintegration begun: among business, government, and community organizations.

There are numerous ways in which the public and the private sector interact, each of which could be improved. These include contracting public services to private business; shifting greater responsibility to the private sector for providing services currently the responsibility of government; coordinating public-private capital spending and service operations; creating hybrid organizations that combine the best of both public and private institutions; encouraging private research and development beneficial to government; promoting economic development that is supportive of greater public productivity; fostering more intelligent consumption habits; and developing the creative potential of politics for synthesizing conflicting goals and coordinating means of achieving them. This paper expands on just one of these many facets of public-private cooperation: direct business assistance to government for the purpose of improving public management.

As government costs have increased in recent years public officials have been admonished to be more business-like in their operations. Some governments have sought business assistance to strengthen management, and the help provided has been highly useful.

In other instances, attempts by business to help improve government have failed.

Experience has demonstrated that while there is potential for applying the methods and know-how of business to government to increase effectiveness and efficiency, the transfer must be selective in its approach and sensitive in its implementation.

The Fuzzy Dichotomy: Public and Private Sectors

Definitions of and distinctions between "business" and "government," or "private sector" and "public sector," are increasingly vague. A business may be anything from a small candy store to a large multinational corporation, and may be involved in manufacturing, services, finance, retailing, transportation, or other diverse pursuits. The nature of a government agency can be equally variable. The Department of Defense is a quite different operation from the Social Security Administration. The sanitation department of New York City is an altogether different operation from the sanitation department of Inglewood, California.

Some private sector organizations that are called businesses may be so heavily regulated or bureaucratic that they tend to behave more like the stereotype of a government agency. Some government institutions, on the other hand, may have an entrepreneurial spirit, independent sources of revenue, and flexibility in administrative structure that tend to resemble what we traditionally think of as a business.

A publicly operated hospital has more in common with a privately operated profit-making hospital than with a publicly operated land fill. The characteristic of being a hospital in this instance is more critical than the characteristic of being a government operation. On the other hand, the public hospital will not necessarily benefit from the management techniques used by a neighborhood camera shop, even though it is a business.

Nor should it be assumed that all businesses are necessarily better managed than government agencies. There has been notable improvement in the quality of public management over the years. For all the criticism of government inefficiency, examples are abundant -- at the Federal, state, and local levels -- of public institutions that are unusually well run and staffed by highly trained and proficient managers. The city management profession clearly has raised the level of public management in city governments.

It should also be recognized that the scale of operations of state and local governments would rank them among the top corporations in the country in terms of total budget or number of employees. New York City is, of course, in a class by itself, in size if not in other ways. Fairfax County, Virginia, with an annual budget in excess of one-half billion dollars, would rank in the fourth quintile of the Fortune 500 largest industrial corporations. The Community Services Division of the Department of Social and Health Services of the State of Washington would rank about 175th with a budget in excess of $1 billion. Such government operations as these in recent years have attracted top quality personnel whose management ability would compare favorably and perhaps superiorly to that of the nation's top corporations.

Nonetheless, while progress has been made in improving public sector management, it is still safe to say that, in general, government can still learn from business. The question is what can they learn, and under what circumstances?

Characteristics Common to Business and Government

To suggest that business possesses expertise that may be applicable to government assumes that there are certain similarities between the two. The key similarities include the following:

First, both business and government are organizations, and hence are subjeet to principles that seem to be common to all organizations.

Second, both are organizations that presumably have the purpose of producing something of value to others outside of the organization. This distinguishes them, for example, from other organizations whose principal purpose is to produce something of value principally or exclusively to those within the organization, such as most political and social organizations whose essential purpose is to promote the interests of their members.

Third, many business and government organizations are large, both in terms of the numbers of people employed, the size of their budgets, and the amount of capital employed. Principles and techniques for managing large-scale operations are applicable to both in general.

Fourth, many business and government organizations are complex, partly due to their size alone, and partly because of the degree of specialization required for production, the nature of technology employed, the multiplicity and ambiguity of goals, and the corresponding complexity of the environment in which they must function.

Fifth, the nature of the work force employed by both is more or less the same in terms of cultural and social background, education and training, experience, skills, and values.

Distinctions Between Business and Government

While the characteristics held in common suggest that there would be substantial opportunity for the application of techniques of management from one to the other, there are also important distinctions between the two which limit that applicability or require a substantial degree of modification.

First, the principal goals of government are politically determined. They consequently tend to be multiple and often ambiguous or intangible goals -- even more so than in business. The political goals of government include not only the stated intent of public programs, but also contracts, prestige, power and other such values which are not necessarily related to the presumed "output" of public service organizations.

A second distinction deriving from the first is that in government the measure of output or results is much more cumbersome and less precise than it tends to be in business. Even in those instances where business goals are intangible and in some cases tend to be quite similar to government, business performance is ultimately measurable in terms of the profit and loss statement, whereas government typically does not have so precise a "bottom-line."

A third distinction is in the source of funding. Business revenue derives from sales of the good or service produced, whereas the revenue of most government agencies derives from a budget allocation of taxes collected from the public at large. Businesses and government agencies both have an interest in increasing their revenues, but whereas to do so business must increase the quantity or price of its output (presumably requiring it to be sensitive to consumer tastes and pocketbooks), government agencies can increase the size of their budgets through more skillful competition in the budget process which may require little or no attention to the quantity or quality of its services.

Fourth, government tends to plan and manage on a shorter time perspective than does business. Public policy making is geared as much to the cycle of two or four year elections as to the solving of problems, whereas business decisions have relatively greater flexibility to plan activities according to the time required to meet long-term goals.

A fifth important distinction lies in the structure of employment. Employees in government participate actively in the selection of their employers, i.e., elected officials, in contrast to business where management is selected by means that do not directly involve employees. An elected official, consequently, is in the position of being both the employer of his workers, at the same time that he is their employee in that they are also citizens, taxpayers, and voters. Civil service regulations also limit government management in assigning responsibilities, rewarding performance, and penalizing non-performance.

Finally, government also has fundamental responsibilities for the protection of life and property, the maintenance of order, and the assurance of justice. The government manager works within a complex set of constraints imposed by legislatures and higher levels of governments which presumably are designed to meet a range of public purposes, and which complicate his immediate tasks.

Experience in the Application of Business Methods to Government

The theory of public administration has drawn heavily upon business experience ever since the last century when government began to reach a size where it could no longer be managed solely by the *ad hoc* application of common sense. As a scholar writing about the problems of government administration in the 1880s, Woodrow Wilson suggested a set of basic principles which laid the groundwork for modern public administration. He emphasized the importance and the potential for separating politics from administration, suggesting that once political goals were determined they should be implemented through the use of business-like methods. He also stressed the importance of achieving economy and efficiency in government and the importance of centralizing administrative control.

Business leadership played a major role in the progressive era in attempting to bring professional management to government. Emphasis was placed on centralized administration by a single chief executive, the use of professional city managers, the selection of personnel on the basis of merit rather than political patronage, and the organization of similar activities into functional departments.

Businesses continued to provide direct expertise to government throughout most of this century, and the tendency has, if anything, increased in recent years. There have been numerous efficiency studies initiated by businesses or undertaken at the direct request of a governor or mayor. In North Carolina, for example, a Governor's Efficiency Study Commission estimated that it contributed more than 34,000 hours of executive time in identifying a potential savings of $67 million, and recommended a host of actions to boost efficiency, 85 percent of which they believed could be implemented directly by executive action.[1/] In New York City the Economic Development Council has provided business expertise to government in recent years. Efforts such as these are common throughout the country at the state, county and local levels. Two recent noteworthy examples occurred in Niagara Falls and Pittsburgh.

Niagara Falls, New York: SPUR. In Niagara Falls a business group called the Society for the Promotion, Unification, and Redevelopment of Niagara, Inc. (SPUR) worked with the city government to resolve the city's serious financial situation and improve management. The group formed a City Management Advisory Board to provide technical assistance to the city government. Among the accomplishments of the program were the following:

- Saving $160,000 by pooling and renegotiating the city's liability insurance policies with the county's.
- Reducing volume of the city's data processing system reports from 190 to less than 40 through user analysis and reprogramming computer routines where serious errors existed. The new routines yielded an additional $60,000 in overdue parking tickets.

1/ Governor's Efficiency Study Commission, State of North Carolina, 1974.

- Saving $80,000 yearly by replacing public works equipment purchasing with a leasing program.
- Proposing the reduction of equipment maintenance through a preventive program, yielding a yearly savings of $30,000 in labor and materials costs.
- Improving inventory management techniques at a savings of $20,000 annually.
- Evaluating parks and public roadways crew sizes, which resulted in increased productivity by reducing manpower without reducing workload. The resulting annual savings is $36,000.
- Establishing new procedures for street repairs, leading to material and labor savings of $80,000 yearly.
- Revising runs for snow plowing-cleaning operations to better utilize labor and equipment at annual savings of $45,000.
- Reducing, revising and eliminating unnecessary street lighting after evaluating grids use. Yearly savings amount to $60,000-$100,000.
- Creating a conservation program for city buildings with all thermostats set at 65 degrees at a savings of $15,000 annually.
- Analyzing sewer treatment plant costs. The result was a reduction in utility usage and anticipated annual savings of $30,000.[2/]

Allegheny County, Pennsylvania: COMPAC. In Pittsburgh, a business group called the Committee for Progress in Allegheny County (COMPAC) formed to "assist the county government assess its current operating practices in light of modern business technology." The Allegheny County Board of Commissioners requested the assistance of business executives in the area, and a program was jointly agreed upon. Task Forces were assigned to examine and help improve selected areas of the county government's operations:

2/ Lee J. Stillwell, "Niagara Falls Experiment - Public-Private Sector Marriage Saves City from Brink of Bankruptcy--But It Ain't No Honeymoon!" Public Management, August 1977.

- Purchasing and Contract Administration. A new purchasing system was developed with estimated 50 percent reduction in the time required for processing purchases and savings of more than $250,000.

- Personnel Administration. A unified and computer-oriented "Personnel Action Authorization" form was designed to consolidate and simplify personnel procedures. EEO/AA procedures were improved; the recruitment base was broadened; position classification was improved; and numerous other changes were made to strengthen the system of personnel administration and labor relations.

- Computer Services. Task Force recommendations were expected to provide an integrated computer operation that would more fully utilize existing equipment and personnel, identify actual data processing costs and controls, and provide for long-range planning of computer operations for the entire county government.

- Cash Management. Recommended changes were estimated to provide an annual cash acceleration of $2,667,000 for investment purposes (which at 5 percent could earn $133,000 annually).

- Program Budgeting and Management Information. The Taxes Receivable system was to be computerized enabling the Tax Claims Bureau to collect delinquent taxes more effectively. Related changes were recommended to provide more complete information on full program costs that could be used in the budget process, in applying for Federal and state grants, and in performance evaluation.[3]

In general, business efficiency studies have been most successful where business advisors have confined themselves to government operations that are most akin to business operations with which they are familiar. These are generally characterized by having specific, clearly identifiable, and usually quantifiable objectives. For example, the Dallas school system was most successful in using business expertise to improve such elements of the educational system as transportation, food services, and building maintenance. New York City's Economic

3/ "Task Force Report Overview," COMPAC/County of Allegheny, Pittsburgh, Pennsylvania, 1977.

Development Council had its greatest success in the court system where EDC advisors helped to cut a mammoth case backlog from 59,000 to 14,000 in two years (the first reduction in case load in 18 years), reduced the number of defendants in detention from 4,200 to 1,300, and produced an annual savings of $6.7 million in addition to a one-time savings of $48.5 million. The court problems for the most part involved work flow and scheduling, areas where advisors from Metropolitan Life, Equitable, and New York Life could readily apply their expertise.[4/]

There has been less success in those activities characterized by a higher degree of political ambiguity or sensitivity. The Economic Development Council's experience in the New York school system is illustrative. While substantial advances were made in improving the auditing, payroll, and personnel systems, problems arose when EDC advisors suggested "objective criteria" for hiring school executives. The school board was concerned not only with management experience and capability of the candidates, but also with the ethnic background and acceptability to parents, teachers, and voters.

The Greater Hartford Process, a consortium of business groups which has provided substantial financial contribution to the metropolitan area of Hartford in the past few years, encountered similar problems in dealing with politically charged issues. One of the participants in that effort concluded that business can best be of assistance in pursuing clearly established goals that are determined by government through the political process, rather than attempting either to

---

4/ David Rogers, "Business and the Urban Crisis: The Case of the Economic Development Council of New York City" in Willis D. Hawley and David Rogers, Improving the Quality of Urban Management, Sage Publications, Beverly Hills, California, 1974, p. 457.

establish those goals themselves or to assume responsibility for programs which are politically sensitive.

Even where business efficiency studies have tended to focus more on the basic administrative problems of government, a number of complaints often have arisen. Criticisms include the following: that businessmen tend to focus on efficiency to the detriment of effectiveness or quality of public services; business people tend to be patronizing or scornful of government officials; businesses may assign less than top quality people to advise city government; business advisors fail to understand or to acquaint themselves with the special political and administrative problems that characterize government operations.

What Can Business Contribute?

Based on all of these factors -- the characteristics that business and government share in common, the distinctions which would limit the possibility for applying business methods to government operations, and the knowledge gained from practical experience -- there appear to be four principal ways in which the expertise or experience of business could be useful in attempting to improve government management.

1) Administrative Components. All large organizations share certain characteristics which require basic support systems for smooth operation. In general, these relate to the more routine functions of administration, including finance, accounting, auditing, personnel, information and data processing, purchasing, inventory control, planning, budgeting, and similar organizational requirements. While each of these components requires tailoring to account for important

organizational differences, many of the more substantive examples of administrative improvement in government through application of business methods have occurred in these areas.

2) Analytic Technique. The Federal government in recent years has devoted more attention to the use of analysis -- such as systems analysis, cost-effective analysis, program budgeting, and management by objective. And while some state and local governments have made impressive progress, many others still do not recognize the need for, or actually use, analytic technique in an effort to reduce costs or improve the quality of service.

While the substance of operations of many businesses and government agencies may be different in many respects, analytic method, or an emphasis on the application of rational problem solving, often using quantitative methods, as an integral part of management and organization, is generally applicable to most productive organizations.

Many of the more successful examples of direct application of business expertise to government have involved the use of analysis to improve operations with relatively clear objectives. For example, in the early 1970s, the New York City Department of Human Resources hired 500 managers, industrial engineers, and specialists from the private sector to improve the effectiveness and efficiency of welfare administration. According to one report,

> The team effort...reduced the agency's error rate by 50%, increased staff productivity some 16%, trimmed the case load by 109,000 people, and generated a $200 million savings in welfare payments.[5]

5/ Arthur H. Spiegel, III, "How Outsiders Overhauled a Public Agency," Harvard Business Review, January-February 1975, p. 117.

The reported success caused the leader of the effort to conclude that:

> ...the scale of the team's achievements suggests that the application of standard business practices and results-oriented people can produce high-magnitude gains in government.6/

There is a substantial body of specific analytic technique in business that is applicable to government operations. This includes industrial engineering, value engineering, linear programming, operations research (although it should be noted that operations research was first developed in the Federal defense establishment and has since become more broadly developed within the private sector), financial planning and analysis, and other standard and developing techniques of analysis.

Of special importance is the need to develop in government a grasp and use of the concept of marginal cost and marginal return which is either consciously recognized and used in business or else is an implicit part of private management understanding and decision making. When government was relatively small and its objectives fairly straightforward, it was a generally accepted practice to simply establish objectives and to allocate whatever resources were required for their accomplishment. However, the size, cost, and complexity of many government operations today require more systematic assessment of the trade-offs between the incremental costs and benefits of meeting progressively more complicated, difficult, and marginally important goals. In many government programs the relaxation of

6/ Ibid., p. 117.

standards or objectives by a slight margin could produce substantial cost savings. While it is not generally recognized, the zero-based budgeting technique which was developed in the private sector and now is being widely touted in government, essentially aims to get managers to identify levels of service ranging from the absolutely essential to the more luxuriant, and assess the relative or marginal costs of those various levels of services.

Business experience could also be helpful in determining how analytic technique can be effectively managed, and incorporated as an integral part of government operations. It is one thing to have the analytic capability available, and to know that it is applicable to specific operations, but it is quite another to master the art of building in the use of analysis to improve planning, decision-making, and the ongoing operations of government. Some state and city governments have established analysis units, but have not successfully used them to improve operations. They may be simply ignored by line agency managers who either do not understand them or fear them, or the analysts themselves may not have learned the art of selecting doable projects that will show results, and working with line managers to implement them. Without top management support, such capability is likely to go unused.

3) Line-Operation Experience. Many line operations of government are similar to business operations. Examples include food services for public institutions; motor pool operations; building maintenance; refuse collection; small transportation systems; and paper processing. Such government operations stand to benefit from

the substantive know-how of businesses that provide similar services. The expertise, technology, or general know-how that tend to make business provision of the services more efficient or of higher quality should be equally useful to the management of similar government operations.

These are also the services that are most successfully contracted directly to private businesses, i.e., those that have precise and quantifiable objectives, tend to be relatively routine, and are generally free of political conflict.

Governments traditionally have purchased such goods as vehicles, office equipment, and other materials, and contracted for such services as street lighting, solid waste collection, consulting, communications, equipment repair, cleaning and laundering, and the health care of individuals. Private firms collect commercial, institutional, and industrial refuse in roughly three times as many cities as do municipal agencies, and they collect residential refuse in twice as many cities as public operations (although, since the larger cities tend to operate their own service, 60 percent of the population is serviced by public refuse collectors).[7/]

Less frequently contracted services include water supply, street maintenance, snow removal, building and safety code enforcement, animal pounds, building maintenance, food service operation, transportation, health services, data processing, welfare administration, air

7/ E. S. Savas, Evaluating the Organization of Service Delivery: Solid Waste Collection and Disposal, preliminary report, Center for Government Studies, Graduate School of Business, Columbia University, New York, 1975, pp. iv-v. Private arrangements include direct contact with a government, franchise granted by a government to a private firm to service a designated area, and private competition with no government relationship.

pollution control, flood control, jails and detentions, work release programs, civil defense, motor pool operations and education. 8/

Deciding whether to provide service with in-house staff or to contract with a private business is similar to the "make or buy" decision faced by a business firm. Simply put, the question is whether it is cheaper or more effective for an organization to make a given product component itself, or to purchase it from an outside firm (or to do both as a means of fostering competition for the in-house operation).

In theory, there is no reason government agencies cannot use the same management techniques and technology as the private sector in the provision of similar services. And several studies have indicated that in certain instances public operations are indeed more efficient than private operations of a similar nature. Private businesses, however, often do have a practical advantage in being free of restrictive administrative or civil service standards and attracting more capable or more highly motivated management and supervisory personnel through higher salaries or other forms of compensation.

Contracting, however, also has its drawbacks. Governments often have difficulty in drawing up contract specifications that assure the job is done effectively and responsively, or otherwise assuring compliance. And corruption -- principally bribes and kickbacks -- is a perennial problem with government contracting.

Experience and study have demonstrated that contracting can be beneficial for some government operations, but the potential is

---

8/ Purchase of Service Contracting by Local Governments: An Initial Examination, The Urban Institute, Washington, D.C., 1974, pp. 131-132.

not boundless nor can the risks be ignored.[9/] Success is highly dependent upon specific conditions relating to the nature of the service, the government's skill in contract management (which for most jurisdictions is limited), the availability of competent businesses to do the work, and the size of the jurisdiction to be served. One study, for example, found that contracting refuse collection for residential waste was less expensive for cities above 50,000 population, but not significantly different for cities with a population of 10,000 to 50,000.[10/]

The principal advantage in contracting may be to foster competition among organizations providing services whether they happen to be in the public or private sector. Monopolies, whether government or business, tend to become less efficient, charge higher prices, or provide lower quality or less responsive service; competition -- even for public services -- is an alternative to regulation as a means of curbing these tendencies.[11/]

4) Management Know-How. A fourth type of business experience applicable to government is personal management talent. The formal tasks of management for any large organization tend to be similar in type if not in substance. They include the establishment of goals; the analysis and selection of alternative means of achieving them; the assembly and allocation of resources; implementation to achieve

9/ See Lyle C. Fitch, "Increasing the Role of the Private Sector in Providing Public Services," in Hawley and Rogers, op. cit., pp. 501-560.

10/ Public collection in a city of 60,000 typically was 22 to 35 percent higher than contract collection depending on the level of service. (Savas, op. cit.)

11/ Allen E. Pritchard, "Private Delivery of Public Services," Urban Options I, National Urban Policy Roundtable, Academy for Contemporary Problems, Columbus, Ohio, 1976, p. 63.

objectives, including the coordination, monitoring, and control of resources; the evaluation of accomplishment; and the linking of the knowledge gained in evaluation back into the planning and goal-setting process. The less tangible qualities of management have been endlessly debated -- "vision, courage, sensitivity"; ability to synthesize and act on limited information; skill in working with people; etc. The intangible qualities of successful management probably vary as much among private sector organizations as they do between business and government. The entrepreneurial talent required to initiate or aggressively expand a new or uncertain business enterprise may be more applicable to the creation of a new public program -- such as the control of the environment or reducing poverty -- than to the management of a well-established business corporation which may be more interested in protecting its position than venturing into new fields.

While the tasks of management may be the same for both large businesses and large government agencies, the content of activities and environment will likely have important differences, as discussed above. While successful managers in both the public and private sectors concern themselves with "purpose, organization, and people," those factors are generally quite different in government and business.[12/] Nonetheless, experience has shown that capable managers in business who are also adaptable and sensitive to the differences in government can bring the same talent for management to the public sector.

12/ Joseph L. Bower, "Effective Public Management," Harvard Business Review, March-April 1977, p. 140.

The Problem of Transfer

Over the years a wealth of management and operational experience has been transferred from the private sector to the public sector through a variety of means. Governments hire consultants who have business experience; government managers receive training based upon business principles; public administration schools have developed curricula which rely heavily on business experience; the vast and ever-growing literature of public administration draws heavily on the experience of managing organizations in general, and business operations in particular; and in recent years many governments at all levels have hired an increasing number of MBA's who have been trained specifically in the techniques of business management.

The direct transfer of business expertise to government, however, generally involves a personal relationship between business advisors and government employees. The likelihood of success in these cases depends not just on the applicability of business practices, but also on the circumstances and the skill with which the transfer is undertaken. While the factors affecting success or failure in technical assistance efforts may seem obvious, they are all-too-often ignored.

The first is the nature of the government operation and type of technique to be applied. The simpler and more precise the technique, and the greater its compatibility with the government operation, the more likely a transfer is to take place. Establishing a new payroll system will likely be more easily accomplished than developing a more complex management system which requires a high degree of modification and threatens political and bureaucratic interests.

A second factor is the political environment. It is a truism -- but often forgotten -- that most change in a government agency, or in any organization for that matter, requires the support or, at the very least, the acquiescence of top management. Identifying the sources of power influencing a government agency can often be a problem, since they may be found outside the agency itself, at higher levels of government, or among private interest groups. For example, New York's Economic Development Council found that its recommendations to improve management of the city schools received what they felt to be inadequate attention; to push for change they had "to go 'outside' and mobilize pressure on the board to get its reform recommendations implemented."[13/]

Business advisors to government often find the most difficult challenge adjusting to or allowing for the role of politics. Felix G. Rohatyn, a general partner with the investment banking firm of Lazard Freres and Company, became chairman of the New York Municipal Assistance Corporation during the height of New York City's fiscal crisis. He has characterized politics as "probably the cruelest form of activity known to man, short of war and cannibalism. The ruthlessness of political relationships, the callous disregard for a minimum level of human kindness, have to be seen to be believed."[14/]

A third factor is the skill and sensitivity of the business advisors. Where the task is simple, technical expertise may be all that is required. In more complex situations, however, a host of other qualities is also necessary. Credibility -- which usually requires,

13/ Rogers, op. cit.

14/ The New York Times, July 12, 1978.

but cannot be assured by technical capability -- can be as important as real technical expertise in persuading people to try something new. Sensitivity to the needs and hidden agendas of both the agency and individual employees is important for building support and in establishing trust. The ability to speak the language of the people with whom one is dealing, both figuratively and literally, is important both in building trust and in communicating to get the job done.

Fourth, ambitious transfer efforts require a well-planned strategy of intervention. Goals or expectations must be clear and realistic. Timing must be correct; the date of entry and maximum activity must be compatible with important events, such as elections, promotions, or budget cycles. And the commitment of resources (usually meaning a sufficient number of capable advisors) must be assured.

Accounting for Changes in Business

A final caveat: those who would transfer business methods to government might well ask how applicable the business methods are to business. As noted at the outset, the distinctions between government and business are not as clear as they once were. And there are several trends that are tending to affect the functioning of all organizations, whether business, government, or otherwise, which require adjustments in management.

All organizations, whether public or private, are subject to such changes as employee attitudes and educational levels, and political and economic uncertainty in the country as a whole. Businesses themselves are continually working to adjust to such changes, and business advisors to government should be cautious about transferring techniques that may be outmoded for business itself. In fact, it may be that experience gained in the public sector in learning how to make large complex organizations perform effectively in an environment characterized by tightening resource constraints, uncertainty, and conflicting political interests, may in the future be of some value to managing business.

Conclusion

There clearly is potential for business to assist government in strengthening management in order to improve effectiveness and efficiency. That potential, however, is limited to those aspects of government operation that clearly lend themselves to the application of business expertise. Not only does the target of business assistance need to be carefully chosen, but the skill and sensitivity with which the transfer of experience is undertaken will also affect its likelihood of success.

Chairman REUSS. Thank you, Mr. Fosler.

Now, finally, Mr. Jack Nichols of the Evansville, Ind., Area Labor-Management Committee.

STATEMENT OF JACK G. NICHOLS, COORDINATOR OF THE EVANSVILLE AREA LABOR-MANAGEMENT COMMITTEE, EVANSVILLE, IND.

Mr. NICHOLS. Thank you, Mr. Chairman.

I understand I am the last to give testimony this morning. In my kind of business, operating in the sensitive area between labor and management, it is not often that I have the chance to get the last word on anything.

The labor-management committee concept is not an especially new one. It dates back prior to the productivity committee of the Second World War, but it gained a great deal of stature there because it was critical to our Nation that we have increased productivity and efficiency in our war effort industries. Labor cooperated fully, for the most part, in doing what was necessary at the time to crank out the goods and services that were required for our survival.

Productivity committees are not something that we can carry over to present-day efforts especially well, however, because they do not reflect a balance of the needs and concerns of labor as that group sees them. Human relations committees, in effect, are a parallel kind of effort. They are another slice of the overall concerns that labor and management might have and be able to work on jointly. Neither has the impact and application that the labor-management committee concept can have and that we have in Evansville.

At present, there are essentially three types of labor-management committees operating. The first is at the national or regional advisory level, such as the President's Labor-Management Group.

The second type is industry wide, organized according to the goods and services produced. The Department of Labor sponsors and is involved in four that I know of—in Boston, Kansas City, Chicago, and San Francisco. The one in Chicago concentrates, for example, in the building and construction trades and deals with those kinds of businesses and labor groups only. Wayne Horvitz, Director of the Federal Mediation and Conciliation Service, headed one of these up in the food industry before occupying his present post.

A third type, the one I represent, is an areawide committee. Essentially, it takes an entire geographic area and promises to work with any and all kinds of industries, especially those that have the most immediate impact on the overall health of the local economy, but eventually promises to hold out some kind of help or assistance to all groups within that area.

There are some trends we need to be aware of. I suspect that a plant-by-plant emphasis for labor-management committees, dealing with plant-level management and the particular labor group involved in that site or complex, is where the greatest successes will be achieved in the foreseeable future.

I also suspect that we will not find any formula approach to making a labor-management committee work. There have been many suggestions on how we might go about setting up large numbers of committees, perhaps having some kind of set structure, end behaviors, and so forth. This approach will not work in many places without so many variations in the formula that it is not a formula at all. Our Evansville committee, for example, is very distinctive in that it is structured systematically for the kind of industry and problems found in our area.

There is a general balance of power between labor and management in our country. Congress and the citizens of the United States seem to be geared for maintaining this balance. It is precisely in the areas of overlapping interest between labor and management where the labor-management committee concept has the most to offer.

There are some ingredients of success which can be drawn from the experience of existing committees. First, there needs to be some kind of local initiative and control. Evansville started with a handful of people sitting around a table, meeting regularly for over a year, discussing what kinds of things they did have in common, what kinds of issues they might work on together, and what kinds of pitfalls and problems they ought to avoid. Second, the source of funding is ideally from outside the community. With the cooperation of local politicians, Evansville and the other groups have found this kind of help, and it has meant independence from the ebb and flow of local politics. Third, there should be an emphasis on slow but steady progress. Area groups generally start with the creation of in-plant committees dealing with working conditions and matters that are relatively neutral, not spelled out in contractual language, and to the mutual benefit of both labor and management to resolve. Issues relating to restrooms and lunchrooms can be a vehicle for getting at more complex issues of overlapping interest between the two groups.

There needs to be strong input from labor for the labor-management committee concept to work. Typically, those on the assembly line or in production feel that the comments and suggestions are not listened to and not made a part of management planning. In-plant committees, where they have been most successful in our community, are exactly those where there has been this kind of attention paid to labor.

We have worked in Evansville for some kind of official status for committees in contractual form, and have often been able to achieve that. In four of the eight groups presently functioning after 1 year's operation, that status has been achieved.

There are some measures of success for labor-management committees that I think can and need to be applied to such efforts.

First, rather than using overall economic indicators as the measure of success, as some of the early labor-management committees did, we need to find others that are more precise indicators of whether something has actually been accomplished or not. Evansville has tied its successes to a reduction of grievances, to reduced tardiness and absenteeism, to lower rates of turnover, to the committees, and to the balance achieved by our local media in dealing with the complex issues between labor and management either at a given plant or in the overall community.

Second, research on new measures must be continued. Evansville is working with the Institute of Labor and Industrial Relations at the University of Illinois to develop measures of attitude change, of public awareness, and of other kinds of impact which can be achieved.

There are some unique problems which will govern ultimately whether the committee concept can be moved to the public sector from its successes in the private sector. There are legal barriers to be faced. There is the bitterness of municipal employees over their growing feelings of powerlessness, even as their numbers increase. And there is the increasing trend of government to deal directly with private business by contracting services out. There is the further difficulty of committees becoming very much involved in local politics if they assist municipal employee unions.

There are problems ahead. Labor, in our community, is quite bitter over the congressional losses of common situs picketing and NLRB reforms, but there is a very strong feeling by both labor and management that we have come too far to let the committee concept down. We will continue very much as we have begun in Evansville, and in that sense, even without Pete Rose, we have a new ballgame.

Chairman REUSS. Thank you very much, Mr. Nichols.

I would ask just one question of the panel, and a question, I think, which was raised, if I am not mistaken, by the testimony of Mr. Donaldson, who, I believe, said that if a city should, for reasons of the laws of dynamics, shrink its size over a period of years from 800,000 to 600,000 people, then you would assume that you could do with three-fourths of the employees that you once had.

Without disagreeing with your principle, there need, however, to be a couple of important glosses on that principle; do there not? One, for a while, at least, it may actually cost more for the city of New York to send police and fire patrols to the burned out, depopulated South Bronx than was the case when it was full of people.

And second, the mere reduction of numbers in a city may not reflect who are the reduced numbers; and, therefore, there may not be the precise arithmetic ratio between that which you had and that which you have got, as described.

And there may be others. Would you accept those two?

Mr. DONALDSON. Yes, Mr. Chairman. I think some of the most interesting insights into this whole problem are really some that you developed in some hearings that you had previously, where you talked about the problems of limits of growth and reduction. I thought some of that testimony and some of the ideas that came out of that were helpful.

But I think that the point I am really trying to make is that while there may be some immediate problems, as you suggest, on the other hand, we maybe need to think a little bit about what is that going to mean 5 years from now.

Does that mean we are going to have big open spaces in our city? Does the fact that we are getting smaller really mean that we have an opportunity to provide larger plant sites?

I do not think that getting smaller is all that bad. But the point I am trying to make is that we can use that by doing some long-range thought around that issue to be able to solve some of the problems we have had over these years and that the opportunity, for instance, in the South Bronx now to have large open spaces, that may very well have future for industrial parks or have future for recreational uses and things like that, are the opportunities we need to seize on, and we need to see what we can do with that.

I think the point I was really trying to make was that we tend to deal with problems like the "taxpayers revolt" as a problem that is a 6-month problem or a year problem and it will go away. The problem of getting smaller and getting a larger dependent population is one that we are going to have with us for a long time, and what we need to do is to look at the implications of that in reducing municipal costs and increasing municipal opportunities.

Chairman REUSS. I am entirely with you. For example, Vienna, when it was descending from its level of the imperial city to that of a provincial capital, found that the old battlements of the city made a magnificent ringstrasse which added greatly to its elegance and beauty.

And in Munich today the city is surrounded by layers of the onion. Heavy forests right in the city limits harbor sufficient deer so that venison happily shot under license by native sportsmen is cheaper than beef, veal or pork in the Munich butcher shops.

So while I am not suggesting this is an immediate solution in the South Bronx, you could do worse.

Mr. WASSERMAN. Mr. Chairman, may I add a word to that? I think one other ingredient missing from Mr. Donaldson's statement is understanding which level of government in a State provides what services. It is quite conceivable, depending upon the city, the government level providing the service, and the nature of the population loss, that such a decrease in population warrants no decrease in service or employment.

During the last few years our experience has verified this point. The recession of the mid-1970's played an important part here. So at least in the larger, older cities of the East and Midwest, that the need for services in these cities increased with a drop in population.

Chairman REUSS. Right. But if there were sensible Federal policies regarding full employment without inflation, which there are not now, would you be willing to see somewhat of a shrink in the membership rolls of AFSCME?

Mr. WASSERMAN. We would hope to make up the loss in any membership in the central city by expanding our organizational base into the suburbs.

Chairman REUSS. Splendid. Thank you. Representative Pattison?

Representative PATTISON. I was going to follow up that question. Let me begin by saying that I think Mr. Wasserman's union is one of the most progressive unions in the country, and not just in the public service area.

But there is a natural tendency among any labor organization or, for that matter, any human organization, that when things begin to shrink you resist it. Featherbedding is the pejorative term, anyway, of when somebody develops a new kind of printing, and you keep the people setting lead type, et cetera.

Similarly, in New York recently, there was that marvelous coup that AFSCME made with the New York State union. When you are talking about the deinstitutionalization of particularly retarded, putting them out in the community where, I think, most of us believe they belong, there is a resistance on the part of CSEA; using terms like dumping, which may have some validity, but nevertheless, there sort of stinks a bit of job protection there too. What is the attitude of AFSCME about that? And is it different than the public perception?

Mr. WASSERMAN. Well, as a matter of fact, Congressman, originally the policy of our union favored deinstitutionalization as it was originally presented to us in most States. That is, there would not be a complete dumping; rather there would be an exodus from the so-called warehouses which, Lord knows, are far from ideal places of residence for anyone.

But the other side of the proposal was to be the opening up of community health centers, for example. In other words, people who could not be completely deinstitutionalized, nor who could be completely left on their own, would have accommodations made for them.

Our experience, however, in a majority of States, was that while the institutions were closed and cut back, there was no corollary opening up of community health facilities. And so you did have many people who were deinstitutionalized and left to fend for themselves who were neither prepared nor equipped to do so.

Representative PATTISON. Aside from the merits or demerits of any particular deinstitutionalization program, the thing I'm really most interested in is the attitude of public service unions, public employee unions, toward that phenomenon. In other words, not the merits of it, but that you are going to lose some jobs from your rolls because when you deinstitutionalize—for instance, even if it is done well—you tend to have smaller units scattered around which are much more difficult to organize.

Mr. WASSERMAN. We are willing to pay those consequences. Our arguments against deinstitutionalization are based on human needs not membership concerns. I would further say that there's one analogy that has to be made between the concept of redundancy in the public sector and the private sector, when in the private sector, where there are layoffs, or where there are plant closings because a plant is outmoded or shifts to another area, or where a manufacturer changes lines of products, or whatever, typically there are institutional arrangements that have been built up so that the brunt of the dislocation does not fall on the worker himself.

In nationwide industries, for example, there are arrangements to move employees. There are built in encouragements to aid mobility of employees. There are supplemental unemployment benefits. There are severance arrangements. Typically none of these arrangements are found in the public sector.

Representative PATTISON. So what you are saying is, you make it that much more difficult for a union to even be responsible if they want to because of the pressures of their members, for instance? If you don't have those arrangements to transfer people and get them other jobs and adjustments, then you're going to have some problems of your own. I think that is a good point.

My time has expired.

Chairman REUSS. Representative Oakar?

Representative OAKAR. Thank you, Mr. Chairman. Just for Mr. Fosler, very quickly. You mentioned that one of the things you thought cities ought to do or might do is to contract city services to private business, et cetera. And I would assume you would probably not like to see that happen, Mr. Wasserman. But are you assuming that the services, then, would be cheaper and better and more efficient? Your testimony seemed to suggest that if cities would just have businessmen running the cities, or at least assisting them——

Mr. FOSLER. No; I tried to be careful in suggesting not only what kind of assistance business people might provide to cities, but also, in the case of contracting out, what kind of service may be successfully contracted out, under what circumstances, and what some of the implications are.

There is nothing that says that if you contract a public service to a private organization, that they are going to do it more efficiently. And there is documentation to the effect that in some cases it is not only less efficient, but you invariably run up against problems of corruption, kickbacks, bribes, and the like.

You have got problems of performance compliance. How do you draw up specifications in contract which are going to guarantee that a private contract is really going to do the job, that he is going to be as sensitive to some of the nuances of public service that the public employees themselves might be able to with public management?

There are all kinds of problems, and one of the dangers in talking about contracting out public services is that I think in the public mind there is the sense that business is efficient, government is not; therefore, if you shift responsibility from government to business, you get greater efficiency.

I think that we begin to get some more studies to provide some data on what kinds of services, under what conditions, for what levels of population, can be contracted out successfully. And I know some of the information that AFSCME has developed, demonstrating that in many cases contracting out has been detrimental—it has cost more, it has caused problems, and there is no doubt that that is the case.

I think you have got to be selective.

Representative OAKAR. Can you give me an example of where you think a service might be contracted out, or in your research where that type of service was more successfully run by the private sector than by public employees?

Mr. FOSLER. In my prepared statement I noted some examples including—there was a study that was done recently by Columbia University which attempted to determine what level of refuse collection, in what population city, under what circumstances, can be contracted out or franchised or the like. And I do cite that. And there are some potential problems with that because you have questions of accounting, of how much does it really cost to provide the service in the public sector, and how much will it really cost to contract out.

But, in general, the study found that contracting refuse collection for residential waste was less expensive for cities above 50,000 in population, but that it really didn't make that much difference for cities with a population of 10,000 to 50,000. There wasn't that much of a cost advantage.

Now, in addition to the fact that you may have a cost advantage for cities about 50,000, you have also got to consider what are the possible disadvantages in terms of the opportunities for corruption or the effectiveness or quality of the service, and the like.

It is not an open and shut kind of thing by any stretch of the imagination. It is one more alternative. I would say that based on the experience that I have seen, that contracting out to business has the advantage, not so much of having a more efficient business operation doing it, but of encouraging competition, of having more than one organization providing the service. And that by having that kind of competition, there is a tendency for organizations to pay more attention to quality and to pay more attention to cost, and that goes for public organization as well as private.

Mr. WASSERMAN. May I add a word to that? It seems to me that rather than the automatic assumption, too frequently made, that contracting is going to be beneficial, that is, it is either going to increase the service or reduce the cost of the present service, one alternative is a study of the economy of scale for that particular operation.

While there has been much discussion here about Government consolidation which may be somewhat far off in most cases, we do have experience where governments have at least gotten together to establish a special district or special authority, because of economy of scale these special districts may be established to collect or dispose of trash, to provide water services, or a host of other activities. This is an often overlooked alternative to the automatic assumption that contracting out is going to be beneficial to the taxpayer.

Again, I would reemphasize what Mr. Fosler said. Certainly, our own studies have indicated that contracting out frequently creates far more problems. Our own review of the Columbia University Graduate School of Business study indicated the same thing. We disagree with both the hypothesis upon which this study was made and the so-called conclusions of the study. We think both are faulty.

This study, I might add, was done by the same individual who some years ago was advocating the voucher system for public education, and who continues to advocate the privatization of public services.

Representative OAKAR. Just one more quick question, and that is Mr. Fosler, you mentioned that essentially businesses and cities employ the same kinds of people and so forth.

This is just a question for anybody who wants to answer it. To what extent is the patronage system involved? Is it on the decrease in cities or are the drones still there that you really can't get rid of?

How have we been able to cope with that problem in cities?

Maybe the council member would like to answer that.

Ms. Lamphere. I would like to respond more positively to that question than I think is honest.

It is still a problem and I think a good deal of the problem is a management problem, in that we have really not developed the kinds of incentives and payoffs for public employees that we really should.

We are doing better and there, we have found, for instance, in the water department in the city of Seattle, that the most effective management study we put together was one that had heavy involvement of the employees on the task force that described jobs, the flow of work, accountability, the reorganization.

The same thing is true in transit. I think Don Wasserman can probably give you other examples. But I think it is discouraging but I don't think it is impossible. And I think that a facile answer for too long has been that the system itself precludes change of attitude and better performance, and I think until management really rolls up its sleeves and tries some of the techniques that we now know are available, they can't get away with that excuse any longer.

I think, however, having said that, that there is a need for reform within the system from the Federal level on down.

Representative OAKAR. Some sort of civil service reform?

Ms. LAMPHERE. Yes; to introduce a greater element of merit and reward for performance.

Mr. MENDONSA. You said patronage. Is that what you asked?

Representative OAKAR. Yes.

Mr. MENDONSA. Because in many of our communities, patronage has long since disappeared. We hire people on the basis of their competencies and training and we have people heading our departments who have masters degrees and Ph. D.'s and bachelors degrees, and they come from outside of our city and have had nothing at all to do with the election of any of the officials.

Representative OAKAR. Can't you find any within your city?

Mr. MENDONSA. We certainly look for people within our city but it doesn't necessarily follow that because someone grew up there, that he is better qualified to deal with the problem than someone from out of town.

As a matter of fact, he may know so many people in the community, that each time he comes up with making a decision he is going to offend some elder that he used to know as a child and, therefore, he will not react quite as objectively.

So I think there are two sides to that issue. But patronage is not an issue, at least in our city, and I suspect in most other cities.

Mr. WASSERMAN. May I add just one word of frustration and at the same time a touch of irony. Some of the chief executives in State and local government who yell the loudest about the productivity of employees working for them, administer patronage ridden governments. There is a contradiction here, on the one hand, yelling for productivity, and on the other hand, loading up the payroll with political hacks and favorites.

Representative OAKAR. Thank you, Mr. Chairman.

Chairman REUSS. Thank you, Representative Oakar. I thank each one of the members of the panel for a remarkable presentation, and particularly, Phyllis Lamphere for acting as coordinator.

Ms. LAMPHERE. Mr. Chairman, I would just like to add one thing. We had hoped to have a film ready to show to you today. And the schedule on that slipped a little. It will be available shortly and we will invite members of the two committees to a viewing at your convenience.

Chairman REUSS. We understand these lapses in productivity from time to time and we are looking forward to seeing it. It is my hope that some of the materials in it may be useful for the report. In fact, the series of reports and the subsequent series of hearings which are planned on a subject that will not go away.

Thank you all very much.

[Whereupon, at 12:05 p.m., the hearing was adjourned, to reconvene subject to the call of the Chair.]

APPENDIX

THE FOLLOWING ADDITIONAL MATERIAL WAS SUBMITTED FOR INCLUSION IN THE RECORD

I. BACKGROUND MATERIALS ON THE GROWTH OF THE PUBLIC SECTOR, TAX AND SPENDING LIMITATIONS, AND MATCHING REQUIREMENTS IN FEDERAL GRANT PROGRAMS

---

1. Chart I & Table I: Growth in Number of Public Employees.

2. Chart II & Table II: Own Source Revenue as a Percent of GNP, by Level of Government.

3. Chart III & Table III: Expenditures as a Percent of GNP by Level of Government.

4. Chart IV & Table IV: Tax Burden as a Percent of Income for an Average Family, 1953 & 1975.

5. Table V: Recently Enacted or Proposed Restrictions on State and/or Local Taxing and Spending Powers.

6. Table VI: States Which have Petitioned to Convene a Constitutional Convention to Consider an Amendment Requiring a Balanced Federal Budget.

7. Matching and Maintenance of Effort Requirements for Selected Large Federal Grant Programs.

Chart I

GROWTH IN NUMBER OF PUBLIC EMPLOYEES

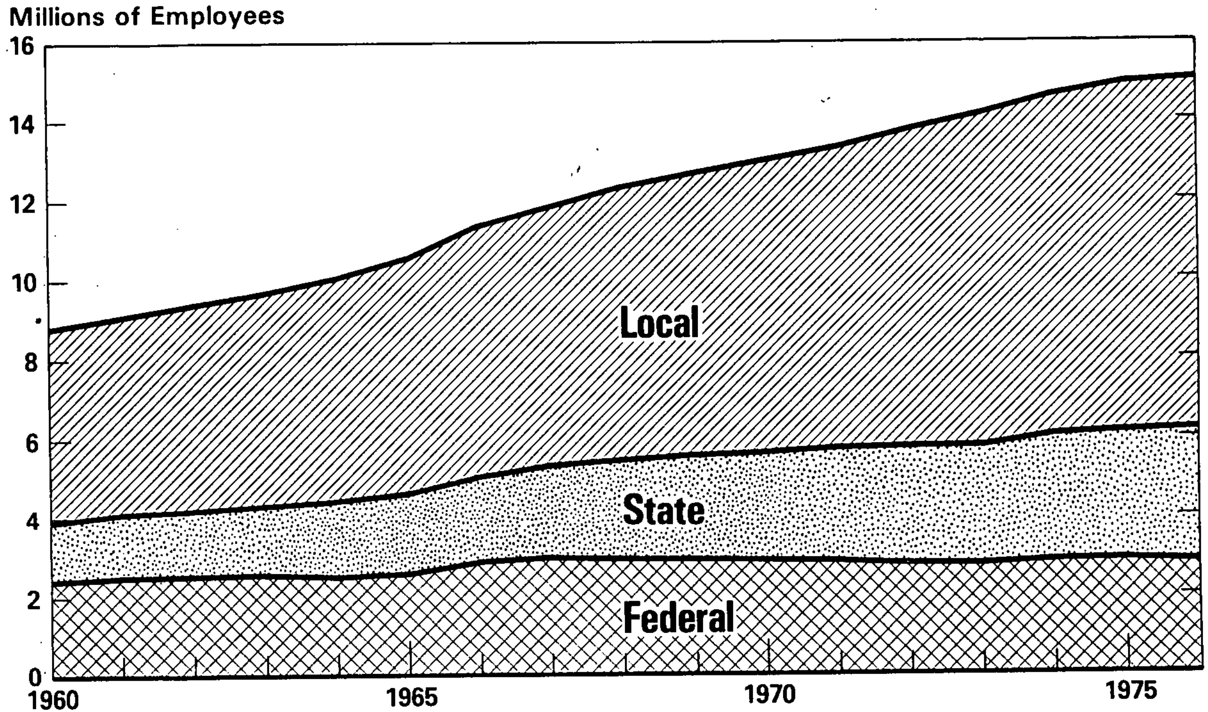


TABLE I: GROWTH IN NUMBER OF PUBLIC EMPLOYEES[1/]
(Amounts in Thousands)

	Federal[2/]	State	Local
1960	2,421	1,527	4,860
1961	2,484	1,625	4,992
1962	2,539	1,680	5,169
1963	2,548	1,775	5,413
1964	2,528	1,873	5,663
1965	2,588	2,028	5,973
1966	2,861	2,211	6,316
1967	2,993	2,335	6,539
1968	2,984	2,495	6,864
1969	2,975	2,614	7,102
1970	2,881	2,755	7,392
1971	2,872	2,832	7,612
1972	2,795	2,957	8,007
1973	2,786	3,013	8,339
1974	2,874	3,155	8,639
1975	2,890	3,268	8,828
1976	2,843	3,343	8,826

1/ Full and part-time employees, in thousands.

2/ Federal civilian employees.

SOURCE: U.S. Department of Commerce. Bureau of the Census, Public Employment Series.

Chart II

OWN SOURCE REVENUE AS A PERCENT OF GNP, BY LEVEL OF GOVERNMENT

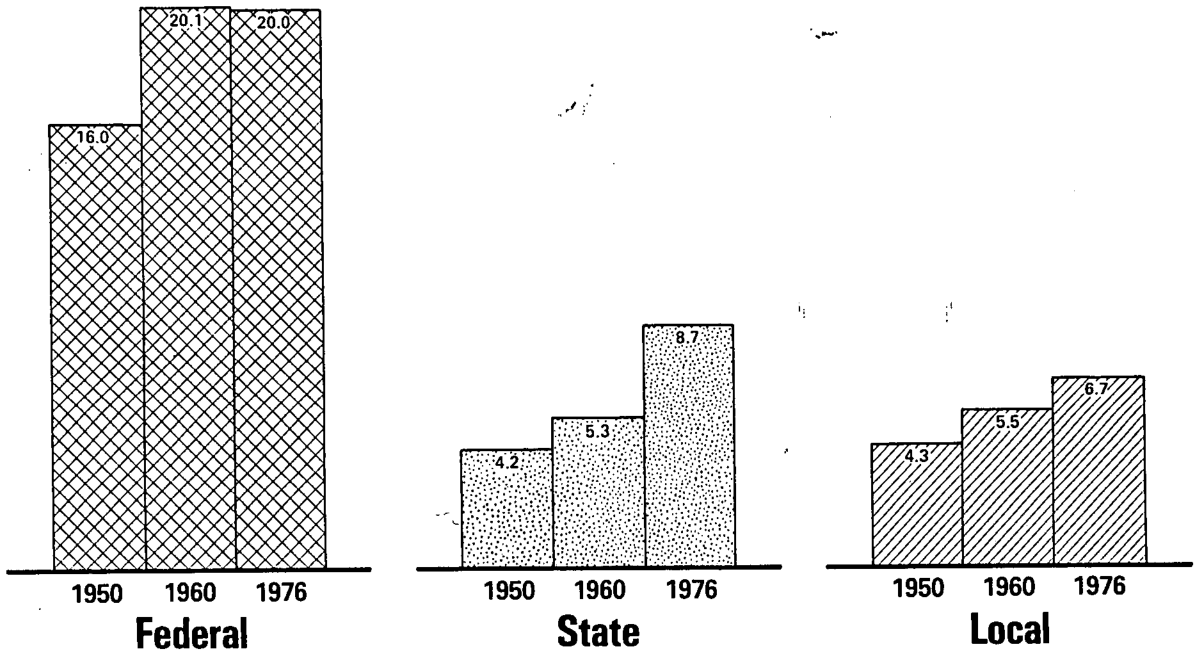


TABLE II: TOTAL OWN SOURCE REVENUE AT EACH LEVEL OF GOVERNMENT, SELECTED FISCAL YEARS

FISCAL YEAR 1/	TOTAL 2/	FEDERAL 3/	STATE 4/	LOCAL 4/
Amount (millions of dollars)				
1946	61,532	46,405	7,712	7,416
1950	66,680	43,527	11,480	11,673
1955	107,602	73,113	16,678	17,811
1960	153,102	99,800	26,094	27,209
1965	202,585	125,837	38,507	38,242
1970	333,810	205,562	68,691	59,557
1972	381,849	223,378	84,327	74,144
1974	484,650	288,565	107,645	88,440
1976	572,615	323,527	140,926	108,592
As a percent of G.N.P.				
1946	29.2	22.0	3.7	3.5
1950	24.5	16.0	4.2	4.3
1955	28.1	19.1	4.4	4.7
1960	30.9	20.1	5.3	5.5
1965	30.6	19.0	5.8	5.8
1970	34.8	21.4	7.2	6.2
1972	34.2	20.0	7.5	6.6
1974	35.6	21.2	7.9	6.5
1976	35.4	20.0	8.7	6.7

1/ These data relate to governmental fiscal years which ended June 30th or at some date within the 12 previous months except that State governments of Alabama and Texas (as well as their school districts) with fiscal years ending September 30th and August 31 are treated as though they were part of the June 30th group. Although Michigan extended its June 30, 1976 fiscal year through September 30th, the data in the report are for the period July 1, 1975 through June 30, 1976.

2/ Consists of the actual receipts--net of refunds or recoveries---for all activities undertaken by the individual governments or their agencies including governmentally operated enterprises and public trust funds. Excludes the proceeds from borrowing and intergovernmental transactions.

3/ Includes tax revenue, charges for specific services or sales of commodities, interest earnings, as well as receipts for the Federal Old Age, Survivors, Disability, and Health Insurance Systems. (The major Federal source of "current charges revenue" are postal receipts, payments for equipment, services, and supplies related to national defense and international relations, and proceeds from agricultural product sales.)

4/ State and local Government revenues from "current charges" are largely derived from tuition, fees, and other income of higher educational institutions, hospital charges, school lunch sales, and sewerage charges. In addition includes: sales of commodities, interest earnings, and miscellaneous sources of revenue for general governmental purposes.

SOURCE: U.S. Bureau of the Census: Historical Statistics on Governmental Finances and Employment, 1972 Census of Goverment, Volume 6, Number 4 and Annual Series, Governmental Finances in 1975-76.

Chart III

EXPENDITURES AS A PERCENT OF GNP, BY LEVEL OF GOVERNMENT

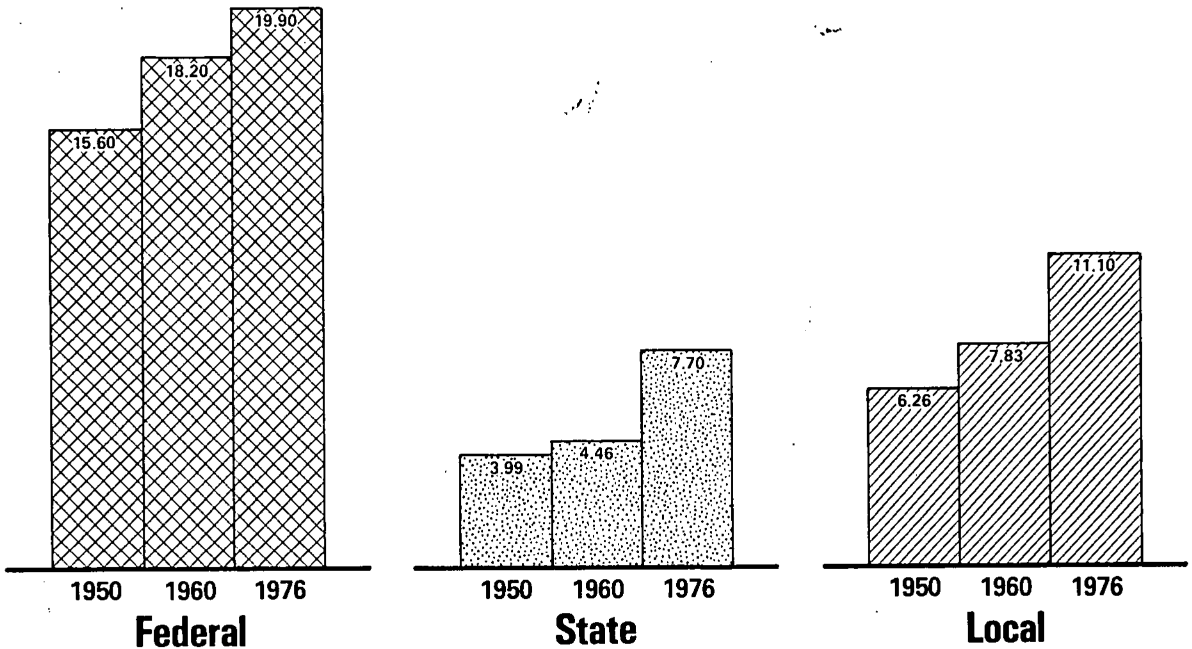


TABLE III: TOTAL GOVERNMENT EXPENDITURES[1/] AT EACH LEVEL OF GOVERNMENT, SELECTED FISCAL YEARS

Fiscal Year [2/]	Total	Federal	State	Local
Amount (millions of dollars)				
1946	79,707	65,640	4,974	9,093
1950	70,334	42,429	10,864	17,041
1955	109,685	69,310	14,371	26,004
1960	151,288	90,289	22,152	38,847
1965	205,682	118,996	31,465	55,221
1970	332,985	184,933	56,163	91,889
1972	399,098	208,602	72,496	118,001
1974	478,325	252,634	86,193	139,495
1976	626,116	322,028	124,108	179,980
As a percent of G.N.P.				
1946	37.8	31.1	2.4	4.3
1950	25.8	15.6	4.0	6.3
1955	28.7	18.1	3.8	6.8
1960	30.5	18.2	4.5	7.8
1965	31.1	18.0	4.7	8.3
1970	34.7	19.3	5.9	9.6
1972	35.7	18.7	6.5	10.6
1974	35.2	18.6	6.3	10.3
1976	38.7	19.9	7.7	11.1

1/ Payments to employees, suppliers, contractors and other final recipients of governmental payments other than Intergovernmental Expenditures. Intergovernmental transfers are treated as expenditures of the recipient governments so that Federal aid to state and local governments is reflected in the total expenditures for those governments receiving the Federal aid.

2/ See Footnote 1 to Table II.

SOURCE: U.S. Bureau of the Census: Historical Statistics on Governmental Finances and Employment, 1972 Census of Governments, Volume 6, Number 4 and Annual Series, Governmental Finances in 1975-76.

Chart IV

TAX BURDEN AS A PERCENT OF INCOME FOR AN AVERAGE FAMILY, 1953 and 1975

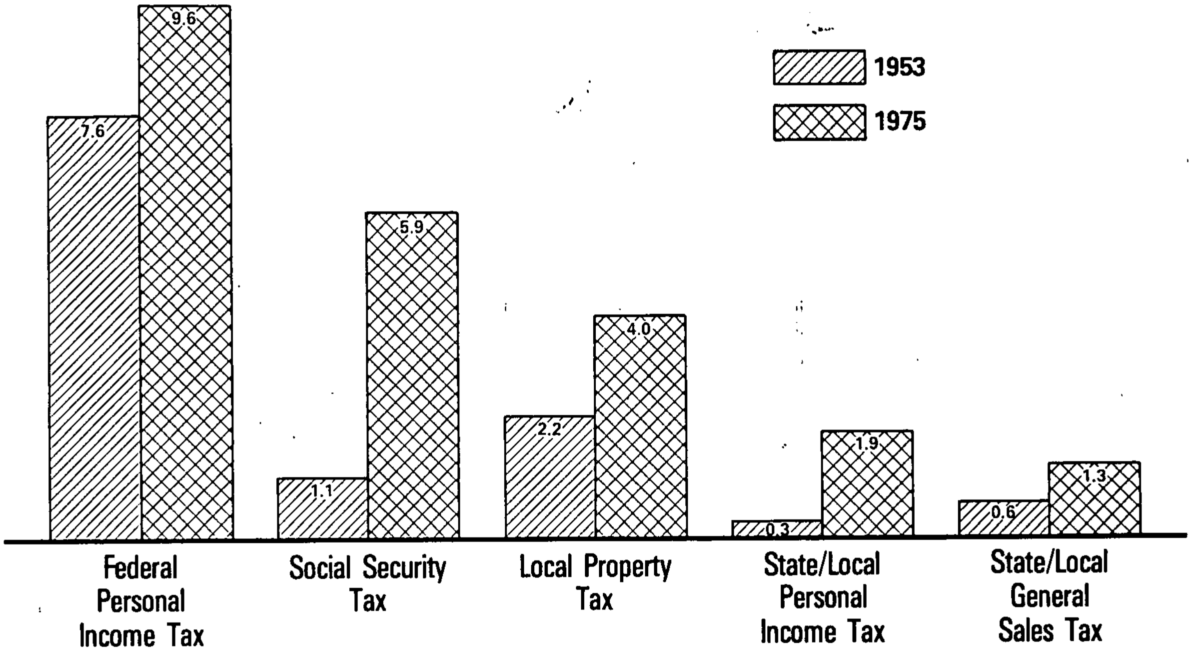


TABLE IV: TAX BURDEN AS A PERCENT OF INCOME FOR AN AVERAGE FAMILY, 1953 and 1975

Type of Tax	Average Family[1]			Twice the Average Family[2]			Four Times the Average Family[3]		
	Tax as Percent of Family Income		Percent Increase	Tax as Percent of Family Income		Percent Increase	Tax as Percent of Family Income		Percent Increase
	1953	1975	1953-1975	1953	1975	1953-1975	1953	1975	1953-1975
Total	11.8	22.7	92.4	16.5	24.6	49.1	20.2	29.5	46.0
Federal Personal Income Tax	7.6	9.6	26.3	12.8	14.7	14.8	16.6	21.1	27.1
Social Security Tax (OASDHI)	1.1	5.9	436.4	0.5	2.9	480.0	0.3	1.5	400.0
Local Residential Property	2.2	4.0	81.8	1.8	3.2	77.8	1.7	2.5	47.1
State-Local Personal Income	0.3	1.9	533.3	0.9	2.9	222.2	1.2	3.7	208.3
State-Local General Sales	0.6	1.3	116.7	0.5	0.9	80.0	0.4	0.7	75.0

[1] Estimates for average family earning $5,000 in 1953 and $14,000 in 1975 assuming all income from wages and salaries and earned by one spouse.

[2] Estimates for twice the average family. Family earning $10,000 in 1953 and $28,000 in 1975 and assumes that earnings include $105 (interest on state and local debt, and excludable dividends) in 1975 and $25 in 1953 also assumes the inclusion of net long-term capital gains of $1,040 in 1975 and $350 in 1953.

Table IV: Tax Burden as a Percent of Income for an Average Family, 1953 and 1975
Page 2

[3] Estimates for four times the average family. Family earning $20,000 in 1953 and $56,000 in 1975 and assumes that earnings include $965 (interest on state and local debt, and excludable dividends) in 1975 and $265 in 1953; also assumes the inclusion of net long-term capital gains of $6,400 in 1975 and $1,730 in 1953.

(For additional assumptions used in these computations, see "Note" on next page).

SOURCE: Significant Features of Fiscal Federalism, 1976 Edition, Volume 1, Advisory Commission on Intergovernmental Relations, June 1976, Table XVI.

NOTE: In computing Federal personal income tax liabilities, deductions were estimated to be 14 percent of family income for the \$5,000 family and 12 percent of income for the \$10,000 family. Estimated itemized deductions were assumed for the \$14,000, \$20,000, \$28,000 and \$56,000 families. Interest on state and local debt, dividends, and one-half of capital gains (estimated, based on I.R.S., Statistics of Income) were exluded from family income for these computations.

Residential property tax estimates assume average housing values of approximately 1.8 times family income for the average family in both 1953 (\$5,000) and 1975 (\$14,000), 1.5 for \$10,000 income (1953), 1.4 for \$28,000 income (1975), 1.4 for \$20,000 income (1953), and 1.1 for \$56,000 income (1975), with average effective property tax rates of 2.15 percent in 1975 and 1.20 percent in 1953. Based on U.S. Bureau of the Census, U.S. Census of Housing; Commerce Clearing House, State-Tax Reporter; Internal Revenue Service, Statistics of Income, Individual Income Tax Returns; and ACIR staff estimates.

In computing state personal income tax liabilities, the optional standard deduction was used for the \$5,000 and \$10,000 families, the average of standard and estimated itemized deductions for the \$14,000 family and estimated itemized deductions for the \$20,000, \$28,000 and \$56,000 families.

Estimated state-local general sales tax liabilities are based on the amounts allowed by the Internal Revenue Service as deductions in computing Federal personal income taxes.

The percentages shown for state-local personal income and general sales taxes are weighted averages (population) for all states including those without a sales or income tax.

TABLE V: RECENTLY ENACTED OR PROPOSED RESTRICTIONS ON STATE AND/OR LOCAL TAXING AND SPENDING POWERS

STATE	TYPE OF RESTRICTION AND YEAR OF ENACTMENT		REMARKS
	CONSTITUTIONAL	STATUTORY	
Arizona	Pending		Amendment limiting tax revenue to 7 percent of personal income will be on the November ballot. Two proposed amendments similar to Proposition 13 are pending before the legislature.
California	1978		Limits property taxes to 1 percent of assessed value, increases in assessed values limited to 2 percent per year; any new taxes require a two-thirds vote by the legislature.
Colorado		1977	Allows a 7% increase in general fund spending with an additional 4% to reserve fund. Amounts over 11% refunded to taxpayers.
		1978	Indexation of the state personal income tax to prevent inflation from pushing taxpayers into higher tax brackets.
	Pending		Amendment limiting state and local spending increases to statewide cost-of-living increases.
Massachusetts	Pending		An amendment limiting state expenditures passed by this year's legislature must be passed by next year's legislature before being put on the ballot in 1979.
Michigan	Pending		An amendment limiting state revenues to 9.1-9.4 percent of personal income will be on November ballot. It also limits growth in assessed value to cost of living index increases.

Table V - Page 2

STATE	TYPE OF RESTRICTION AND YEAR OF ENACTMENT		REMARKS
	CONSTITUTIONAL	STATUTORY	
Nebraska		1978	Legislature passed two bills in special session limiting local property tax increases and allowing local voters to impose spending lids.
New Jersey		1976	Spending increase limited to increase in the state personal income (federal series). Increase of between 9 and 10% for this year.
Oregon	Pending		Initiative will be on November ballot which is identical to that passed in California except property taxes will be limited to 1.5 percent of assessed value.
Tennessee	1978		Spending increase limited to growth in the economy. Increase approximately 11% this year. Provisions for full or shared costs for mandated programs to local governments.

TABLE VI: STATES WHICH HAVE PETITIONED CONGRESS TO CONVENE A CONSTITUTIONAL CONVENTION TO CONSIDER AN AMENDMENT REQUIRING A BALANCED FEDERAL BUDGET

ALABAMA	NEVADA
ARIZONA	NEW MEXICO
COLORADO	NORTH DAKOTA
DELAWARE	OKLAHOMA
FLORIDA	OREGON
GEORGIA	PENNSYLVANIA
KANSAS	SOUTH CAROLINA
LOUISIANA	TENNESSEE
MARYLAND	TEXAS
MISSISSIPPI	VIRGINIA
NEBRASKA	WYOMING

NOTE: TWO-THIRDS OF THE STATES MUST PASS A RESOLUTION CALLING FOR A CONSTITUTIONAL CONVENTION BEFORE SUCH A CONVENTION CAN BE CALLED.

33-595 O - 78 - 29

*MATCHING AND MAINTENANCE OF EFFORT REQUIREMENTS FOR SELECTED LARGE FEDERAL GRANT PROGRAMS a/

CFDA Reference Number b/	Agency and Program	California's Share of 1977 Program (in thousands of dollars)	Requirement for State and Local Match	Maintenance of Effort Requirement
Department of Agriculture				
10.418	Water & Waste Disposal Grants for Rural Communities	26,387	None	None
10.500	Cooperative Extension Service	6,261	55 percent	None
10.561	Administration of Food Stamps	33,629	50 percent	None
10.555	National School Lunch	32,739	75 percent for paid-lunch program except less in states with per capita incomes below the national average. Ten percent of matching funds must come from state and local revenues other than those raised from student charges.	State spending for administration must exceed fiscal year 1977 levels to qualify for federal funding of administrative costs.
10.557	WIC--Special Supplemental Feeding for Women, Infants and Children	17,340	No; but state and local agencies bear administrative costs in excess of 20 percent of the total grant.	None

(Continued)

*Source: Congressional Budget Office: Proposition 13: Its Impact on the Nation's Economy, Federal Revenues and Federal Expenditures, July 1978

APPENDIX TABLE (Continued)

CFDA Reference Number b/	Agency and Program	California's Share of 1977 Program (in thousands of dollars)	Requirement for State and Local Match	Maintenance of Effort Requirement
Department of Health, Education, and Welfare				
13.224	Community Health Centers	20,101	Yes; determined on a case-by-case basis	None
13.232	Maternal & Child Health	11,493	Part A formula grants have a 50 percent match	None
13.428	Title I Compensatory Education	139,880	None	Fixed Base: Combined fiscal effort per student or aggregate expenditures for preceding year must equal 95 percent of second preceding year. (Waivers are allowed.)
13.449	Education for the Handicapped	18,609	None	Fixed Base: Level of expenditures for handicapped from state and local sources for application year must equal preceding year. (No waiver allowed.)
13.478	School Assistance in Federally Affected Areas (Impact Aid)	98,546	None	None

(Continued)

APPENDIX TABLE (Continued)

CFDA Reference Number b/	Agency and Program	California's Share of 1977 Program (in thousands of dollars)	Requirement for State and Local Match	Maintenance of Effort Requirement
(HEW, continued)				
13.493	Vocational Education	38,803	50 percent	Fixed Base: Per pupil or aggregate spending for preceding year must equal second preceding year.
13.600	Headstart	32,042	20 percent; can be waived for low-income communities and those hit by natural disaster.	General non-supplantation requirement.
13.624	Rehabilitation Services and Facilities--Basic Support	55,996	20 percent	Fixed Base: State spending must equal fiscal year 1972 level.
13.635	Nutrition Programs for the Elderly	17,725	10 percent	Fixed Base: Regulations require continued support at prior year levels.
13.642	Title XX Social Services	262,060	25 percent	Fixed Base: state and local spending must equal fiscal year 1973 or 1974 levels.
13.714	Medicaid	1,217,425	Varies by state between 27 and 50 percent	None
13.808	Aid to Families With Dependent Children	1,005,944	Varies by state between 27 and 50 percent	None

(Continued)

APPENDIX TABLE (Continued)

CFDA Reference Number b/	Agency and Program	California's Share of 1977 Program (in thousands of dollars)	Requirement for State and Local Match	Maintenance of Effort Requirement
Department of Housing and Urban Development				
14.146	Low-Income Housing Assistance	30,659	None	None
14.218 and 14.219	Community Development Block Grants	308,898	None	General non-supplantation requirement.
Department of Justice				
16.502	Law Enforcement Assistance Block Grants	34,951	50 percent for construction; 10 percent all other activity	General non-supplantation requirement.
Department of Labor				
17.207	Grants for Employment Service	67,210	None	None
17.226	Work Incentives Program (WIN)	36,922	10 percent	Public service employment funded through WIN cannot be used to displace regular employees.

(Continued)

APPENDIX TABLE (Continued)

CFDA Reference Number b/	Agency and Program	California's Share of 1977 Program (in thousands of dollars)	Requirement for State and Local Match	Maintenance of Effort Requirement
<u>(Labor, continued)</u>				
17.232	Comprehensive Employment and Training Grants	899,147	None	Statute includes general non-supplantation requirement. Regulations prohibit public service employees from remaining in jobs that are substantially similar to those from which regular employees are laid off.
<u>Department of Transportation</u>				
20.102	Airport Development Aid	30,118	Varies between 10 percent and 25 percent depending on project.	None
20.205	Highway Aid	638,888	Varies between 10 percent and 30 percent depending on project.	None
20.500 and 20.507	Urban Mass Transportation Assistance	165,320	20 percent on capital projects; 50 percent if used for operating expenses.	Operating subsidies must equal the average of the prior two years to qualify for formula grant component.
<u>Community Services Administration</u>				
49.002	Community Action	30,945	30 to 40 percent depending on size of program; can be waived.	General non-supplantation requirement

(Continued)

APPENDIX TABLE (Continued)

CFDA Reference Number b/	Agency and Program	California's Share of 1977 Program (in thousands of dollars)	Requirement for State and Local Match	Maintenance of Effort Requirement
Environmental Protection Administration				
66.418	Construction of Wastewater Treatment Facilities	791,171	25 percent	None
Department of the Treasury				
No number assigned	General Revenue Sharing	709,018	None	If state government reduces aid to local governments below average of preceding two years, part of state government entitlement is redistributed to local governments.

SOURCE: Information on matching requirements from Office of Management and Budget, 1977 Catalogue of Federal Domestic Assistance; information on obligations in California from Community Services Administration, Geographic Distribution of Federal Funds in California, Fiscal Year 1977; information on maintenance of effort requirements from unpublished General Accounting Office materials and other telephone contacts.

a/ Programs were selected if total obligations nationally reported in the Catalogue of Federal Domestic Assistance were greater than $200 million in fiscal year 1977.

b/ Catalogue of Federal Domestic Assistance.

II. Proposition 13 and Its Aftermath

13 JARVIS-GANN INITIATIVE

This proposed constitutional amendment would establish a limit on local property taxation and change the voting requirements for increases in other sources of government revenue.

BACKGROUND

Local government in California now receives its revenue from property taxes, sales taxes, user service charges, a variety of other levies, and from subventions from the state and federal government. The state government receives the bulk of its revenues from the personal income, sales, transportation and bank and corporation taxes. During the current year, local governmental units in California will collect about $10.3 billion in property taxes. An additional contribution of $1.2 billion comes from the state, to replace property-tax revenues lost through certain exemptions. This raises total property-tax revenues to $11.5 billion.

The property tax represents a different percentage of the total income of differing units of government: about 27 percent for cities, 40 percent for counties, 47 percent for school districts and about 90 percent for fire districts. The property tax represents about 2.7 percent of the market value of all taxable property in the state.

Previous tax initiatives

In 1968, a proposal to limit property taxes to 1 percent of value was placed on the ballot under the sponsorship of Phillip Watson, then assessor of Los Angeles County. It was defeated by a margin of about 2 - 1. Watson tried again with a somewhat different proposal four years later. It too was defeated by a vote of almost 2 - 1. Howard Jarvis and Paul Gann, the sponsors of this June's Proposition 13, have tried before to qualify tax measures for the ballot but have not been successful. They pooled their resources last year and managed to obtain a record 1.2 million signatures for this proposal.

Jarvis-Gann provisions

Here are the main provisions of the initiative:

- *The maximum property tax* shall be 1 percent of market value. This does not apply to bonded debt approved by the voters prior to July 1st.
- *The revenues from property taxes* shall be apportioned "according to law to the districts within the counties."
- *Property values* will be based on the assessments of March 1st, 1975. Thereafter, the maximum increase in assessments shall be 2 percent a year, except for new construction or parcels in which there has been a change of ownership.
- *Any new taxes* voted by the Legislature must be passed by a two-thirds vote (not the current simple majority). No new real-estate taxes of any kind may be imposed.
- *Local governmental* units may impose "special taxes" — but only by a two-thirds vote of the "qualified electors." However, no taxes on real property may be imposed.
- *The entire measure* will take effect on July 1st, except for the two-thirds vote requirement in the Legislature, which would go into effect immediately.
- *If any section of the initiative* were to be declared unconstitutional by the Supreme Court, all the remaining sections would remain in effect.

Link to Proposition 8

The California voter faces more than a simple yes-or-no choice on this measure. That is because the Legislature passed an alternative property tax measure, SB 1 by Senator Peter Behr. The Behr bill, which offers $1.4 billion in tax relief from state surplus funds, would go into effect only if Proposition 8 is passed and Proposition 13 is defeated. Therefore, there are several possible ways the 1978 battle over tax relief can come out. Here are five basic alternatives:

- Both Proposition 8 and 13 are defeated. There is no tax relief until the Legislature acts again.
- Proposition 8 is passed and Proposition 13 is defeated. The $1.4 billion Behr plan would go into effect immediately.
- Proposition 13 is passed, is upheld by the courts and no substitute taxes are levied. Owners of all California property would get 57 percent reductions in their property tax bills, and local governments would be forced to reduce services. (If Proposition 13 passes and is upheld by the courts, the outcome of the vote on Proposition 8 is irrelevant.)
- Proposition 13 passes and is declared unconstitutional by the Supreme Court. There would be no immediate property tax relief. However, if Proposition 8 is adopted, the state could implement the Behr bill after the court acts. But there would be legal complications, and the Legislature might have to start all over again.
- Proposition 13 passes, is upheld by the courts and replacement taxes are levied. Owners of all California property would get 57 percent reductions in their property tax bills. But they would have to pay unknown amounts of unknown new taxes.

Impact on government

There are differences of opinion as to the total loss to local government if Proposition 13 is put into effect. The estimates range from a low of $5 billion to a high of $8 billion. Most fiscal analysts in Sacramento place the loss at $7 billion. The impact would be greatest on those units of government depending most on the property tax, with some special districts being hit the hardest. Significant cutbacks would be required in some local services. The cutbacks would vary from community to community.

If replacement revenues are to be provided, they would have to come primarily from the state government, which already gives about two-thirds of its general-fund income to local government. The entire budget for state operations is less than the amount local government would lose from the effects of this initiative. In short, there is no way that state and local government could provide anything resembling the current level of services without levying alternative taxes.

The federal factor

Although Jarvis-Gann would reduce property taxes by about $7 billion, the net tax savings to Californians would be in the vicinity of $5 billion. That's because the loss of property-tax deductions would raise state and federal income-tax collections by about $2 billion.

The passage of Proposition 13 would also reduce the amount of federal revenue-sharing funds available to governmental entities in California. This is because the fed-

...eral formula is based, in part, on local taxing effort. It could also cost the state federal funding for many CETA jobs because the layoff of regular local-government employees in some cases would trigger a mechanism making a community ineligible for some CETA funds. The reason for this is that CETA employees would then be deemed to be replacing regular employees, and that's illegal.

New state tax options

What taxes would the state raise, if any, to keep local government operations running at near their current levels? That, of course, would be a tricky question for the Legislature to decide. But the only major sources of revenue are the sales, income and bank-corporation taxes. The sales and income taxes this year will produce about $5 billion each, and the bank and corporation tax collections will approach $2 billion. Thus, it would take major increases in these levies to match the losses from Jarvis-Gann.

Legal problems

In the past, it has not been unusual for the state Supreme Court to declare an initiative unconstitutional, even though it has been approved by a large margin. This could well be the fate of Proposition 13, despite the clause saying that only those sections found unconstitutional will not become operative and that the remainder of the measure will remain in effect. However, the court could throw out the entire package if it finds that an unconstitutional provision is central to the entire scheme.

Here are some of the legal issues that have been raised by Professor Sho Sato of the University of California's Boalt School of Law:

- How are the property-tax revenues to be divided? The initiative says "according to law," and there is no law. What would happen if the Legislature refused to pass such a law? And do cities and counties qualify as "districts" under the distribution provision of the initiative?
- How are cities supposed to retire tax-increment bonds frequently used to fund redevelopment projects? These bonds are retired from the growth in property tax revenue from the revitalized land. Would they become general-obligation bonds, or would cities default?
- How are assessors to place a value on properties that decrease in value after the base date of March 1st, 1975? Would the 1975 value be preserved? Sato claims there is no apparent mechanism for reducing assessments on such parcels.
- Is it legal to place a 2 percent limit on annual increases in value for those properties that do not change hands, while allowing full reassessment of those that are sold? Is this a violation of the equal-protection clause of the constitution?
- Does this proposal freeze charitable exemptions and

Behr and Jarvis comparison

Here is what would happen if either of the two rival tax-relief plans were to go into effect:

Jarvis	Behr
HOMEOWNER RELIEF	
Statewide property tax rates would be reduced about 57 percent. The tax rate would be based on about 1.25 percent of value (1 percent plus funds for retirement of bonds).	Statewide, the average property tax relief would be 32 percent in the first year and about 35 percent in four years.
OTHER PROPERTY OWNERS	
The 57 percent cut would apply to factories, apartment houses, farms and other classes of property.	No direct relief.
RENTERS	
No direct relief. (Landlords could, however, pass on their savings in property taxes to tenants through lower rents.)	The income-tax credit for renters would be increased from $37 to $75 a year.
SENIOR CITIZENS	
Nothing beyond general homeowner relief.	Homeowners over 62 with incomes below $13,000 a year would be eligible for additional property-tax exemptions. Renters over 62 also would get improved benefits. These senior-citizen benefits work on a sliding scale based on income.
ASSESSMENT FEATURES	
Rates would remain the same for all classes of property.	For the first time, rates could be reduced for owner-occupied homes, while rates remained at a higher level for other classes of property. (See Proposition 8 description.)
GOVERNMENT SPENDING	
Establishes two-thirds vote requirement for increases in state taxes and for voter approval of new local taxes.	Places limits on increases in state and local governmental spending. The maximum annual increases under this provision have been estimated at 8 percent for local government and 12 percent for the state. But these figures could vary significantly with an overall change in economic conditions.
OTHER TAXES	
Californians would pay about $2 billion of their tax-relief money in higher income taxes. They might have to pay additional state and local taxes to make up for the loss from the property-tax base.	The entire program would be financed from current state surplus funds. There would be a $400 million increase in state and federal income-tax collections through loss of property-tax deductions.

prevent changes in the method of taxing open-space lands and agricultural preserves?

- What does the term "qualified electors" mean in the local two-thirds-vote section? Does it mean those voting, those registered to vote, or those of voting age? Is this item so central that the entire initiative could be thrown out because of the vagueness of "qualified electors?"

ARGUMENTS

Pro: Government spending at all levels has gotten out of hand, and drastic steps are needed to bring matters under control.

Public officials are under the thumbs of militant employee organizations, which have obtained excessive benefits at the expense of the taxpayer. This initiative, in effect, is a taxpayer's bill of rights.

By voting for this initiative, Californians can once and for all put an end to big government and high taxes.

Passage of this measure means a $5 billion, not a $7 billion, loss to local government. And this amount can be absorbed by the state and local government without any curtailment of vital services. As Assembly Republican leader Paul Priolo declared, "It means public officials will have to go to work."

The property taxes provided under Jarvis-Gann will be more than enough to pay for police, fire and other services directly related to property.

State Controller Ken Cory has reported that even after this proposal goes into effect, the state and local governments will still collect some $33 billion a year from the taxpayers. That's plenty to run government in California.

Without a measure of this sort, rents would keep rising. But this will prevent an increase and even make reductions certain because landlords will pass their savings on to tenants.

The state now has a huge surplus that can be used to make sure that the most vital of services are not curtailed.

Business and agriculture in California need help to keep the California economy booming. This measure will make it possible for homeowners and businesses to make improvements at lower cost, thus putting a charge into the economy. By helping to stimulate business activity, this initiative will create thousands of new jobs in the private sector.

The rapid increase in property taxes in recent years, especially on residential property, has put an unreasonable burden on many citizens. This initiative will bring the property tax within the ability of most Californians to pay.

Mortgage payments will be reduced by this initiative in virtually all cases where property taxes are collected via the impound-account method.

About 15 percent of all governmental activity is waste. This measure will cut much of that waste.

Above all, this measure provides an outlet for public frustration with spendthrift politicians and pressure groups which keep boosting the expenditure of tax dollars without regard for the general citizenry. This is the ordinary citizen's way to go on strike and tell the politicians that, even if Proposition 13 does create chaos, the years of profligate spending have come to an end.

Con: This measure, if approved, will lead to economic and governmental chaos in California. Unless new taxes are imposed, there is no way that local government can maintain police, fire and school operations at near their current levels.

If this initiative is approved, it will eventually end California's tradition of home rule. If cities, counties and special districts become more dependent on state and federal funds, they will also be controlled by a mass of state and federal laws and regulations. Big-Brother centralized government will be the product of Proposition 13.

Nobody knows what the precise result of this proposal will be because it is so vague and incomplete. Some homeowners will even suffer losses from Proposition 13 when alternate methods of taxation are imposed.

Passage of this measure will be a bonanza for the federal government, because California will lose subventions from Washington and will contribute more in income taxes.

This proposal hurts most that level of government which can afford the losses the least — local government. If there is a great deal of waste in government, it is probably at the federal level. And this measure sends even more California cash to Washington.

In the past few years, the homeowner has been the prime victim of escalating home values and property taxes. But this measure gives relief to all classes of property, regardless of need.

There is no direct aid in this plan for renters, and it might well be called the landlord's enrichment act of 1978, because owners of apartments will get massive amounts of property tax relief. It may be necessary to establish a rent-control system to guarantee that the benefits are passed on to tenants. Renters are doubly jeopardized because they will have to bear the full burden of any new income and sales taxes imposed to compensate for property-tax losses.

If police and fire services are cut back, Californians will have to pay much higher rates for fire insurance and some other types of liability insurance.

This measure would reduce the ability of local government to construct the kind of facilities needed to provide economic expansion in our communities.

This measure has serious constitutional problems. If it is thrown out by the courts, citizens will feel even more frustrated than before, and they may get no immediate property-tax relief. Some provisions of this measure would jeopardize bond issues, establish different assessments on identical pieces of property and make it impossible for voters to approve increases in local taxes if the term "qualified electors" means all those citizens of voting age.

While concerns over government spending and high taxes may be valid, this measure is irresponsible.

Supporters and opponents

This initiative is sponsored by Howard Jarvis of Los Angeles and Paul Gann of Sacramento. Jarvis is the head of the United Organization of Taxpayers and an official of the Apartment House Association of Los Angeles County. He has been active in Republican politics for many years, and has run for office unsuccessfully several times. Gann is a retired realtor who runs an organization called People's Advocate, Inc. He gathered signatures north of Santa Barbara, while Jarvis handled the more populous southland. Relatively few organizations have announced their support for Proposition 13. Among the supporters are the Farm Bureau, the Santa Barbara County Taxpayers Association, Republican gubernatorial candidates Ed Davis and John Briggs, and Assembly Republican leader Paul Priolo.

The campaign against Proposition 13 is being managed by a Los Angeles and Sacramento campaign management firm, Winner/Wagner. Funds for the campaign are being provided by numerous organizations, many of them representing public employees. Among the opponents: California Taxpayers Association, California Tax Reform Association, California Fire Services Coalition, State Board of Education, California Labor Federation AFL-CIO, League of Women Voters of California, California Teachers Association, Common Cause, League of California Cities, California Supervisors Association, California State Employees Association, Sierra Club, Governor Edmund G. Brown Jr., Superintendent of Public Instruction Wilson Riles, Assembly Speaker Leo T. McCarthy.

THE FIELD INSTITUTE

[illegible]

FOR RELEASE: JUNE 16, 1978

CONGRESSIONAL RESEARCH SERVICE
JUN 21 1978
Cont Copy

For more information, call
Mervin Field or Robert Heyer

MAJORITY OF CALIFORNIA VOTERS THINK THAT GOVERNMENT AT ALL LEVELS IS INEFFICIENT IN USING TAX DOLLARS. EVEN WITH BUDGET REDUCTIONS AS HIGH AS 40%, LARGE NUMBERS OF VOTERS THINK THAT THERE WOULD NOT HAVE TO BE SERIOUS CUTS IN PROGRAMS OR SERVICES IF ONLY GOVERNMENT AGENCIES AND SCHOOLS WERE MORE EFFICIENT. PUBLIC HAS DEFINITE VIEWS AS TO WHAT PROGRAMS SHOULD BE REDUCED FIRST IF CUTBACKS HAVE TO BE MADE. BIG INCREASE IN PROPORTION OF PUBLIC WHO EMBRACE THE IDEA OF SETTING A TOP LIMIT ON STATE SPENDING.

As California voters went to the polls last Tuesday to vote in overwhelming proportions for the Jarvis-Gann property tax limitation, they clearly had very strong convictions that there are major excesses in present levels of government spending.

A statewide survey of 1,317 cross-section voters was conducted by The Field Institute a few days before the June 6 election. This opinion sampling revealed a strong belief that government is inefficient in its use of taxes that was apparently as strong as the personal desire to reduce their property taxes. Many voters expressed the view that if there were more efficient use of tax dollars, the necessity of cutting back on existing programs and services would be minimized.

Large majorities of the California primary election voting public believe that government at all levels is inefficient. Proportions as high as 84% and 73% rated federal and state government as "very" or "somewhat" inefficient. Sixty-four percent rated county government inefficient, and 53% to 55% rated city governments and school boards as inefficient in some degree.

In addition to approving the Jarvis-Gann initiative which drastically cut property taxes, a majority of voters now endorse the idea of setting a constitutional top limit on state spending. As recently as one year ago only a minority of the public was ready to do this.

A substantial number of California voters (38%) believe that even a 40% reduction in revenue need not result in any significant reduction in the levels of services provided by state and local government.

The Field Institute is a center where diverse sectors of society take part in an ongoing policy research operation dedicated to the study of public opinion on a wide spectrum of social and political issues. Principal continuing financial support comes from private organizations and state government agencies which are members of the California Policy Survey, from academic institutions which are members of the California Opinion Research Consortium, and from media subscribers to The California Poll.

The Field Institute
June 16, 1978 page 2

If there are to be cutbacks in government services as a result of tax reductions voters have an overwhelming preference (62%) for cutting back on welfare budgets. Many (41%) also point to government backed public housing projects as prime candidates for cutbacks.

Next in priority for reduction if needed are budgets for "environmental protection regulations" (34%), followed by "state funded medical programs" (26%), followed by "courts and judges" (26%). Lowest priority areas for budget cuts were expressed for fire and police departments, and for mental health programs. Less than one in ten voters say that any of these budgets should be cut back.

The table below shows the percentage of people endorsing the idea of budget cuts for each of the various governmental services that were presented to them by the survey interviewers.

PUBLIC OPINION ON THE LEVEL OF SPENDING OF VARIOUS GOVERNMENT SERVICES WITH LOWER TAX REVENUES

	Spending for this category should be cut back...
Welfare and public assistance programs	62%
Government backed public housing projects	41
Environmental protection regulations	34
Medical care programs such as Medi-Cal	26
Courts and judges	26
Higher education such as University, state and local community colleges	24
Public transportation	23
Street and highway building and repair	23
Public schools, kindergarten through 12th grade	22
Parks and recreational facilities	22
Jails, prisons and other correctional facilities	16
Mental health programs	9
Police departments and law enforcement	8
Fire departments	6

When asked to rate government efficiency, majorities of the voting public feels that at every level of government there is inefficient use of the public's money. The federal government is seen as doing a particularly inefficient job in the use of the public's tax dollars. More than four out of five voters (84%) say that the federal government's use of tax dollars is either very inefficient (59%) or somewhat inefficient (25%).

Appraisal of state government's use of tax dollars is only slightly less negative. Almost two out of three people (63%) say they believe state government's use of tax dollars is inefficient to some degree. As many people (64%) also have a negative appraisal of the efficiency of county government's use of tax dollars.

City governments and public schools fare only a little better in voter esteem with a majority (53%) saying city government and 55% saying local public school districts are inefficient in using tax dollars.

PUBLIC OPINION ON THE EFFICIENCY OF VARIOUS LEVELS OF GOVERNMENT

	Federal Government	State Government	County Government	City Government	Public School District
On the whole, feel... is using my tax dollars...					
Very Efficiently	2%	4%	5%	8%	9%
Somewhat Efficiently	9	17	20	24	21
Somewhat Inefficiently	25	31	30	26	22
Very Inefficiently	59	42	34	27	33
No Opinion	5	6	11	15	15

There is considerable feeling by California voters that state and local governments could provide pretty much the same services they now provide even if their budgets were substantially reduced.

The Field Institute sample of voters was divided into four matched segments. Each one was asked to consider the effects of a budget cut of a different magnitude. Four budget cut levels were described: 10%, 20%, 30%, and 40%.

These various possible percentage budget cuts did not produce wide differences in the public's belief that government programs and services could still be maintained. For example, 54% of the public thought that state and local governments could provide the same level of services with a 10% cut back. At the other extreme, 38% thought that the same level of government services could still be provided even with a 40% reduction in budgets.

COMPARISON OF STATE AND LOCAL GOVERNMENT SERVICES NOW, AND WITH A ...% CUTBACK IN FUNDS.

	10% Cutback	20% Cutback	30% Cutback	40% Cutback
Can provide the same level of services	54%	49%	43%	38%
Will have to cut back	39	43	47	50
Will have to do both	4	4	5	7
Don't know/no opinion	3	4	5	5

Finally, the survey revealed that a majority of the voters were ready to embrace the idea of setting a constitutional top limit on state spending rather than regulating spending by the legislature as it is now done. Sentiment for taking spending limits out of the hands of the legislature has increased dramatically during the past twelve months.

PUBLIC OPINION ON CONSTITUTIONAL AMENDMENT TO SET TOP LIMIT ON STATE SPENDING OR REGULATED AS IS NOW:

	June 1978	June 1977
Constitutional amendment	58%	39
Regulate as now	31	49
Qualified/no opinion	11	12

The data on which this report is based comes from a telephone interview survey made by The Field Institute between May 29-31, 1978 in which a representative cross-section of 1,317 registered California voters who indicated a strong likelihood of voting on June 6 was interviewed.

CBS NEWS POLL
The New York Times

JUNE, 1978 -- PART I

THE ECONOMY--The proportion that think the economy is getting worse has increased 24 percentage points this year to a new high for Carter's tenure in office.

REACTION TO PROPOSITION 13--Three weeks after the election people in California would still vote for Proposition 13. Most other Americans would also support a property tax reduction measure, although many believe it would mean reduced services.

TAX REFORM--The property tax is seen as the most unfair tax, even by renters. The fairest tax is Social Security, followed by the sales tax. As for tax breaks, most Americans would prefer that they go to both business and residences.

CUTTING SERVICES--If necessary, Americans prefer reduced government services to increased taxes. If services have to be cut, the prime candidates are welfare, parks, and libraries. Most Americans mistakenly believe that welfare is a large share of their community's budget.

This poll was conducted by telephone June 19-23, 1978, among a nation-wide random sample of 1,527 adults. California was oversampled so that 434 adults were included. The error due to sampling could be plus or minus three percentage points for results based on the entire sample, and six percentage points for California results.

For more information, contact Warren J. Mitofsky, Kathleen Frankovic, or Martin Plissner.

OVERVIEW

Three weeks after passing Proposition 13, and three weeks after government officials announced major cutbacks in services, there is no regret among the California supporters of Proposition 13. Hardly any supporters now say they would vote against Proposition 13.

Vote If Election Held Now	VOTE ON PROPOSITION 13		
	YES	NO	DIDN'T VOTE
YES	95%	5%	39%
NO	3	92	29
WOULDN'T VOTE	1	3	24
DON'T KNOW	1	-	8

The California vote is mirrored in the opinion of the rest of the country about taxes. More people believe it is the property tax that is the most unfair. Like Californians, other Americans would support a Proposition 13-like measure at a rate of about 2 to 1. And, like the California supporters of Proposition 13 on Primary Day, a sizeable proportion of Americans believe that taxes can be cut without eliminating services.

When services must be cut, welfare is easily the most likely candidate. Most Americans, like most Californians, are convinced that welfare makes up a large part of their community's budget, even though most welfare expenditures <u>don't</u> come from local budgets.

There is also evidence in the CBS News/New York Times Poll that a great number of Americans feel that the government (particularly the federal government) needs to be controlled. One way or another, an extremely large proportion favor requiring the federal government to balance the budget. A majority favor a balanced budget even at the risk of losing programs in health and education.

Finally, although a so-called taxpayers' revolt may be the outgrowth of many things, it is not simply a reaction to a belief that times are bad. Although more people now than before -- 58% -- believe the economy is getting worse, that belief does not make them more likely to support Proposition 13. Supporters of Proposition 13 were not as likely to think the economy was getting worse.

TAX REFORM

Which taxes do Americans perceive to be the most unfair--and <u>how</u> should those taxes be reformed? The CBS News/New York Times Poll reveals several paradoxes. First of all, perhaps because of the Proposition 13 campaign, Americans believe that the property tax is the most unfair to them. 27% of all Americans believe this; 41% of Californians name the property tax as the most unfair tax. The federal income tax ranks second among both groups. One surprising finding was that, nation-wide, renters were almost as likely as homeowners to choose the property tax as the most unfair. In general, all groups are about equally likely to think the economy is getting worse.

The fairest tax to Americans appears to be the Social Security tax, followed by the sales tax (although in California, the order is reversed). The Social Security tax is also perceived as the one for which Americans get the most value for their money.

The poll reveals two clear suggestions about changes in the tax system. First of all, if taxes must be increased, about twice as many people prefer to see sales taxes raised rather than income taxes. Secondly, Americans favor tax relief across the board—both for businesses and homeowners. Well over half of all Americans think both businesses and homeowners should benefit from large tax reductions. In California, just about half felt that way. Only the opponents of Proposition 13 support tax cuts solely for residences.

TAXES AND SERVICES

The relationship between how much people pay in taxes and what they can and should get for their money is fuzzy, and uncertain. One thing is clear, however. Support for massive local tax cuts is related to whether or not people believe that services would have to be cut. Opponents of a property tax reduction measure believe that services would have to be cut; supporters of such a measure are more evenly divided. On Primary Day in California, supporters of Proposition 13 were sure that services would not have to be cut, opponents thought they would. Today, about half of those who voted for the measure believe that services in their communities are not now being cut, still in contrast to opponents.

Those people who do support tax cuts are more willing than opponents to see services cut, even though they don't believe it's necessary. Given the alternatives of decreasing services, or raising other taxes, supporters choose cutting back services more often than opponents, both within and without California.

	VIEW ON PROPOSITION 13			
	California		Non-California	
If Necessary, Prefer...	Supporters	Opponents	Supporters	Opponents
Reduced Services	72%	38%	73%	52%
Other Taxes Increased	18	41	12	33

Even though many people believe reduced taxes don't have to result in reduced services, Americans are more willing now than before to accept fewer government services if it means less taxes and reduction in "big" government. In early 1976, the population was fairly evenly split between opting for smaller government with fewer services and bigger government with more services. Now the feeling is clearly on the side of small government -- by 3 to 2 Californians, perhaps because of the Proposition 13 campaign are even more in favor (4 to 2) of smaller government. Those who voted for Proposition 13 are overwhelmingly in support.

WHICH SERVICES TO CUT?

About three quarters of Americans say that welfare services can be cut — and Californians who voted for Proposition 13 feel even more strongly about this — 91% of them were willing to have welfare cut. Reducing park maintainance was second, followed by libraries. In most cases, Californians, who now have to live with Proposition 13, are slightly more willing to see specific service cuts than non-Californians. Supporters of major property tax cuts are more willing to see service cuts than opponents; although the ordering of preferred tax cuts is about the same. However, supporters and opponents of Proposition 13 differ a great deal on their willingness to see school cuts. Over twice as many supporters as opponents were willing to accept school cuts.

	SERVICES WILLING TO SEE CUT	
Service	Californians	Non-Californians
Welfare	79%	72%
Park maintenance	70	67
Library hours	62	66
Street repair	55	42
Public transportation	43	42
Garbage collection	38	41
Schools	37	29
Police	25	33
Fire	16	16

WELFARE

There appears to be little doubt in respondents' minds that welfare services can be cut from local budgets to make up for tax reductions even though, in many places, social services are paid for by federal, state and county governments, not by property taxes. In California, only 11% of local budgets goes for welfare, which is in the form of health services. There is a similar trend in other states. Despite this, about two-thirds of Americans believe that welfare payments make up a large part of their local community's budget. An even greater proportion (86%) of Californians who voted for Proposition 13 believe it.

There is a paradox in the welfare situation. Although people are willing to cut welfare, and apparently think that local communities spend too much money on it, it is not quite the case that Americans completely reject welfare expenditures. A plurality say that welfare is the responsibility of the federal government, and by two-to-one, people admit that people really need the services that welfare provides.

CONTROLLING GOVERNMENT

If the supposed taxpayers' revolt has a message besides cutting taxes, it seems to be a message that the government, particularly the federal government, needs to be controlled. Although property tax initiatives, like Proposition 13, are directed at the level of government closest to the people, most respondents view the national government as the worst offender when it comes to wasting the taxpayers' money. State government runs a very poor second. Over three-quarters of respondents thought that people in government waste a lot of money.

One suggestion that has been made to control big government, and the wasting of tax money is forcing the federal government to balance its budget by means of a constitutional amendment. Over 20 state legislatures have approved such a measure, and it is possible that the 34 necessary states will do so by the end of the year. Three-quarters of Americans agree that the government should be required to have a balanced budget. Slightly fewer--just about half--agree with the idea that the budget should be more balanced even at the risk of cutting back on programs for health and education. However, that is an increase over the proportion who agreed with that idea in early 1976. Two-thirds of Proposition 13 supporters agreed; only two-fifths of opponents did.

ALAN K. BROWNE
Consultant
2101 DAVIS DRIVE
BURLINGAME, CALIFORNIA 94010
TELEPHONE (415) 692-1914

July 27, 1978

The Honorable Henry S. Reuss
House of Representatives
Washington, D.C. 20515

Dear Henry:

Hearing that your committee is to conduct hearings on California's Proposition 13 I thought your staff might find some points of interest in the two enclosed communications.

1. A letter dated May 10, 1978 (pre-election) addressed to Leo T. McCarthy, Speaker of the California State Assembly. (Part of this is referred to in The Bond Buyer - June 12, 1978)

2. A report dated June 22, 1978)post-election) prepared on the eve of California's legislative decision to divide up the surplus of the state.

As you will understand, I voted against Proposition 13 because of the potential inequities inherent in the initiative and because it is more of a tax shift than tax relief or tax reduction.

The several recommendations starting on page 3 of the June 22nd memo might suggest some of the alternatives facing state and local government as well as the federal role. I was interested to note Juanita M. Kreps comments in the July 31, 1978 Business Week concerning the cost-benefits of federal programs, which I mentioned in my paper.

If I can be helpful to you and your committee, please let me know.

Warm regards.

Sincerely,

AKB:eh
enclosures

ALAN K. BROWNE
Consultant
2101 DAVIS DRIVE
BURLINGAME, CALIFORNIA 94010
TELEPHONE (415) 692-1914

May 10, 1978

The Honorable Leo T. McCarthy
California State Assembly
Room 3164
State Capitol
Sacramento, Ca. 95814

Dear Leo:

In the debates over the two measures appearing on the June State ballot, PROPOSITION 8 "Taxation of owner occupied dwellings at a lower rate than other property" and PROPOSITION 13 "The Jarvis-Gann Initiative", there does not seem to be enough emphasis on the impact of proposed tax reform legislation on the credit markets of the State of California and its numerous counties, cities, school districts, special districts and authorities.

The desire to lower property taxes seems to blind proponents to a very real problem --- what happens to outstanding bond issues that have been approved by the voters and/or applicable statutory authority? Also - what about future bond issues which would finance necessary public improvement programs and to meet emergencies?

Speaking as an individual with almost 50 years experience in governmental finance, particularly California municipal finance, I would like to point out some of the dangers and pitfalls that lie ahead. I have been through bond markets that were impacted by the $30 Every Thursday and the EPIC (End Poverty in California) plans, the Banking Holiday of 1933 and ensuing defaults on municipal bonds and subsequent debt re-structuring as well as periods when the State of California was hard pressed to balance its budgets and on occasion resorted to registering its warrants.

These events probably mean very little to the average voter yet they did occur and taxpayers had to bear the brunt of loss of investor confidence, lowered or suspended credit ratings and higher borrowing costs. California's economy was hurt and capital investment was deferred or diminished. Could this happen again? Yes it could - and here are some of the reasons:

1. Under proposition 13 outstanding voter approved municipal bond issues will continue to be supported by the unlimited taxing power of the political entity incurring the debt. So in effect - bondholders will have their bonds and interest coupons paid when due. This means that portions of the tax rate levied to pay municipal debt will be increased to produce the needed revenue so there is no tax reduction for bonds until the

debt is lowered and/or the assessed valuation increases.

2. Municipal tax collectors and treasurers will be required to segregate property tax funds collected and received into accounts allocated to paying debt and accounts for other municipal purposes. In the budgeting process, other than bond funds, reduction in property taxes not compensated for from other revenue sources will require a pro-rating of available funds to all other accounts unless individual budget items have been arbitrarily reduced or eliminated. Thus public officials will be caught between the horns of a dilemma - with both horns turning in. Voters will demand and expect continuation or essential public health and safety services and let their representatives use the axe on other costs of government.

3. Another problem arises when local government has been using other sources of revenue, not specifically pledged under a bond indenture to pay off its general obligation bonds. A typical example is the use of sales tax revenue. In this situation local government will probably shift the sales tax revenue to its general fund and add to its property tax an amount necessary to pay debt. Again the property taxpayer will be hit with a higher tax bill.

4. In recent years it has been popular to local government to enter into sale and leaseback arrangements to acquire property and provide capital improvements. If the property and/or facility acquired produces revenue sufficient to retire debt there is no immediate problem - however, if there is insufficient revenue generated, the sale and leaseback arrangement means dipping into the general fund to make up the deficiency. How will local government treat this claim? On an equal pro-rated basis or pay in full as in the case of general obligation bonds?

5. One of the great selling points used in attracting investor interest in New York City bonds (as well as obligations of New York State and its political subdivisions) was that debt service (principal and interest) came ahead of all other municipal obligations. This is an implied safeguard so long as the municipality is healthy - but what happens if it is in financial difficulty - cannot pay its employees, cannot purchase supplies, its water, sanitation, hospital, schools and fire protection to name a few public services, are unable to function adequately? This is where the priority claim of a bondholder will find the courts unsympathetic if the municipality is to survive.

6. The financial press has commented on the suspension of Moody's Investor Service ratings on tax allocation bonds issued by California Redevelopment Agencies. While each issue must be reviewed individually the purpose of the redevelopment law was to provide financing for blighted areas by using the incremental tax increase generated by improving raw land. Up to 5 years of capitalized interest could be included in the financing package if needed. While this financing method denies the increase in assessed values and related tax revenue to other political entities underlying or overlapping the redevelopment project area until debt is retired, the theory is that the improvements benefit such entities taxpayers. Now, however, bondholders who purchased tax allocation bonds in good faith on the basis of projected flow of funds arising from increased assessed valuation may be faced with a much reduced growth and related

tax revenues, thus jeopardizing their investments.

8. Most general obligation municipal bond issues in California require a 2/3ds approving majority of voters although some can be approved by a simple majority. Under California statutes the amount of bonds outstanding is limited to a percentage of the assessed valuation of the issuer (5% for counties, 5% for school districts, 15% for cities, etc.) These have been considered adequate safeguards for taxpayers even though bonds are secured by unlimited property taxation. While bond issues can be approved in excess of debt limits, they cannot be sold until outstanding debt is paid off and/or assessed valuation increased. Unfortunately in recent years it has been popular for local government to find other ways to finance public improvement programs, thus circumventing statutory protection accorded voters and taxpayers. Under Proposition 13, new general obligation bond issues would be subject to the tax and assessed valuation limitations of the initiative which would effectively put a stop to the growth of new debt.

The initiative also prohibits the issuance of bonds relying upon property taxes without voter approval. While it is a desirable objective to curb excessive debt, particularly debt which impacts the property tax rate without voter approval, the proposed limitations do not provide for normal and expected obsolesence, growth and environmental needs. Nor do they provide for war, acts of God and catastrophies as well as debt re-structuring. Most municipalities have 5 year capital improvement programs projecting their needs for both new facilities and the replacement of others. Inability to go to the voters with adequate bond proposals will invite on the one hand new forms of debt to circumvent the limitations and on the other hand a losing battle to properly maintain existing facilities which means ultimately a capital replacement or a shutdown.

9. The State of California is not immune from the impact of the ballot proposals. The State's general obligation bonds carry the highest rating (Aaa) and its general fund has a comfortable surplus. While the State has the authority to levy a property tax it has not done so since 1910, though it has been suggested as a means of providing school funds. In effect the State is financed by business-cycle taxes. If tax rates remain constant, revenues increase during periods of economic growth and decline during recessions. If budget authority increases expenditures, the general fund surplus declines. Once expended it cannot be replaced unless expenditures decline and/or revenue sources increase. There have been periods in California history when the State has provided financial aid to its political subdivisions and there have been times when the State was hard pressed to pay its bills. It is easy to say it can't happen again --- but the State of California is not the Federal Government. It must balance its budget - no deficit financing and no authority to print money. Its ability to borrow is strictly limited by its constitution. So to think that the State of California has unlimited resources to meet the needs of local government is a fallacy. When the demands are too great the State cannot afford to risk its solvency by helping beyond prudent judgement. Witness what happened to New York State when New York City and Yonkers pleaded for help. The State was already having problems with several of its "moral obligation" authority bond issues. It could

only go so far and hoped the Federal Government would save the city. The potential additional revenue accruing to the State of California - as supporters of Proposition 13 indicate - could be illusory. The financial problems of local government would fester and soon would infect the financial well being of the State. No one could win under such circumstances.

TO SUMMARIZE: Voters and taxpayers face a no-win decision if Proposition 13 is approved. Despite the desirable objectives of tax reform and property tax reduction, the ultimate effect would be to reduce local government to a state of financial and managerial impotency. Voters and taxpayers would find that the sensitive credit markets for the municipal bonds of the State, and its counties, cities, school districts, etc., which have been carefully nurtured over the years at favorable rates of interest, would react. Institutional investors, particularly those domiciled outside of California, would accelerate their credit reviews. They would not only look at the property tax but all other sources of revenue. They would seek legal advice on the priority of payment as well as enforcement of payment of their holdings and they would tak a long hard look at the potential burden of unfunded public pension plans. All of which could mean a very disturbing and potentially explosive period for California, its voters and taxpayers. Should Proposition 13 be approved and its impact felt in the financial centers of the U.S., economic growth, so essential to California's economy and the employment of its growing work force, would be slowed. What is proposed is not really property tax reduction, but a tax shift. Proposition 13 implies that today's tax dilemma is the fault of government when it is really the apathy and self-interest of voters. To attempt to unglue what has been developing over the years by a drastic constitutional change is to invite ill-considered and badly conceived remedies in an emotionally charged atmosphere. This is not good government and it is not prudent judgement. Voters and taxpayers will be the losers.

Sincerely,

Alan K. Browne

AKB:eh

June 22, 1978

PROPOSITION 13 - THE AFTERMATH

By

Alan K. Browne

Campaign rhetoric that preceded California's primary election on June 6, 1978 has subsided. The results are in and leave no doubt as to the mood of the California voter. The almost 2 to 1 vote in favor of Proposition 13 is indicative of taxpayer's concern that has been building up in recent years, particularly in the last two years.

Replacing the campaign arguments is the almost unprecedented media coverage of the election results, its implications and the proposed implementation of Proposition 13.

As Proposition 13 takes effect July 1, 1978, the remaining days will see a flurry of action. First has been the filing of suits with the Supreme Court to contest all or part of the initiative, followed by the filing of briefs by the State Attorney General's office in defense of Proposition 13. Early action by the court can be expected.

Meanwhile California's Board of Equalization has been determining how county assessors as well as the State will assess property for the 1978-79 fiscal year.

In addition - local units of government, some 5000, are facing the difficult task of setting their 1978-79 budgets and determining the source of funds now drastically cut by Proposition 13.

In keeping with the emergency created by the passage of Proposition 13, the Governor has called a concurrent joint special session of the legislature to be held along with the regular session. The legislature is tackling the problem of allocating the State's surplus to assist local government, including the school system, providing emergency funds for local government and addressing themselves to the State's budget.

In the coming weeks and months much more will be heard on the subject of California's property tax revolt and what it means. It will require a continuing review and assessment of each governmental decision. For those who are concerned with municipal finance there are a number of facts emerging which should be considered as future guidelines in dealing with State and local government.

1. Analysis of the California election will provide statistics to prove almost any conceptual approach as to why voters responded as they did. It is known that California has had high property taxes. During the last two years the sale of single family homes has reflected an unusual degree of inflation, some the result of normal housing patterns, but much from speculation. Under existing law property was re-assessed to reflect the changing market level. However, instead of a reduction in tax rates to equalize budget needs, local government budgets expanded and tax rates were seldom if ever reduced.

2. Typically, California's voters when given the opportunity to express themselves in the voting booth, usually responded intelligently to the issues

and candidates. However, apathy and self-interest were often the motivating factors. Attendance at public hearings on legislative matters were minimal. They had voted their candidates into office and they expected them to perform. In effect, the average voter did not understand what were the causes behind higher taxes - but they could feel the effect as a personal matter.

3. Proposition 13 provided the voters with an opportunity to express their frustrations and lack of confidence in government. They were sending a message that they wanted less (expensive) government and lower taxes. They were not too concerned with details as many did not understand the initiative and its overwhelming impact on State and local government finances. In the past voters have usually listened to warnings when ballot measures were interpreted as being potentially harmful to the credit of State and local government. They understood what higher borrowing costs meant and also the possibility that some units of government might be excluded from the marketplace. But - on June 6, 1978 it was a whole new ballgame. Warnings were disregarded. It was a game of "Truth or Consequences".

4. Voters were also telling their public officials that they disapproved of the never ending transfer of their tax dollars to non-productive programs conceived in Sacramento and Washington.

In addition - there are some interesting aspects of Proposition 13 which should be kept in mind:

1. The property tax reduction applies across the board so that business property benefits as well as the single family home owner. This can improve the financial statement of many business'.

2. Despite the fact that California has a high percentage of renters, there is no relief for them under Proposition 13. Only the hope that landlords might pass on some of their tax savings.

3. If and when the State subvents any or all of its surplus to aid the school system and local government, it is expected this will provide an economic stimulus, possibly for one year.

4. The State's surplus invested in money market instruments, presents a possible market factor to be considered when being liquidated.

5. An unexpected beneficiary of Proposition 13 will be the U.S. Treasury due to the reduction of income tax deductions for property taxes. Those who will be hurt the most will be public employes, senior citizens, minority disadvantaged and the handicapped.

6. Proposition 13 appears to be in conflict with the Serrano decision school finance reforms that are still subject to review by the State's Supreme Court. It will take time to determine the impact on the reforms and it may be necessary to return to square one.

Predictably the early moves on the part of public officials to deal with the impact of Proposition 13 seem to be retaliatory. However, common sense and reason now appear to be the moving forces behind the decisions being made. Some of the areas that need careful scrutiny are:

1. The State of California and many local units of government have built up reserves and surplus' over the years. Where not specifically pledged by a trust indenture behind a bond issue, the trend is to channel these funds into general fund expenditures. A one time shot-in-the-arm is hardly an answer to a cash flow problem. Public officials must carefully weight the temptation to expend such surplus funds to continue a way of life which the voters disapproved. Once the funds are gone and the interest earned is no long accruing - how will government make up the difference?

2. Cash management at the State and local level will undergo changes. The ability to earn interest on investments and/or deposits will be reduced by tax reduction of investable funds. In addition - the borrowing in anticipation of tax and revenue receipts will be somewhat less flexible.

3. Bonded debt limits prescribed by the State's constitution and statutes will require re-computation as the assessed valuations are returned to the 1975-76 fiscal year and adjusted upward under the new limitations. This may mean some units of government will be over their debt limits while others will be unable to incur much new debt, if any, (voters willings), Computation of overlapping debt may reveal a few situations where the burden might be considered excessive.

4. Proposition 13's limitation on the imposition of new taxes will probably produce numerous concepts of how to raise additional funds. Ingenuity and imagination will play a prominent role in the quest for revenues, but public officials must be careful that levies are not counter-productive, chilling economic growth and employment.

5. In recent years all levels of government have been moving toward paying fees for services rendered by the private sector rather than using compensating balances. This is more businesslike and can show positive savings. Now California's State and local government have a golden opportunity to follow this trend in establishing fees and charges for various municipal services previously supported entirely or partially out of the general fund. It is a practical way of having the user pay for benefits received - and when appropriate, if the entire community is the beneficiary, subsidizing to the extent necessary or desirable. Self-liquidating projects will be financed by revenue bonds rather than reliance on general obligation funding.

6. Government has a way of acquiring and squirreling away property presumably used or to be used for a public purpose. Plans change, buildings and facilities become obsolescent, and growth patterns are altered. Proposition 13 will provide a stimulus for public officials to check their public property inventory and develop plans for liquidation of that property no longer needed.

7. Another opportunity provided by Proposition 13 is to review municipally owned utilities, transportation systems and recreational and convention facilities. Those that are fully self-supporting would obviously be retained. However, those that are not being supported 100% by the user and must be subsidized by other sources of revenue, including the Federal and State government, should be subjected to critical analysis to determine cost-benefits and the desirability of continuing operations, sale or shutdown.

8. When in financial difficulties, each layer of governments tends to seek help from the next higher level of government all the way up to the Federal government. New York City has been a prime example. Much or the opposition to

a Federal guaranty of New York City paper has been the precedent it would establish. Unfortunately those seeking help cannot see the forest. However, aside from New York's problems, peculiar to its own lifestyle, some of its trauma can be traced to State and Federal legislation which ensnares New York City through its financial participation. Proposition 13 should be a warning to State legislatures and The Congress of the United States that passing legislation which imposes a financial burden on lesser levels of government without determining their ability to raise such funds at the local level is invitation to financial insolvency. What is needed is a cost-benefits analysis before enactment. In addition -- the intrusion of "big brother" into local affairs is contrary to the concept of "home rule".

9. Not much was said during the Proposition 13 campaign concerning the non-productive cost of government regulation and its impact on taxpayers. Whether it is passed-on-cost to the consumer by business and industry or a governmental cost to support the bureaucracy needed to regulate. The well meaning enthusiasm of government types to protect us from ourselves and to protect the environment has resulted in many decision that add to our tax burden without commensurate benefits. Proposition 13 is a timely warning that taxpayers are fed up with government costs that tend to be non-productive. Considering the far reaching effects of Proposition 13 it is a wonder that an environmental impact report was not required or requested.

10. Proposition 13 effectively insures that California's outstanding voted general obligation bonds are secure and will continue to be met from unlimited ad valorem taxes or assessments. Fully self-supporting revenue bonds will continue to look to the user to pay debt service. However, there are many other non-voted municipal bonds that do not have the same protection. These are paid from special taxes and general fund transfers. All have been legally issued and purchased by investors who have provided the funds for many public facilities. I do not think it was the intent of Proposition 13's proponents to jeopardize the creditworthiness of the State of California or any of its units of government by reducing or impeding the cash flow to service outstanding non-voted debt. They are fully aware that debt incurred and purchased in good faith if allowed to default would do more than harm the investor. It would impact the issuers credit for years to come and would only add to the tax burden. Therefore, it is imperitive that such issuers take immediate steps to insure that they continue to meet their obligations in the same manner as voted bonds.

11. The California State Legislature "can giveth and can take away". The statutes of the State are crowded with enabling legislation which authorizes the creation under prescribed procedures of innumerable political entities, each unit with it revenue raising and debt incurring authority to meet every conceivable public need. The legislation has been drafted by individual legislators, legislative counsel or special interest groups, including local government, the securities industry and the legal fraternity. With the passage of time and the sophistication of the securities industry, there has been a tendency to create statutory vehicles which tend to circumvent voter approval and debt and tax limits. Some of the debt created under certain statutes, directly or indirectly, impact the taxpayer either by a special tax, access to the property tax, or access to the general fund. While such debt has probably not substantially raised taxes, there are situation where the impact has been noticeable. Proposition 13 pinpoints the need for voter approval of tax supported debt. Recognizing the perspicacity of the financial community in designing and marketing a variety of debt instruments, the securities industry must share responsibility

with public officials in making certain that taxpayers-voters know the cost-benefits of proposed financing and in turn cast their ballot either for or against the issue. Resorting to "back door" financing should be a no-no for public officials.

12. Despite emphasis placed on financial reporting by State and local government, it is doubtful that the average voter-taxpayer is aware of the issue. They may see an annual financial statement, a copy of the budget and a statement of taxes, but probably not all. Most would not understand or even attempt to seek an explanation - yet to all intents and purposes such publications do disclose the financial well being of the political entity, its revenues and the sources and how they are spent. Many levels of government have tried to communicate with their constituents and have produced exemplary reports - but not all. Proposition 13 in effect asks government to be much more frank in explaining their actions and their costs. R porting to the voter-taxpayer should be worded as simply as possible and there should be no doubt as to what governmental services are costing and how they are being paid for. It is one thing to use acceptable accounting and statutory terms understood by professionals - but it is another matter when presenting a financial statement to those who are not familiar with such terminology or phraseology.

13. Special interest groups have usually opposed the State's involvement in local government affairs as a metter of self-interest rather than public interest. What is often overlooked is that all levels of government below the State level have been created by Acts of the Legislature either through constitutional provisions approved by the electorat e or by statutory authority. This is why Federal-local efforts to bypass a State is contrary to sound public finance. It is timely for State government to collate all assistance programs for local government to be either administered, reviewed and approved by a State official, preferably a constitutional officer such as the State Treasurer. In keeping with the times, State government should be geared to assist its local governmental units when they need help. Legislation should be enacted to provide a variety of viable methods, including insurance, to protect their financial well being. Fortunately some progress has been made in this direction, but more can and should be done if Proposition 13 is to be carried out without any serious financial flaws.

The full impact of Proposition 13 on California's way of life will not be known for some time. Because of the early effective date of the initiative (July 1, 1978) there will not be enough lead time to produce legislative action which will reflect a high degree of thoughtful and prudent consideration.

The State Legislature and the governing bodies of local governmental units are all faced with the necessity of dealing with a voter decision, frequently referred to as a "meat axe" approach to reduce property taxes. It is not enough for taxpayers to "pass the buck" on to their duly elected public officials without participating in the decision process. As Senator Robert Byrd said recently to reporters - "Big government is the result of Big demand". "It is one thing to demand lower taxes but another to pinpoint the services that should be cut".

It is no time for hyperbole. Proposition 13's passage provides a unique opportunity for government at all levels to address themselves to governing the people within the constraints mandated by the electorate. It means less government and more citizen participation. No matter how well conceived, programs which could increase the tax burden must be carefully scrutinized and explained to the voters on a cost-benefit basis allowing them to record their views. The temptation to shift the tax burden from property to other taxable sources or to expect that some higher level of government will assume all or a portion of the tax load is unrealistic as it implies "business as usual" rather than a reduction in the cost of government - which is what Proposition 13 is all about.

WALL STREET JOURNAL
MONDAY, JUNE 5, 1978

'Meat-Axe Radicalism' in California

By WALTER HELLER

The property tax revolt is reaching white-heat intensity. How else would a radical measure like the Jarvis-Gann Initiative (Proposition 13) have a good chance of passing in California tomorrow even though a superior and more moderate alternative (Proposition 8) appears on the same ballot?

The apparent determination of California voters "to send them a message" through Proposition 13—at a tax loss of $7 billion a year, perhaps the most costly message in history—has evidently caught the country's imagination:

Item: This is the second article on Jarvis-Gann in two weeks in this space. (See Jude Wanniski's article of May 24, plus the subsequent letters on June 2.)

Item: Just last week, 50% of the respondents in a Minnesota Poll survey voiced approval of the Jarvis-Gann amendment (even though significant property tax relief has already been voted in Minnesota).

Item: Whether one appears before audiences in Norfolk, or New Orleans, or New York, one of the first questions from the floor concerns Jarvis-Gann.

The Essential Elements

Yet at the peak of this inverted pyramid one finds a seriously and perhaps fatally flawed proposal. The essential elements of Proposition 13 are as follows:

—It slashes the maximum property tax rate to 1% of the full cash value (1975-76 assessed value) of real property.

—Assessed values may not be increased more than 2% per year except on property that changes hands.

—At the state level, the majority vote is replaced by a two-thirds vote requirement for new or increased taxes. New taxes based on the value or sale of real property are banned.

—No new substitute taxes can be levied at the local level unless approved by two-thirds of the "qualified electors."

Far from being a constructive "experiment in democracy," Proposition 13 would help dig the grave of local self-government. It would rip the heart out of local finances by chopping away nearly 60% of the $12 billion of local property taxes. And by freezing assessments (except for the glacial thaw of 2% a year) and requiring a two-thirds majority of all electors for any new taxes, it would bar any life-giving local tax transplant.

Chaotic cuts in local school, hospital, police and fire services would be the order of the day. Indeed, to meet advance-notice requirements, wholesale dismissal letters have already gone out to a large number of teachers in San Diego, Los Angeles and other communities. The strangled local governments would be forced to turn to the state for fiscal handouts, not just from existing surpluses, but permanently. State sales and income taxes would have to be boosted.

Apart from this erosion of local self-reliance, since when is it good democratic practice to imbed in the Constitution measures that prevent elected representatives from responding to the changing needs of the electorate? Indeed, under Jarvis-Gann, the fiscal noose would grow tighter and tighter. Rolling back assessed values to 1975-76 would cut the initial effective rate on today's values to perhaps three-quarters of 1%. And with market values of real estate growing at even a "modest" 10% a year, the 2% limit on growth in assessed values would cut the property tax ceiling to less than one-half of 1% of market values within a few years. By putting legislators in such fiscal irons, the new constitutional tax limit would enfeeble government and weaken democracy.

Even apart from broader questions of fiscal management and philosophy, the effects of Jarvis-Gann would range from capricious to deplorable.

Board of Contributors

By putting legislators in such fiscal irons, the new constitutional tax limit would enfeeble government and weaken democracy.

The provision freezing assessed values to the 1975-76 level (except for the token 2% annual rise) for properties that do not change ownership, while permitting properties that change hands to be appraised at the full market value at the time of transfer, is anomalous, not to say weird. Two properties of identical market value could have sharply different assessed values if one of them were sold after March 1, 1975. This unequal treatment of equals flies directly in the face of constitutional tax principles. And the lock-in effect, the restriction of mobility, the inequities between those who can stay and those who have to go, make this provision a nightmare.

Nothing in Proposition 13 requires a pass-through of benefits from landlords to renters. And the slow and viscous process of competition in housing offers little promise of relief to renters. Those who are too poor to own their own homes take it on the chin twice—once as renters and again as recipients of curtailed local services.

To the surprise of many, the biggest bonanza under Jarvis-Gann goes to Uncle Sam. A UCLA study shows that $2.7 billion of the $7 billion denied local governments would end up in the U.S. Treasury as a result of shrunken income tax deductions.

The UCLA econometric model also shows a loss of 300,000 public jobs, plus 100,000 private jobs, under Proposition 13—hardly the economic tonic that proponents promise.

A Constructive Alternative

Fortunately, Californians will have a constructive alternative when they enter the voting booths tomorrow, namely, Proposition 8, which would activate Senate Bill 1. Under the prod of Jarvis-Gann, the legislature passed and Gov. Brown signed SB 1 providing: (1) a 30% immediate property tax cut for homeowners, to be financed primarily from the state's $3 billion budget surplus, (2) a curb on local property tax revenues by limiting their growth to the rate of inflation (specifically the rise in the GNP deflator) plus taxes on new construction, a combination that would save taxpayers about $1 billion a year by 1983; (3) added relief of about $175 million a year for renters, together with liberalized relief for senior citizens; and (4) an implicit curb on new state spending by dedication of the existing state surplus to property tax relief, plus an explicit curb by a complex formula tying the rate of growth in state tax revenues to the rate of growth in state personal income.

Thus, Proposition 8 offers sizable relief for hard-pressed homeowners without crippling effects on local self-government, on essential services, and on the California economy.

But there is an electoral booby-trap. If *both* 8 and 13 pass, 8 is preempted and 13 prevails. And since 13 is self-contained while 8 is a bare-bones authorization that requires a knowledge of SB 1, the balance may be swung by ignorance.

And speaking of ignorance, or misunderstanding, one finds that a blizzard of higher assessment notices has generated a last-minute surge of sentiment for 13 even though much of the impact of higher valuations will be offset by lower tax rates.

Clearly, governments the country over need to be brought to book, they need to deliver more value per dollar of tax, and they need to deliver excessive tax dollars back to the taxpayer. But all of that can be readily granted without committing fiscal hara-kiri.

One has to hope the Californians will send their message to government via the moderation of Proposition 8 rather than the meat-axe radicalism of Proposition 13.

Mr. Heller is Regents' Professor of Economics at the University of Minnesota, former chairman of the Council of Economic Advisers under Presidents Kennedy and Johnson and a member of the Journal's Board of Contributors. An editorial on this subject appears today.

THE WALL STREET JOURNAL, WEDNESDAY, JUNE 28, 1978

The Meaning of Proposition 13

By IRVING KRISTOL

Having just spent a couple of weeks in a California suburb, I had a ringside seat from which to observe the turmoil created by the passage of Proposition 13. It was a fascinating experience. For the first time one could witness a direct confrontation between middle-class Americans and the politicians who preside over the ever-expanding public sector. The politicians, utterly confident they had been riding the "wave of the future," lost badly and gracelessly. They still cannot understand why or how it happened.

I also find, on returning to New York, that many of our professional interpreters of the social scene don't quite understand it either. They see little more than a self-serving rebellion of the "affluent" against government spending which favors the poor and unfortunate. But that is not what Proposition 13 was about at all.

To begin with, it is ridiculous to talk as if all government services were of primary benefit to the poor. Summer schools, for instance, now closed in California, may be useful to some poor kids, but they are no less useful to children of the middle class, and they are beyond all doubt profitable to middle-class teachers. There are precious few social programs that do not massively benefit middle-class professionals of all kinds—which is hardly surprising, since it is these professionals who devised those programs in the first place.

Who Is 'Poor'?

Moreover, there are far fewer truly poor people in this country than the conventional statistics suggest. The greatest distortion results from neglecting the factor of age. A couple of married graduate students who are "making do" on an income, say, of $4,000 a year may frequently be broke, but they are in no sense "poor"—nor do they so regard themselves. Poverty in a society such as ours is not merely a function of money income. Prospects are at least equally important.

And so are what might be called "retrospects." An elderly couple on Social Security is not necessarily poor. They may have modest savings which they can draw on to supplement Social Security. They may own a house, mortgage-free, on which they can borrow. Or, and above all, they may have children who contribute to their support. This last is a possibility that liberals regard as distasteful, since they see it as a private usurpation of a public responsibility. But not all children or parents are of this opinion.

Similarly, a household with an income of $30,000-$40,000 a year, as a result of husband and wife both working, is not necessarily "affluent." There are taxes to be paid, mortgage payments to make, two cars to support, and perhaps a child (or two or three) who is going (or will soon go) to college. Such a household has to struggle to make ends meet. That is not what "affluence" is supposed to mean.

Having said that, one must quickly add that there are indisputably people in this country who can fairly be called "rich" or "poor." But their combined electoral significance is negligible. The overwhelming majority of Americans are—actually, prospectively or retrospectively—middle class. And the reason Proposition 13 was passed so enthusiastically, in a state with a liberal governor and legislature, is because the politicians, bemused by fantasies of "small is beautiful" or "fair shares for the underprivileged," forgot that home ownership is a central passion of this middle class.

Most Californians (like most Americans) own their own homes or aspire to do so as soon as possible. But inflation, combined with a series of "no-growth" measures by the state and various localities, have sent real estate values soaring. The ironic, indeed absurd result was that Californians found themselves so house-rich that they could no longer afford to live in their own homes!

Board of Contributors

It worked this way. A house purchased for $45,000 10 years ago might today, as a result of inflation, have a marketable value of $125,000. Real estate taxes, based on current valuation (as they should be), will have increased from $1,000 annually to $3,000. But the after-tax income of the homeowner has surely not trebled—the progressive income tax, federal and state, plus increased Social Security taxes, see to that. So what is the homeowner to do?

From a purely "economic" point of view, the rational thing for him to do is to sell his house, realize his capital gain, and live elsewhere more cheaply. But where is elsewhere? It is not in California, where he can no more afford to buy (or rent) than he could support his original residence. He can, it is true, migrate along with his money to South Dakota, where real estate values are much lower. But for some reason or other Californians seem strongly disinclined to move to South Dakota. They prefer something like Proposition 13.

In a sense, then, Proposition 13 was a vote against inflation—and especially the unholy alliance of inflation, deficit spending and increased taxation. A cynic would note that, had specific cuts in government spending been defined, that majority could easily have fallen apart. But the voters knew that well enough—which is why they left it to the politicians to make the hard and controversial decisions. Isn't that what politicians are for?

What is really astonishing is that California's state government did not see this tax rebellion coming or do something to forestall it. It was sitting on a $5 billion surplus, after all, so it was in a comfortable position to cut the income tax, or the sales tax, or the property tax, or some combination of all three. It had plenty of time to contemplate a more "finely-tuned" tax cut than Proposition 13. But there was little talk of tax cuts—only of new ways of "distributing" the surplus to this group or that program. If there was going to be any tax cut at all, it was evident that only a "meat ax" could do the job.

Once passage of Proposition 13 became a possibility, politicians reacted with a fury matched only by their own demagogy. Dismissal notices were sent to all teachers, contingent on the outcome of the referendum. Libraries and hospitals put up closing notices, with the same contingency clause. Rarely has there been such a disgusting episode in American state politics—one in which politicians, fighting for control over their constituents' money, lied and threatened and lobbied without scruple. It was a new kind of class war—the people as citizens versus the politicians and their clients in the public sector. And the people won.

Now that Proposition 13 is law and the politicians are having to live with it, it is becoming clear that the effects will not be nearly as painful as had been predicted. The welfare population will be but minimally affected, suffering only the loss of a cost-of-living increase to welfare rates that are the nation's highest. The major groups that will be adversely affected are the public employes, whose unions had been granted high wages and exceedingly generous pension agreements. (Half of Los Angeles real estate taxes go to pay for such pensions.) There is no way in which the politicians could be persuaded to stand up to those unions without something like Proposition 13 to provide the necessary backbone. There will be some turmoil, even a few strikes—but if the money simply isn't there, the politicians cannot spend it.

Changing the Climate of Opinion

In the end, there is the most important possible effect of all: a change in the climate of opinion affecting the issue of economic growth. One has to put the matter in so qualified a way because an awful lot of important people in California who don't like the idea of economic growth believe that Californians would all be happier if only existing "affluence" were more equally shared. As a consequence, there will certainly be efforts to raise taxes on business, to "compensate" local governments for lost revenues. San Francisco has already moved in this direction—which will hasten the decline that city is already experiencing, and be a further stimulus to now-booming Reno, not far across the state border.

The enemies of growth—in high office and out—are still well entrenched in California. They will work very hard to nullify the intent of Proposition 13, since they see larger political and ideological implications in it, with further efforts to restrict the size of the public sector along with further efforts to encourage private savings and investment. I think they are right about this, if about nothing else. That is indeed what Proposition 13 was ultimately about: economic growth in a free society vs. the allocation of income and wealth by government in a stagnant economy.

Mr. Kristol is Henry Luce Professor of Urban Values at NYU, a Senior Fellow of the American Enterprise Institute and a member of the Journal's Board of Contributors.

FISCAL WATCHDOG

Column 20
June 1978

COPING WITH TAX CUTS

By Robert W. Poole, Jr.

By a two to one margin California voters have approved Proposition 13, the Jarvis-Gann initiative. As of July 1 California property taxes will be slashed by about 60%. Similar property tax limit measures are pending in seven other states, and state tax limitation petition drives are under way in 27 others.

The era of free spending by cities and counties is ending. Taxpayers have made it clear that what they want is not more and more services, but a reduction in the size and cost of government. So today's number one local issue is: How can cities and counties cope with reduced budgets?

To begin with, it's important to understand the size of the cuts. In California, like most states, property taxes make up far less than half of most local governments' revenues. The actual cuts resulting from Jarvis-Gann will average about 12% for cities, 15% for counties, and 30% for school districts.

As readers of this column know, savings of this size can be produced by a variety of innovative methods. It is not necessary to take a meat-axe to local services. What's needed is an intelligent application of business-like methods, and some rethinking of what services taxpayers should be asked to pay for. Below is the briefest overview of the types of changes that can do the job.

- Fire. The use of paid reservists instead of full-time firefighters for up to half the force can save 20 to 40% of a fire department's budget. Using modified tract houses for suburban fire stations can reduce station costs by 60%. Computerized fire station location planning can often reduce the number of stations needed--and thereby the number of men and trucks. Contracting with a private firm can save up to 50% of the total cost of a fire department. In suburban and rural areas, private subscription fire departments cost 50 to 75% less than municipal departments--and only the subscribers pay. (Subscribers get a break on their insurance rates.) Some small cities and towns have abolished paid departments and returned to volunteer departments--cutting tax costs to zero.
- Paramedics. There is no reason for local governments to operate or

subsidize paramedic service. Already, 50% of California's paramedic programs are run by private companies. Direct comparisons of public and private paramedic operations show over 70% less cost for the private firms. More important, since nearly all private hospitalization insurance and Medicaid programs pay for paramedic services, there is little reason for local government to subsidize paramedics, even where a private firm provides the service. In Santa Barbara County, the private paramedic firm bills all users, and the county government pays only for service to true indigents. The cost to taxpayers is less than 2¢ per person per year.

• Police. Large cities can save nearly 50% on police patrol costs by switching from two-man to one-man patrol cars. A Police Foundation study showed that one-man cars performed virtually the same as two-man cars. The use of compacts instead of full-size sedans can cut vehicle operating costs by one-third. Many routine public service duties can be transferred to civilian police aides--up to one-third of the force--at about one-half the salary of sworn officers. Costly support services like dispatching and crime labs can be consolidated and shared among several cities. Smaller cities can often contract with a larger, adjacent department at up to 40% savings over operating their own force. Switching to ten-hour shifts with two of them overlapping in the (high-crime) evening hours can put more officers on the street when most needed--at no increase in cost.

• Parks and Recreation. City recreational facilities like beaches, tennis courts, and museums are really no different from bowling alleys, movie theaters, and amusement parks. People expect to pay for the latter when they use them--and should learn to pay for the former as well. There is no reason why all taxpayers should pay for the tennis courts used only by a few, any more than they should be taxed to provide "free" bowling alleys. All such programs can be made self-supporting by user charges, and removed from the tax burden. Public parks can be maintained by private contractors at savings of 10 to 30% compared with municipal crews. Or neighborhood groups and local businesses can be organized to take responsibility for local park maintenance at their own expense--saving taxpayers 100%.

• Garbage. A Columbia University study found that it costs 68% more for a city department to collect garbage than for private firms to do so. Across the country more cities switch to private firms every year. Other cost-cutting changes include modern one-man trucks (30 to 40% savings) and computer-designed pick-up routes (10 to 20% savings).

• Public Works. A management technique called "work measurement" redesigns jobs for greater efficiency. It has saved many cities 20 to 30% of their public works operating budgets. Using private contractors can also save money in areas like street maintenance, traffic signal maintenance, and pavement striping. This way the city can avoid tying up millions of dollars in specialized but little-used equipment, and need not worry about keeping a large work force occupied. It pays only for work that's actually needed. Major city systems--water, sewers, harbors, airports--can be put on a fully self-supporting basis by appropriate user charges, removing them completely from the tax burden.

• Welfare. Errors and fraud plague most welfare programs. Yet Los Angeles County cut the error/fraud rate from 14% to 2.67% in just four years, using new management methods and a computer system. Estimated four-year savings: $60 million.

• Data Processing. A number of cities and counties have turned over their entire data processing departments to a private firm--at a guaranteed saving of 30%. In Orange County, California, 98% of the employees accepted jobs with the company, but after two years only 72% remained in the data processing operation. The others had either left via normal attrition or had been promoted to other jobs within the company.

These are only a few examples of the many innovations we at the Local Government Center have identified over the last few years. (More are described in my handbook, Cut Local Taxes--Without Reducing Essential Services.) Though most are in use in only a few cities or counties, all are fully proven, workable techniques. And all produce impressive savings--of 20%, 30%, 50%, or more.

The important point for taxpayers is that sharp cutbacks in property taxes need not cause chaos or disruption of vital services. Officials who claim otherwise are either sadly ill-informed or unwilling to be responsible.

The Untested Medicine

By Marsha K. Strong

OJAI, Calif.—Just like any other town in the state of California, the small resort community of Ojai is undergoing numerous changes due to the passage of the Jarvis-Gann initiative (Proposition 13). Many services are being cut back. Parks will have no caretakers. Schools are cutting curriculum. Summer school has been called off. Libraries are closing down or close to it. Firefighters are being laid off. Jails are being closed.

To the casual observer the sky is falling. But the rest of the nation is watching California, and they are *not* casual observers. The guinea pig has been fed the experimental formula and the nation sits back to see if it thrives or dies.

Opinions are still varied only one month after Jarvis-Gann became law. Doomsday preachers still claim that the end is near. Jarvis-Gann backers still wave their fists in protest that government is thumbing its nose at the taxpayers, cutting back on necessities and keeping the extras.

This is without a doubt positive proof that we, the people, are in the same type of situation our founding fathers were in when they rallied against "taxation without representation." The people have made their wishes clear. But the politicians in their positions of power act in opposition to the wishes of the people. In short, taxation without representation.

Yes, California is still in upheaval. And it probably will be for some time to come. But the people in Ojai, as in other California towns, are taking this rare opportunity to make the first steps toward doing away with big government. Jarvis-Gann may not be perfect, but it has opened up some doors that were never open before.

When Ojai learned that its library would be shut down due to lack of funds for staffing and supplies, a committee was quickly formed to save the people's library. Volunteers came forth to man it, donations pledged to supply it, and the library will remain — now, more than ever — the people's library. The community, which always took pride in its little library, will now have a greater pride because it will now feel *directly* responsible for its existence and maintenance.

Teachers and taxpayers have joined in this small town to demand that the school board cut back in the area of administration rather than curriculum. An alliance of this kind would never have come about without Jarvis-Gann. And, though it is still too early to tell who will win the battle, the point is that the people have been drawn together in this common bond.

So, for the nation who watches California with the interest of a scientist observing a guinea pig, please take careful notes. The patient is still sick and is suffering from monstrous blows to its life-giving sources. It is, however, at the same time beginning to discover that it has more control over its own life-giving sources than it had previously realized. And it is thusly slowly gaining an almost superstrength. There will probably always be internal scarring left from the mightly battles this test animal has undergone. But I believe, that the test animal will not only live, but be better off in the long run. And it is my opinion that one day a good, stiff dose of Jarvis-Gann-type medicine will be prescribed for the rest of the nation in order to keep the political nasties from getting total control of our country.

Marsha K. Strong is a writer who contributes editorials to the Ojai Valley News, in Ojai, Calif.

July 19, 1978, New York Times, Page A21

C A L I F O R N I A   D R E A M I N G

Some Observations on the Taxpayers Revolt

Norman R. King

City Manager

Claremont, California

July, 1978

CALIFORNIA DREAMING: Some Observations on the Taxpayers Revolt

CALIFORNIA DREAMING

CALIFORNIA DREAMING: Some Observations on the Taxpayers Revolt

On June 6 California voters overwhelmingly (65 percent) approved proposition 13, labeled by some as the taxpayers' initiative. Proposition 13 will restrict property taxation to one percent of market value; roll back property assessments to 1975 levels until the property is sold; require a two-thirds vote of the legislature to increase state taxes and put real property virtually off limits to new taxation. It provides no methods of offsetting the loss of approximately $7.5 billion in local revenues in the fiscal period beginning July 1, 1978. The only sure thing is that the effects of proposition 13 will be pervasive and largely unpredictable.

There is much discussion of a nation-wide tax revolt. There are many ways to limit government spending, right ways and wrong ways. The following observations are written for those who will be facing similar attempts to reduce government expenditures, by choice or by chance, and who would like to avoid some of the pitfalls which, unfortunately, the author believes that California has not avoided when adopting proposition 13.

I. THE TIME WAS RIGHT

The time was right. No one disagrees with that. In no particular order consider the following:

1. The State Surplus

The state government was reporting an unprecedented surplus totaling $3 to $4 billion accumulation at a rate of $1.5 billion per year. California's economic recovery from the 1974 recession was one of the most impressive in the country, and fueled by a progressive state income tax the surplus kept growing. Of importance was that much (some say most) of the surplus came from the individual income tax, not because of increased rates but because inflation-pushed higher earnings were taxed at progressive rates. Also, as sharply increased reassessments occurred in the past three years--due largely to increased assessment of single family homes--state funding for many school districts decreased under a formula which decreased state school support as local assessed value increased. This state surplus was well advertised and became a major factor in the campaign with many proponents of proposition 13 pointing that the surplus should be "returned" to the people and that proposition 13 was a vehicle that would do this. A final irony: The state surplus will grow more quickly by one billion dollars per year under proposition 13 because the state will receive higher income taxes caused by less deductible property tax payments and because the state funded "homeowners exemption" transfer will be reduced.

2. Housing Inflation

The value of single-family homes has been increasing phenomenally in California, particularly Southern California. One study showed that whereas in October 1973 the average price on an existing home in Southern California was $35,800 ($1,100 less than the national average) in April 1978 the average existing home in Southern California was priced at $83,200 ($26,200 more than the national average). These values pushed assessments up rapidly and although the overall tax declined somewhat over the past three years, most homeowners experienced increased property taxes in excess of the rate of inflation. On the other hand commercial and industrial property did not experience nearly the same rate of value increase as did single-family homes.

These rapid increases in the value of single-family homes, when combined with the federal and state income tax deductability of property tax payments, caused low and moderate income homeowners to receive tax increases disproportionate to the more affluent homeowners. (The reason for this is that a homeowner in the 50 percent combined federal and state income tax bracket will effectively pay only $500 more if his property taxes are increased by $1,000. The homeowner who is in a low tax bracket--such as 20 percent--pays an effective increase of between $800 and $1,000.) This situation especially angered retired homeowners who formed the initial but by no means exclusive strong support base for proposition 13.

In spite of rapid increases in assessments of single-family homes, both the state income tax and sales tax increased more rapidly in the past ten years than property taxes. The homeowner's share of total local and state revenues remained virtually the same (13.5 percent) for ten years. However, these facts meant little to those who felt that all taxes were too high and that proposition 13 was an appropriate vehicle to express that belief.

3. Failure of Legislature to Deal with Property Tax Relief

For several years the public has been used to hearing about the "tax reform" and "property tax relief" attempts of the state legislature. After a much-heralded session in 1977, a bill supported by Governor Edmund G. Brown, Jr. died in the senate after being approved by the assembly. The public was well aware that the state legislature had failed to do anything, and this was a major reason why many voters refused to believe that the passage of the "Behr bill", which led to proposition 8 appearing on the ballot as the alternative to proposition 13 (more later on this) and which was adopted in February after proposition 13 qualified for the ballot, was anything more than a last-minute sop offering no substance and no relief.

One voter wrote that "I find it interesting that our legislators in Sacramento waited until more than 1,000,000 Californians signed a state-wide people's petition to control taxation before they frantically came up with a piecemeal legislation in hopes of deterring and confusing the California voters from taking destiny into their own hands by voting for proposition 13."

4. The Los Angeles County Board of Supervisors

Another factor which contributed to the average taxpayer's belief that nothing less than a "revolution" was necessary and that the taxpayer must take charge were the antics of the Los Angeles County Board of Supervisors. This board of five members represents 7,000,000 people. Los Angeles County voters representing one-third of the state population often swing the balance in state elections. Unlike many other California counties in which property is evaluated and reassessed each year usually only one-third or one-fourth of Los Angeles county is reassessed in a given year (in fact, in the city of Claremont the assessor had not reassessed over half of the property within the city for at least ten years prior to 1975). In a time of rapid escalation of housing prices this cyclical reassessment procedure caused increases which frequently were in excess of 50 percent for some homeowners. (Though for the next two or three years the property would remain unreassessed.) In May, just in the heat of the proposition 13 campaign, the Los Angeles County assessor announced that the overall assessment role for Los Angeles County would increase by over 18 percent in 1978-79 with most of this increase coming from only approximately one-third of the county, and more importantly that three-fourths of the increase would be borne by homeowners although homeowners represent only approximately 35 percent of the overall value of property of the county. The five members of the board of supervisors had previously voted by a 3-2 vote to oppose proposition 13. In non-agendized action in early May, the board (with two of the supervisors who were in favor of proposition 13 voting) voted 3-0 to request the assessor to notify property owners of the increase of assessed value before the June 6 election. Normally, such notices of reassessment were sent out in July although prior to this the assessor had made available the tentative reassessments to owners who took the time to make a direct inquiry to his office. Then two weeks later, also in non-agendized action, the board voted 5-0 to request a rollback of the assessed value to the 1977 levels. Immediately members of the state board of equalization and others questioned the legality of such a rollback, but three days later the county assessor announced that the previously announced reassessments would not be implemented. The combined effects of these contradictory actions which were well publicized throughout the state and which to the public were contrived, inconsistent, and representative of their belief that "politicians" could not be trusted was to cause a sudden turnaround in the polls. Support for proposition 13 began to pick up again, after previous surveys showed the proposition beginning to lose support. In my opinion, these actions of the county board of supervisors were the death knell of those opposing proposition 13.

33-595 O - 78 - 32

II. THE CAMPAIGN

1. "Shift the Property Tax Burden" or Cut Government Spending"?

The tax revolution in California was built fundamentally on two not necessarily consistent premises. Many people supported proposition 13 out of a genuine personal concern that the property tax, as a source of government funding was inequitable and that funding must be shifted to other taxes such as the state income tax or sales tax. Probably a greater number of voters felt that they were voting for proposition 13 in order to tell the "politicians" that government spending must be reduced; that compensating revenue should not be raised; and that the only way to curb government spending was to reduce revenues so that the "bureaucrat" could not keep spending. The shifting back and forth between these two fundamental premises kept the proposition 13 opponents on the defensive. One moment a supporter of proposition 13 would state that no "essential services" would be curtailed because the idea was to shift funding to the state; the next moment a proponent, perhaps a different one, would argue that there should be no increased state funding to make up for the proposition 13 reduced revenues because the purpose of proposition 13 was to limit government spending.

A great deal of newsprint was blackened with letters urging that government be "disciplined". One lady stated, "The opposition does not discuss cost reduction in government services which is one of the main reasons for the proposal to cut down the revenues available to government spenders." Neil Jacoby, UCLA professor and widely quoted by proposition 13 supporters stated that "if the initiative should fail, California politicians will be free to pursue their present course of wanton spending which encumbers our economy and threatens the material security of our homes".

2. "Show the Politicians Who's Boss"

In some respects it is fair to say that the effects of the proposition are so overwhelming, diverse, and complicated that the average voter could only deal with the issue simplisticly. The proposition seemed to be an opportunity for the voter to cut government spending without being responsible for even offering advice as to what programs should be cut. The litany that "essential services would not need to be cut" from the proponents of proposition 13 was stated so many times that it seemed to become a truth unto itself even though "essential services" was never defined and certainly meant different things to different people. The shedding of the responsibility of the electorate to indicate to local elected officials what programs should be cut may be viewed as the ultimate "dropout" from the democratic process in which, under the guise of "showing the politicians who's boss", the people reduced funds available and turned over the decisions as to what should be cut to the same "politicians" who they claim don't represent them.

The average voter could truly not fathom for what he was voting. Not only are there many taxing agencies to whom property tax is paid (in the City of Claremont there are ten agencies which receive a property tax), but there is tremendous variation around the state in the degree of dependence on the property tax even among the same type of government agencies. For instance, though the budget of the average city is 27 percent dependent on property tax, the range is 0 to 60 percent. Schools are 47 percent dependent on the average, but the range is 20 to 90 percent. In this environment some cities, schools, and special districts were tremendously affected while others not at all. With this smorgasbord from which to choose, both the proponents and opponents could find any number of specific examples which would either be greatly affected or not be affected at all by proposition 13. The conflicting testimony as to what would happen was, of course, confusing to the average voter. Quite a number of agencies prepared "contingency budgets" before the election. However, because of the number of taxing agencies involved, it was difficult for the media to begin to either comprehend or convey the diversity of the impacts. Furthermore, the proponents were very successful in branding any possible major service reductions as being "scare tactics", and with the possibility of state reimbursement (however remote) the public agencies had to qualify their contingency budgets. This was often intentionally misread as being a "threat" or an attempt to "coerce votes".

In summary, the average voter had very little idea about what services would be affected, or the implications of proposition 13, nor did he care. The idea was to cut government spending, and a great many proposition 13 supporters sincerely believed that by forcing the politicians to cut the "bureaucratic fat" that there would be no noticeable impacts.

3. "Send a Message to Sacramento"

One of the most frequently played-upon emotions of the campaign was the idea that because the state legislature had refused to grant tax relief or tax reform the people should "get" the legislature. It was widely held by many voters that proposition 13, in fact, would impact state government although the $7.5 billion property tax revenue reduction will be extracted exclusively from local governments. Even on the last day of the campaign, Paul Gann, one of the initiators, stated that "the voters are telling Sacramento they are sore as hell". There was nothing more frustrating to a city council member, who having suffered from state-imposed mandates or state court decisions which increased the cost of local government in regard to everything from insurance to retirement systems, than being told by a constituent that he was voting for proposition 13 in order to "send a message to Sacramento".

4. "Vote for Jarvis"

One of the unique aspects of the campaign was the strong identity of Howard Jarvis with the ballot proposition. Aside from his colorful, if not rude and argumentative, personality, the inititiative took on a personality of its own. The opposition had no particular personal identity other than being "anti-Jarvis". Thus proposition 13 had the advantage of a personality to make the abstract idea concrete with no <u>person</u> running against him.

5. "One Percent is Enough for Property Related Services"

The basic feature of proposition 13 is the rollback of property taxes from the present average of three percent to one percent of market value (based upon the 1975 values). According to proposition 13 proponents the one percent is the amount necessary to fund "property related services". By providing a maximum annual increase of 2 percent (unless the property is sold) it is obvious that in real dollars even the magic one percent figure will not be achieved.

In any case, without being specific the proponents successfully conveyed to the public that one percent was enough and a great many opponents conceded that the present heavy reliance on property tax to fund many non-property related services such as health, welfare, and education was inappropriate. It remains to be seen how the one percent works out; I am not optimistic. For instance, in Claremont the total property tax revenue which the city can hope to receive under proposition 13 is $250,000, and the budget of our police department (a service which most consider to be property related) will be in excess of $1.2 million per year. The rhetoric of the one percent has significant holes.

6. Distortions and Misrepresentations

The proponents consistently downplayed that local governments would miss the $7.5 billion. Two approaches were taken, both deliberate distortions. First, without qualification proponents stated boldly and frequently that proposition 13 would not lead to curtailment of "essential services" (essential services was never defined). For instance, economist Milton Friedman stated, "I strongly support Jarvis-Gann... the big government's coalition has been threatening dire consequences...police and fire departments crippled, bond issues in default, bankrupt schools...Jarvin-Gann won't have any of these 'dire consequences'." Randy Goodwin, campaign coordinator for proposition 13, said that statements made by union leaders and government officials about probable layoffs were "part of the scare tactics, and we believe that the budget cutbacks will not result in the loss of any jobs and will just make government more efficient." Secondly, the proponents played upon the notion that by trimming bureaucratic fat the loss of $7.5 billion would not be noticed. Several pro-proposition 13 advertisements lumped all local and state funding ($40 billion); assumed that the total existing state surplus of $3 billion built up over several years would be reimbursed to local governments; and that the remaining deficit of approximately $4 to $5 billion would equal only "ten percent of spending" which can 'easily be made up by trimming some bureaucratic fat". This slight of hand obscures the following:

> State government expenditures are not required to be decreased by proposition 13; in 1978-79 all local and state government raised a little over $30 billion (not $40 billion) with federal grants increasing the total to approximately $37 billion; and the $30 billion figure includes those funds and fees earmarked

by law for specific purposes and trust funds--
water, sewer, road construction, etc.

Most local government budgets provide programs funded by non-property tax related revenues (grants, trust funds, fee-sponsored activities, earmarked revenues, etc.) and eliminating such programs entirely would not reduce the extent of the cutbacks necessary because of property tax revenue loss of proposition 13. For instance, in the City of Claremont "only" 25 percent of the total city budget is funded by the property tax. However, by the time all expenditures, directly or indirectly funded by the property tax were identified, we found that our total $1.2 million tax loss must be extracted from only $2.8 million of expenditures, well over 40 percent. This $2.8 million contains the entire $1.2 million police department budget. Thus, the "ten percent myth" sounds reasonable (who can knock a ten percent reduction?). It was in reality a gross distortion of the fiscal situation confronting most local agencies, especially once the state surplus is exhausted.

In addition to the above misrepresentations, the net tax loss of $7.5 billion is probably substantially understated to the extent that in all probability the local match for a number of grant and aid funded programs (both state and federal) will likely be withdrawn as a result of proposition 13 cutbacks; thus, substantially increasing the total revenue loss to local government in California. A study done by the Office of Management and Budget indicated that about $6.9 billion dollars of federal grant programs may be affected with a probable range of loss from 2 to 3 billion (of the $6.9 billion, $4.1 billion are dependent on local match).

All in all, the average voter put down the possibility of service level cutbacks. One poll taken on election day indicated that less than 25 percent of those voting <u>for</u> proposition 13 believed that local services would be reduced if proposition 13 passed; 71 percent of the yes voters believed that they could obtain drastic property tax reductions without any significant reduction in government services.

7. <u>Venting Frustration</u>

The campaign afforded a number of citizens a sense of power at the expense of the government employee and the predominantly part-time local elected official. Letters to the editor were filled with vindictive advice from those venting their frustration by lashing out at the "politician", and the "bureaucrat". Howard Jarvis provided many examples of this disdain. Jarvis stated that of the public employees who might lose their jobs that those that are competent "can get a job in 20 minutes" in private business. "If he can't write his name and address, and wastes time on the job, he may have to work somewhere else and that's fine with me."

Government was clearly the enemy and though few of those making such insinuations had ever made the attempt to contact a local council member or city manager to discuss his/her concerns that a particular program or programs should be reduced, there was widespread opinion that the "politicians" were obviously motivated against the public interest.

8. "Proposition 8 is a Cruel Hoax"

As mentioned above, the inaction of the state legislature was a major impetus to the initiative campaign. When the legislature did act in February, it was several weeks after the initiative had qualified for the ballot, and at that point, the voter would not believe that the legislature could come up with anything worthwhile; that the last minute action was obviously a sham (in fact the state legislature acted too late for a description of proposition 8, which was the legislative alternative to proposition 13, to appear on the same ballot). The irony is that proposition 8 (which was also referred to as legislative bill SB 1, or the "Behr" bill) did in fact provide substantial tax relief which, if enacted prior to October 1977, probably would have been well received by the public. The important elements of proposition 8 were as follows:

1. Provided a minimum 30 percent decrease in homeowner property taxes (from what the rates would have been in 1978-79) for all homeowners by allocating $1.5 billion of the state surplus exclusively to homeowner tax relief. This was different from proposition 13 which allocated its tax relief provisions to all property including income producing property.

2. Limited the increase in property tax revenue received by local taxing agencies to no more than the rate of inflation, exclusive of property taxes from new construction. This was to be done by forcing the local taxing agency to lower the tax rate when reassessment

caused the assessed evaluation within that jurisdiction to increase at a rate greater than inflation.

3. Provided a small increase of direct assistance to renters.

4. Transferred a significant portion of county health and welfare costs to the state government.

The net effect of "1" and "2" above was to provide immediate relief to homeowners not receiving a reassessment and to greatly reduce the financial impact of reassessments on homes. For instance, in Claremont it was anticipated that a home would have to be reassessed by 65 percent or more before the owners of that property would pay more taxes in 1978-79 than 1977-78.

Regardless of the above, proposition 8 was branded as a "cruel hoax". Few voters understood proposition 8 and it was complex. Proposition 13 proponents exploited the fact that proposition 8 would not force government cutbacks. This was true although the revenue limit would certainly impose a major new limitation on the ability of local governments to grow any faster than the rate of inflation. The fact that proposition 8 targeted its direct relief to homeowners only and not to income producing property did not seem important to most voters. In the end proposition 8 received only 47 percent of the vote even though it was well advertised that if both proposition 8 and 13 received more than 50 percent of the vote, 13 would take precedence.

In the last week of the campaign some proponents of proposition 13 were also urging those voting for 13 to vote for proposition 8 as "insurance" should anything happen to proposition 13 in the court. Even so relatively few voters voted for both proposition 13 and proposition 8. If proposition 13 is struck down by the courts, proposition 8 will not take affect. The fact that this was not understood by the voters was another example of the highly emotional content of the campaign in which true self-interest was often not recognized.

9. "It Will All Work Out"

Throughout the campaign there was the unshakable belief that though it was fun to "shake up the system" and put a scare into a major institution of American life that nothing was being done by proposition 13 that would cause major disruptions. People believed that it would all work out. And it may. But quite likely at the expense of certain segments of the population and with the risk that the California body politic may have been irreparably ruptured.

III. THE IMPLEMENTATION

On June 7 local government throughout California began to deal even more seriously with the impacts of proposition 13. Some of the implications of proposition 13 are discussed below. Not addressed is the possible unconstitutionality of proposition 13. This issue has already been raised in the state courts. Although it is possible that proposition 13 will prove vulnerable from a constitutional viewpoint, the following discussion assumes that proposition 13 will go into effect as presently written.

1. <u>The Opportunity</u>

I am not overly optimistic. However, there is no question that the public is now officially on record of desiring a more streamlined and efficient government. (Did anyone doubt that in the first place?) If used creatively, local elected officials and urban administrators may be able to implement cost reducing measures and reforms which have not been previously possible because of special interest group opposition or restrictions imposed by the state legislature and federal government. Don Benninghoven, executive director of the California League of Cities states that local elected officials are probably more frustrated than many of the people who voted for proposition 13. They are, he says, "frustrated with endless red tape and regulations imposed by the county, the region, Sacramento, and Washington". With public opinion apparently on the side of more efficient management there may be a great opportunity to reduce the amount of regulation and red tape presently impacting local governments.

In addition, those of us who are professionally involved in local government administration have been presented with a unique, if not exciting challenge, perhaps even an opportunity. Although government administrators seem to be now viewed as the "enemy" we are entrusted with the responsibility of assisting local elected officials of doing the best we can to make proposition 13 work. I personally believe that a more moderate and less emotional approach to the problem of rising taxes would be far preferable and would have inflicted far less damage to the good things than government services can provide. However, perhaps it is true that major changes only take place in times of crisis, and now that we have inflicted a crisis on ourselves, I hope that we can make the most of the opportunity to make other needed and beneficial changes.

2. Distribution of the State Surplus

Upon passage of proposition 13 the state legislature began to define the role of the state government in regard to the approximately $7 billion deficit facing local governments in California. There were two immediate issues to address: First, it was necessary to develop guidelines in regard to the distribution of the remaining "one percent" property tax. The state legislature adopted a formula, for one year only, which will distribute the remaining property tax based upon the average percent of the previous total tax rate. That is, if a city had previously received 10 percent of the total property taxes paid by its residents, that city would receive 10 percent of the remaining property taxes.

For sake of quick agreement the proportional formula was adopted.

However, the formula does have potential equity problems. For instance, the county (which has a uniform rate throughout the county) will receive a different portion of taxes from various parts of the county. For instance, a resident in an area which had a disproportionately high total tax rate might end up paying only 35 percent of the tax dollar to the county, whereas a resident in a jurisdiction which had a low total tax rate might pay as much as 50 percent of each dollar to the county, ostensibly for the same services.

Secondly, the state has decided to distribute $5 billion of the state surplus to local agencies. Although prior to June 6 Governor Brown repeatedly stated that there were no guarantees the state would help, the state legislature and governor decided to distribute the entire existing state surplus even dipping into a portion of surplus revenues anticipated to be received in 1978-79. As described below, the surplus comes with significant new restrictions on local government.

The legislature chose to distribute the entire surplus in one year in spite of testimony given by some officials that the surplus should be distributed over more than one year's period, thus giving the state greater flexibility to deal with potential proposition 13 related effects. Instead, the state has temporarily postponed the effects of proposition 13 for one year. With considerably less surplus fund available in 1979-80, this virtually assures that either taxes will increase or major service reductions will occur after June 30, 1979.

It is important for residents in other states and California to understand that the distribution of the state surplus will only postpone the real effects of proposition 13. It is reasonable to assume, state-wide, that at least $1 billion will be raised by local governments in increased non-property tax fees (water rates, recreation, street sweeping fees, etc.). This amount added to the $5 billion state surplus, will mean that local governments will actually have to make cutbacks of only $1.0 to $1.5 billion in 1978-79. But beginning in July 1979 it would appear that from $3 to $5 billion further cutbacks will be necessary or new fees must be imposed. In my opinion, the state has made it certain that 12 months from now California will have a real crisis (unless state taxes are raised).

Local officials have again been placed in an impossible no-win situation in which prior to the action of the state to allocate the state surplus, it was only prudent and wise to plan for a rediction of services to a sustainable level. In spite of charges of scare tactics, by and large, this planning was based on accurate projections of secure revenue; and not upon some possible future action of the state legislature. By allocating the entire state surplus to be spent in one year, Governor Brown and the state legislature have now confirmed in people's minds that predictions of large cutbacks were in fact scare tactics. And citizens can live with the fantasy that major cutbacks will not be necessary--for one year.

Indicative of the somewhat cavalier attitude of certain state officials, State Finance Director Roy Bell stated that, "a lot of these sort of scare tactics were on the basis that local government didn't trust the state to put any money in at all. Nobody had promised them the state would put in $3 or $4 billion. Jarvis said that scare tactics were there because the state had the surplus to bail out local government, and Jarvis wasn't that far off in that statement, you know." It is statements like these; the inaction of the state legislature before June 6; and the action of the state legislature since June 6 which are in some senses penalizing those local governments which are trying to be prudent by not counting on money that isn't there or won't be there in the long run. A series of disincentives to conservative fiscal management practices is now being spawned by the state government to the point that conservative fiscal planning (to the extent that meant deferring, or postponing today's consumption to ensure future economic health) is suspect. Furthermore, those who are trying to look ahead and plan accordingly are being ridiculed for having talked realistically about the long range effects of proposition 13.

3. User Fees

In spite of propositions 13's severe restrictions on the imposition of new local taxes (two-thirds of the qualified voters must approve) and the fact that most special districts and school districts cannot impose any additional taxes or fees, many jurisdictions have the opportunity to impose new or increased user fees to cover the cost of services which were previously

33-595 O - 78 - 33

funded by the property tax. As a principle of municipal finance, user fees are generally regarded as desired method of financing those programs for which the benefit is received by an identified user. This principle will likely be reinforced by proposition 13. The Metropolitan Water District has indicated that they will increase water fees (to wholesale operators) as a means to recoup lost property taxes. In my opinion, there is little justification for property tax support of water prices and this proposition 13 induced change should be helpful in this regard.

However, there are limitations on user fees. For instance, fees cannot be deducted from the income tax whereas property taxes can. Thus, depending on one's tax bracket, the imposition of a fee equal to the amount of lost property tax revenue will result in increased net tax burden of anywhere from 0 to 70 percent. Furthermore, cities do not get credit for user fees under the "local tax effort" portion of the general revenue sharing formula. This ultimately means less general revenue sharing for cities which are more dependent on user fees.

Proposition 13 will also likely force a court determination of what actually is a fee versus an excise tax. Some attorneys argue that unless the fee is based on benefit (which should vary according to use) that it is an excise tax. This perhaps could invalidate a uniform refuse collection fee charged to all residences.

4. <u>Tax Relief for the Federal Government and Non-Residents</u>

One of the greatest ironies of proposition 13 is that the federal government will be the single greatest beneficiary of the tax relief effort. It is estimated that of the total $7.5 billion property tax reduction that $2.0 to $2.5 billion will flow to the federal government coffers because of the loss of deductability of property taxes from the income tax. (In other words, a person or corporation paying taxes in a 50 percent bracket may pay $2000 less property taxes under proposition 13 but because of the federal deductability his net decrease will only be $1,000, with the remaining $1,000 staying with the federal government. Thus, unless deductible state taxes are increased the federal government will end up with $1,000 more money.) It is also likely that not only will the federal government receive more income taxes from Californians as a result of proposition 13 but that the federal government may end up spending less in California as a result of proposition 13. A study by the office of management and budget indicated that a total of $6.9 billion in federal grants is presently allocated to California. Some authorities believe that from $1 to $3 billion of these grants will be ultimately curtailed because of the reduced level of local tax effort and reduced local matching funds. One of the most urgent issues is the Department of Labor's requirement that for the CETA program if a regular city employee is laid off that a CETA employee in a similar classification must also be terminated. Efforts to persuade congress and the Department of Labor officials to modify this policy have so far been unsuccessful.

Furthermore, it is common to believe that the federal political and bureaucratic establishment while not being vindictive, can be counted upon to be rather inflexible in regard to making changes which would ease or modify the proposition 13 effects in California.

5. Economic Impact

The economic impact of proposition 13 is of course largely unknown. There are many different estimates. The UCLA School of Management Study projected that unless the state allocated more than $1.5 billion of the state surplus to local governments that the state's unemployment rate would increase from 6.0 to 10.1 percent and that total income in California would drop by $4.8 billion. In the longer term many of these jobs would be transferred to private industry with severe transition problems. The study indicated that 50,000 of the state's 75,000 CETA positions would be terminated and that 450,000 in the public and private sector would be involved.

Now that the state has allocated a $5 billion surplus, the result of this study will be impossible to validate at least until 1979-80 when the real effects of proposition 13 will occur. After the June 6 election the study was revised to assume a $5.5 billion state surplus allocation. The study indicated that there would be a short-lived economic upturn, but by the end of 1980 unemployment would climb to exceed 10 percent (or 3.7 percent above the rate the UCLA model would have foreseen without proposition 13).

The revised study also unveiled a new assumption corroborated by a state legislative analyst report. This was that it appears that only $2 billion of the total $7 billion in property tax savings is assured of staying in the California economy. The net loss of $5 billion was stated to be caused by the $2 billion windfall to the federal government for reduced deductability of property taxes and $3 billion windfall to out-of-state corporations and individuals from which it is either unlikely or not assured that the savings would be reinvested in the California economy. The Los Angeles Times reported this conversation between assemblymen when being told of this information (June 12, 1978): Assemblyman X (referring to the legislative analyst's report that $5 billion would be drained from the state), "I just cannot accept that. I find that prediction to be excellently absurd and disasterous". Assemblyman Y, "Please do not become upset every time you hear 'a piece of bad news'."

6. The Sale of a Birthright

In my opinion, one of the most sacred of American freedoms is the privilege of citizens in a community to come together and decide to do something (such as build a park, a street, a police station, etc) for themselves. And to raise the money locally without having to go hat-in-hand to Uncle Sam or to the state government to build their project. Proposition 13 has, for all practical purposes, eliminated the possibility that local citizens can do something for themselves. In this sense, proposition 13 must be viewed as a powerfully centralizing influence which will reinforce our society's general tendency toward uniformity and less diversity. To the extent that the state funds will be rebated to local government, the authority of the state and local government will be increased. Most of the local government revenues will not be raised through local tax efforts. Instead, the local government finance system in California will resemble that existing in the socialized countries of Western Europe in which the state or central government commonly provides 80 to 90 percent of local government funding. The traditional conservative suspicion of intergovernmental transfers (such as Federal grants) because local accountability for raising the funds will be lost because the funding agency could more easily impose conditions has been bought-off by visions of tax savings and a reduction in the size of government. The polls indicate that conservatives were the strongest supporters of proposition 13 with 82% of self-labeled conservatives voting for proposition 13 and 45% of self-labeled liberals. It would appear that the proposition 13 vote clearly indicates that voters do not perceive it as important that local government shall have the authority to raise funds for local programs, but rather shall be dependent for funds on other levels of government.

It did not take long for the state to begin exercising its new found power to place restrictions on local government. Within 20 days of the election, the legislature had imposed three important strings on the surplus funds distributed to local government:

1. Restricted local governments from giving any salary increased in excess of that given to state employees. (At this time it would seem likely that no increase in salaries will be allowed for local or state employees in California.)

This requirement has the effect of overriding previously authorized state legislation mandating a "meet and confer process" which provides for the signing of multi-year memorandums of understanding. The legal authority of the state to override a memorandum of understanding is unclear. Many city councils around the state are in an impossible catch-22 situation which places them in the position of either refusing state funds and honoring an existing memorandum of understanding; or accepting state funds and invalidating a contractual agreement, and facing possible legal action. Furthermore, if it is found that salary increases may go only to those employees represented by bargaining groups which have multi-year agreements, the state will have encouraged further union organization of state and local employees.

2. Required cities to ensure that police and fire programs are maintained at 1977-78 levels. Although not prohibiting economy and efficiency measures this provision makes these two departments, which together represent more than 50% of most city budgets, immune from major economy moves. It further limits the ability of a city to implement or retain non-police or fire expenditures which may actually prevent fire or crime more effectively (such as improving water pressure, funding a juvenile diversion counselling program for youth, etc).

3. Restricted the amount of state surplus distribution that a city could receive if the city's surplus exceeds 50% of the 1977-78 budget. Although information as to

how a surplus is defined is unclear at this time, this restriction will potentially penalize those agencies which froze or reduced expenditures in 1977-78 in anticipation of proposition 13. Furthermore, this restriction will reward those agencies which were not cautious and managed to spend every dime. Thus, the state has given incentives to local governments in California not to plan ahead, a lesson which may not be lost on cities one year from now when the real crunch comes and when there will be the pressure on the state to come to the rescue again.

In summary, another irony of proposition 13 is that though the people thought they were voting against big government, they may well wind up giving more power to big brother.

7. Shifting the Tax Burden: From Income Producing Property to the Single-Family Homeowner

The greatest irony of proposition 13 is that without question proposition 13 will increase the relative burden of total taxation (especially preoperty taxes) on the homeowner. In other words, proposition 13 disproportionately benefits income-producing property vis-a-vis owner-occupied property. In response to the hue and cry coming from homeowners who have suffered increasing property taxes at a much greater rate than income-producing property the citizens of the state have voted a tax relief mechanism which will provide the greatest share of property tax relief to income-producing property.

There are several aspects of this situation. First, as stated above, reassessment rates of single-family homes have been in excess of income-producing property over the past few years. The primary cause of the tax revolution were single-family homeowners who were paying an increasing share of the total property tax burden. In 1977-78 homeowners paid approximately 35 percent of the total property taxes in the state with income-producing property paying the remaining 65 percent. The irony is, of course, that proposition 13 allocates the same percentage of property tax relief to <u>all</u> property and thus income-producing property will receive 65 percent of the tax relief and the homeowners only 35 percent.

A second irony is that, as stated above, the state's surplus can be attributed primarily to taxes paid by homeowners and individuals rather than business and commercial taxpayers. The state surplus will be redistributed on a one-time basis to local governments to fund a portion of the total tax loss. Thus, surplus taxes coming primarily from individuals will be used to offset property tax losses resulting in a great part (65 percent) from less taxes paid by income-producing property.

Thirdly, if new state taxes are imposed to make up any portion of the property tax loss (and this seems unlikely in the immediate future but possibly inevitable in the long run) there is strong likelihood that individuals, and especially homeowners, will be assessed a greater proportion of the new taxes than individuals and homeowners received in property tax decreased from proposition 13. This is because the homeowner and individuals pay more than one-half of all sales and income taxes.

Finally, the reassessment process established under propositon 13 will work to the advantage of income-producing property rather than homowner property. This is because reassessments cannot be greater than two percent per year on any property except when a sales transaction has taken place that property will be reassessed at the present market value. Thus, property which is sold more frequently will tend to have higher assessments than property which is sold less frequently. Individual homes are sold much more frequently than commercial and industrial property. For instance, Standard Oil will likely never "sell" a refinery. Presently homeowners are paying 35 percent of the total property taxes. Because of the proposition 13 reassessment process estimates have indicated that within five years homeowners will be paying more than 50 percent of the total property taxes with this percentage continuing to increase in the future. In San Mateo County it was found by 1983 under proposition 13, the homeowners share of property taxes would shift from 50 percent to 60 percent.

In summary, the inevitability of a major shift of the tax burden away from income-producing property to the homeowner and the individual taxpayer is truly the "cruel hoax" of the California dream. Someday, its citizens may wake up to this fact.

8. Inequities and Differential Effects

Proposition 13's alleged 60 percent reduction of property taxes is in reality a variable reduction of 57 to 80% depending upon several factors. First property owners in areas with a higher than average tax rate (more than $12 assessed valuation per $100) will realize a greater percentage reduction in taxes and the local agencies correspondingly will incur a greater percentage decrease in property tax funds available. The reverse will be true in those areas presently having less than average tax rate. Secondly, as pointed out above, there is a great diversity among various types of units of local governments (county, district, school district, cities, etc.) in the dependence on the property tax as a portion of total revenue. For instance, the average school district is 47 percent dependent on property tax funds, whereas the average city is 27 percent dependent on property tax funds. And, thirdly, there is great variation among the same type of local agencies in their relative reliance on the property tax. For instance, cities vary from zero to 60 percent dependence on the property tax.

As a general rule it is fair to say that cities in California which are considered relatively "rich" will be far less affected by proposition 13 than other cities. This will be true because the richer cities tend to have much higher sales tax revenue (which is distributed on a point-of-origin basis). "Poor" cities have tended to have low sales tax receipts and higher property tax rates (often applied against a less than average assessment base) in order to compensate for the lower sales tax. Those cities with high tax rates will be especially hard hit under proposition 13. I believe it highly likely that proposition 13 will inevitably lead to a Serrano-type equalization ruling applied to cities. The gross inequities caused by the present sales tax distribution are perhaps tolerable when a city can increase local property taxes in order to compensate for the less sales tax. However, once the option of raising local revenues is eliminated, as is done by proposition 13, the stage will be set for court challenges of the equity of the distribution of the sales tax and other revenues. In anycase, the revenue reduction forced under proposition 13 will likely substantially increase the discrepancy among the service levels provided by the various cities throughout the state. Some cities will have to make severe cutbacks; others very little. How tolerable such variable service levels will be remains to be seen. The issue might be summarized by the following question: If proposition 13 was adopted in order to reduce government spending why should some cities have to cut <u>more</u> than other cities just because some cities had to rely more on property taxes than other cities?

Finally, distribution of the state surplus to local governments raises important equity issues. Should the state distribute funds under a uniform state formula, if so, what should the formula be based upon--last year's budget, per capita distribution, or need? Or should the allocation authority be given to the county board of supervisors or a newly appointed allocation board. It is certain that there will be dozens of controversies about what constitutes an equitable distribution of the state surplus. The formula adopted by the state legislature is based primarily on relative loss from proposition 13. However, if used in the long term, the formula will most certainly lead to severe equity criticisms. As equity concerns become more intense--and hence the need to accurately quantify the costs and benefits of local government services--there will likely be renewed pressures on comparative productivity and performance accounting in government services. Ideally a formula for distribution of state funds would include components of both relative "need" and a criteria of performance and productivity. Perhaps proposition 13 will renew efforts to develop an objective and quantifiable standard.

9. Diminished Economic Benefit of New Development

Another impact of proposition 13 is that local government will receive substantially less tax benefit from new development. Redevelopment "tax increment" financing has been virtually destroyed. The economic return for any new development (except development with a high sales tax potential) has been substantially reduced. It is likely that some cities will impose moratoriums on certain types of development on the basis that the local agency will have no certainty that the new development will in fact "pay" for the services rendered. In Claremont we have calculated that prior to proposition 13 a new single-family home must be worth at least $50,000 in order for the city to "break even" between the revenue generated and the services provided. With property tax revenues cut back by more than two-thirds, the city will have to reduce services substantially in order for the $50,000 house to pay its own way--yet, as stated above, it is by no means certain that after July 1, 1979 Claremont will receive <u>any</u> property tax from this home because of the unresolved questions concerning the allocation of the one-percent property tax to taxing agencies within the county.

10. <u>Majority Politics and Special Interests</u>

Proposition 13 raises a number of important issues concerning how local government decisions about programs and services are made or should be made. The primary dynamic of the initiative was the strong majority statement that property taxes are too high and that government is "spending too much". Within that majority there were numerous and conflicting factions who believe that certain local government programs should not be cut, such as library, fire, police, health, parks, etc. Some of these services are used disproportionately by a minority of the population. In the past various coalitions have successfully generated support for these services. The initiative process, however, is basically anti-coalition, anti-special interest and anti-compromise. It is sheer populism--all or nothing. And, in this case, the frustration was so great as to overwhelm what had been the "normal" interplay of special interests coalescing to support specific programs.

Another factor is that many property tax-related services are not visible to the user even though a majority of property owners are benefit by them--flood control districts, Metropolitan Water District (water), sanitation district, etc. The first proposition 13 layoffs in Southern California were 579 termination slips sent to engineers and personnel of the Los Angeles County Flood Control District. Most people were not even aware that this operation was funded by the property tax or even what it was. (The basic function of the district is to design, construct, and maintain flood improvements including debris clearance from existing channels.)

Another dynamic was that a great many people felt that they were voicing policy disagreements with a particular agency by voting for proposition 13--as a form of punishment. Implicit in this approach (such as those who voted for proposition 13 to keep Los Angeles City schools from being "integrated") was the desire to completely disrupt the game. One local citizen told me that he would vote for proposition 13 to "get" the city for a zoning decision with which he disagreed. His desire, shared by many on other issues, was simply an expression that he would rather disrupt the system than work within it.

Finally proposition 13 raises questions about <u>who</u> should make decisions. There was great emotional fervor during the campaign that local elected officials and "bureaucrats" didn't really represent the people. Political advertisements and letters to the editor were filled with general references to government services that "no one wants". One advertisement stated: "If proposition 13 fails, the politicians will feel that the taxpayers do not care and that they have a mandate to spend your tax dollars as they see fit". The irony is that local elected officials often complain that during the budget development process too few citizens come to meetings or express opinions on how local funds should be spent. And invariably those who do take the time to participate are usually those requesting additional services and programs. As a city manager I have been criticized by various portions of the public far more for what I have <u>not</u> included in the budget than for what I have recommended. Admittedly, attending a council meeting or calling a council member takes time, and a vote is a lot simpler and requires less thought and frees the voter from any accountability for stating <u>what</u> should be cut. Predictably in the post proposition 13 environment there is much advice from citizens about what programs should <u>not</u> be cut and very little advice about what programs <u>should</u> be cut. The local elected official is thus placed in the difficult position of implementing the general will of the people (reduce spending) while at the same time hearing primarily from very vocal constituents who do not want specific programs cut.

II. <u>"Cutting the Fat"</u>

This paper is not the place in which to discuss the extent of the various cutbacks that will be necessary under proposition 13. As stated previously, the distribution of the state surplus will delay the greatest impact for one year.

The City of Claremont, which is more affected than most cities, expects a revenue loss equal to about 25 percent of the total budget. However, more significantly once all grants and earmarked programs were identified it was found that the revenue loss represents over 40 percent of the property tax-related programs of the city--which include the entire police department budget, all facility maintenance, planning, engineering, social service, recreation, administration, etc. Some examples of our tentative cutbacks include 50 percent reduction in street lighting, 50 percent reduction in park maintenance, 75 percent reduction in street landscaping maintenance, 25 percent reduction in tree maintenance, 10 percent reduction in the police department, etc. Our focus has been to specify service level reductions and quantify "savings" of such reductions. With the distribution of state surplus, the city anticipates phasing these reductions over the next 12 months so that by July 1, 1979 the city budget will be sustainable.

The city anticipates raising approximately one-fourth of the total tax loss by increasing fees and non-property taxes and increasing the allocation of overhead costs to grant-funded and certain fee-funded programs. The first official action of the city council was to immediately raise all recreation and day care fees to cover all direct costs of providing the service including a facility maintenance charge and departmental overhead. Within hours the first protests began to arrive including the gentleman who was furious that the senior citizen club yearly dues were increased from $3 to $10. He stated in all sincerity that the purpose of the Jarvis initiative was not to reduce programs or increase fees but to get rid of all that bureaucratic fat and cut property taxes.

33-595 O - 78 - 34

I have grave concerns that the extent of Claremont's cutbacks will ultimately result in severe disruption to our local economy and the social fabric of our community. There is no question that many of the cutbacks reducing the maintenance of city facilities (streets, parks, trees, buildings, etc.) will lead to deterioration of these facilities though it may take two or three years before such deterioration is visible. There is also no question that it will be more expensive to repair the damage (should funding be available) at a later date than it would have cost to prevent deterioration in the first place. Furthermore, proposition 13 will greatly reduce the scope of our human services activities and in my opinion, the city's investment in human services issues over the past eight years has been among the city's most important and beneficial investments.

12. <u>The Catch-22's</u>

Local officials around the state are just beginning to feel the effects of becoming even more subservient to the whims of the state legislature. The uncertainties and contradictions of the state legislature and the governor in regard to proposition 13 has created a number of "no-win" situations which in the short and long term could be extremely damaging to the morale of local officials. At some point the frustration of being continually caught in a series of catch-22 situations will be viewed as intolerable, thus discouraging participation as an elected or appointed official in local government. The most frustrating dilemma facing local officials is as follows: Many local officials voiced grave concerns about proposition 13 and responsibly outlined some of the potential negative impacts. These warnings were obviously discounted by the voters. Now that proposition 13 is law, it is the primary concern of local government officials, both elected and otherwise, to make the law work. And as noted elsewhere in this dissertation, that will likely be extremely difficult, if not impossible. Thus, local government officials are placed in an impossible double bind: if proposition 13 doesn't work, it's the politician's fault; if it does work, the politicians were wrong in stating that it would not work.

In addition the past four weeks have produced a series of other catch-22 situations. The state's massive "bail-out" which postpones the severe effects of proposition 13 for 12 months makes the responsible local government officials, who stated that either major cutbacks or increased non-property taxes would be necessary if proposition 13 passed, look silly--at least temporarily. The state's action to invalidate labor contracts which were entered into in good faith by local agencies places the local city council in the impossible "no-win" situation of either breaking a legal agreement or losing a sizable amount of state surplus funding. The state legislature's grant of 12 months immunity from cutbacks to police and fire departments precludes consideration of possible appropriate service level reductions and cost saving items in those departments and sets the stage work for a major crisis at the beginning of next fiscal year. The state's limitation on local agencies ending balances penalizes those cities which did not spend as much as budgeted in 1977-78 in order to have funds available to provide more flexibility for 1978-79 once proposition 13 was approved. Though a great many layoffs can be postponed until later in the year, those agencies forced by financial circumstances to make layoffs at this time must do so immediately in order to escape the substantially increased financial liability to fund the federally mandated unemployment insurance program which requires the local government to begin financing a portion of the program by August 1, 1978. The layoff of the employees with the least seniority will undoubtedly cause the retirement system costs to increase to the extent that the average local government employee will be older and thus more likely to retire from the system. These dilemmas will likely only compound in the future, each one bringing a new frustration and feeling of impotence and helplessness to local governments throughout the state.

13. We are the Enemy

Finally, I must express a sense of personal loss which I, the city council, and the professional staff feel. We believe that we have been responsible to the will of the public as it has been expressed in our city. We believe that tough-minded decisions had been made; that the city is operated rather efficiently; that the city is actively looking for ways to improve. Because Claremont is affected more than most cities, we have the added frustration of knowing that most cities will not have to make as severe reductions. In many respects the proposed 1978-79 budget, which offered a substantial tax decrease, was a culmination of much individual and city council effort of the past few years because the budget, if implemented, would have realized a number of objectives which were only hopes and plans a few years ago. From a professional and taxpayer's point of view, it hurts to know that unless new taxes are imposed we will see a gradual deterioration of our community's facilities and that needed personnel will be terminated. But, what hurts most is that local government is now perceived as the enemy, and we just don't believe that we are.

IAAO INFORMATION ON ASSESSMENT ADMINISTRATION / INTERNATIONAL ASSOCIATION OF ASSESSING OFFICERS 1313 E. 60th St., Chicago, Ill. 60637

ASSESSMENT OFFICIALS ADOPT POLICY
ON PROPOSITION 13 AND "TAX REVOLT"

The Executive Board of the International Association of Assessing Officers (IAAO) has adopted the following policy statement concerning the recently passed property tax-cutting initiative in California, Proposition 13, and similar tax limitation measures being proposed in other parts of the country:

The objective of the assessing function is to arrive at the market value of property for tax purposes. This market value standard enables assessors and taxpayers alike to judge the equity of the assessment process. Control of government spending can and should be achieved through other available means without impairing the market value standard and the equitable administration of the property tax. The International Association of Assessing Officers therefore opposes provisions of property tax limitation measures that destroy the market value standard and are detrimental to uniform and equitable assessment. Specifically, IAAO opposes freezes, arbitrary limits on assessment increases, and measures that forbid reassessments unless a property changes ownership or is newly constructed while ignoring the economic facts of the market.

Willis L. Holland, CAE, President of IAAO and Assessor for Fort Madison, Iowa, announced that Proposition 13-type legislation would be on the agenda at the association's Annual Conference in Toronto, September 17-20, 1978.

PROPERTY TAX INFORMATION

"For Concerned Legislators"

International Association of Assessing Officers
1313 East 60th St., Chicago, Il. 60637

June, 1978

* *

INFORMATION FOR CONCERNED LEGISLATORS
Periodically, information on Property Tax matters that concern legislative leaders will be sent to you. We welcome any comments or suggestions. If you have a topic we can cover for you, please contact Paul Corusy or Marion Movrich at the above address or call 312/947-2064.

* *

PROPOSITION 13: EFFECTS ON PROPERTY TAX ADMINISTRATION

Dramatic changes in property tax administration may occur in California and elsewhere as a result of the passage of Proposition 13 by the voters of California on 6 June 1978. The ultimate effect of Proposition 13 (also known as the "Jarvis-Gann initiative") on assessing in California will depend on (1) the constitutionality of the measure, (2) how certain key phrases are interpreted, and (3) how real estate market participants react. Elsewhere, Proposition 13 seems likely to have a strong symbolic effect, but its specific provisions are unlikely to be copied.

Proposition 13 attacks "excessive, wasteful" local government spending by amending the Constitution of the State of California to: (1) limit total ad valorem taxes on real property to 1 percent of the full cash value of such property and (2) change the definition of "full cash value."

Full cash value, according to Proposition 13, is:

> "The county assessor's valuation of real property as shown on the 1975-76 tax bill under 'full cash value,' or thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership has occurred after the 1975 assessment."

Proposition 13 further provides:

> "The fair market value base may reflect from year to year the inflationary rate not to exceed two percent (2%) for any given year or reduction as shown in the consumer price index or comparable data for the area under taxing jurisdiction."

The first task confronting California assessors, therefore, is to roll back assessed values to their 1975-76 levels. Properties underassessed in 1975-76 may be raised to 1975-76 levels. Properties that have been purchased, been newly constructed, or have changed in ownership since 1 March 1975 may be reappraised. The basis of such reappraisals presumably is the market value of the property in question on the date the transaction or ownership change took place or the construction was completed. In 1977-78, 1.4 million properties were transferred. No data are available on new construction. However, in 1977-78 California assessors reviewed the valuation of 36 percent of the 7.8 million real property parcels in the state.

The method of assessing real property under Proposition 13 seems subject to a challenge of being unconstitutional under the due process and equal protection clauses of the Fourteenth Amendment to the U.S. Constitution, the parallel clauses of the California Constitution , or both. In any given year, there will be no uniform or predictable relationship between the current market value of a property and the property taxes levied against that property. In other words, properties of equal market value will have dramatically unequal assessed values.

Whether or not Proposition 13's assessment procedures are found unconstitutional, they do not conform to generally accepted assessment practices. For example, the forthcoming IAAO book, Improving Real Property Assessment: A Reference Manual, characterizes as "plainly unacceptable" reappraisals that are "triggered only by an external activity affecting comparatively few properties." Among the events so classified are (1) the sale of a property ("welcome stranger" assessing) and (2) physical changes in a property. Improving Real Property Assessment also condemns general limits on assessment increases, such as Proposition 13's 2 percent limit on general increases, as a detriment to equitable assessments.

Paradoxically, Proposition 13 will make assessment administration relatively more expensive. Existing computerized mass appraisal methods will be of little use because each property that may be reappraised will have to be valued on the basis of events peculiar to each. Therefore, labor-intensive appraisal methods will have to be used.

One key question with respect to the language of Proposition 13 is what does "newly constructed" mean? Does it apply to improvements to existing property? If it does not, it will be possible to make substantial improvements (multi-million dollar improvements in some cases) that will never be reflected on assessment rolls.

Another key question is what does "change in ownership" mean? Are name changes, corporate reorganizations, joint tenancies, inheritances, dissolutions of marriages, and foreclosures changes in ownership?

Proposition 13 raises additional questions by the things it omits. How are demolitions and the destruction of property due to disasters to be treated? What about properties that have declined in value since 1975? What about increases and decreases in property value due to changes in land use controls? Will assessors be permitted to reflect such changes as these?

Proposition 13 may have several other effects on real property. In order to avoid reappraisals, sales may become rare and long-term leases common. New construction may similarly be discouraged, or property owners may try to conceal the extent of new construction.

Proposition 13 has attracted widespread attention to property taxation and has generated substantial interest in "doing something" about high property taxes and wasteful government spending. Because the situation in California is not typical, it is difficult to predict what the effect of Proposition 13 will be elsewhere.

California is among the "high" property tax states. In 1975-76 it ranked fourth in property tax revenues per capita and sixth in property tax revenues per $1,000 of personal income according data compiled by the U.S. Bureau of the Census (see table below).

TABLE

Comparative Statistics on Property Taxes

State	Property Taxes per Capita	Property Taxes per $1,000 personal income
Highest state (Alaska)	$1048	$120
California	415	64
United States Average	266	45
Median State	236	39
Lowest state (Alabama)	57	13

Source: U.S. Bureau of The Census, Governmental Finances in 1975-76

When property taxes are expressed as a percentage of market value (the effective tax rate), California is also somewhat above average. The average effective tax rate in California is about 2.8 percent, while the median effective tax rate for the areas surveyed during the 1972 Census of Governments was 2.1 percent in 1971. Nationally, effective tax rates ranged between 0.1 percent to 5.7 percent. Proposition 13 would reduce effective tax rates in California to 1 percent or less, a level of property taxation that was exceeded in 92 percent of the areas surveyed in the 1972 Census of Governments.

Proposition 13 pinpoints a growing concern about increasing spending by local governments. Between 1971 and 1976 local government revenues in the United States increased 77 percent to $178 billion. During the same period, local property tax revenues increased 49 percent to $55 billion (property tax revenues now exceed $60 billion annually). Thus, while the relative importance of property taxes has decreased from 36 percent of local government revenue in 1971 to 31 percent in 1976, the property tax remains the single most important source of local government tax revenue (81 percent in 1976). It is also the most visible source of government revenue.

This visibility tends to make assessors the scapegoat for the increased local government spending. In most circumstances, increased property value is good news, but this is not so when the assessor is the bearer of the news. Many taxpayers believe that an increase in appraised value causes an increase in property taxes. While this is technically not true, many local governments rely on increases in assessed valuation to raise additional revenue. It is therefore not surprising that increases in assessed values are viewed with alarm by taxpayers concerned about the total tax bill.

An increasing number of states have enacted "truth in taxation" laws that require local governments to publicize plans to increase property tax levies and to vote on such increases. Increasingly, statutory limits are being placed on the amounts by which property tax levies may be increased without a vote of the people. New Jersey has enacted expenditure controls. Measures such as these focus responsibility for spending on local elected representatives. These are therefore a more direct approach to spending problems and do not raise the kinds of assessment equity issues that are raised by Proposition 13. Similarly, they do not have the disasterous consequences in the municipal bond market that Proposition 13 will inevitably cause for California's local governments. Property tax relief is also better faced directly, through programs that reduce the property taxes of the poor, the elderly, and others especially hard hit.

Paul V. Corusy, Executive Director

III. Proposition 13, Tax Reform, and Efficiency in Government

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-163762
GG8-314

August 10, 1978

The Honorable Henry S. Reuss
Chairman, Subcommittee on the City
Committee on Banking, Finance and
Urban Affairs
House of Representatives

Dear Mr. Chairman:

I am pleased to provide you with the enclosed statement on State and local productivity as you requested in your letter of July 14. The GAO report on State and local productivity that you referred to should be issued shortly.

Please let me know if I can be of any further assistance.

Sincerely yours,

Elmer B. Staats
Comptroller General
of the United States

Enclosure

I appreciate the opportunity to express our views on the issue of local government productivity. GAO has long been involved in State and local productivity improvement. We have provided technical assistance to many State and local governments on productivity projects.

Most recently, the GAO staff has completed a review to assess how the Federal Government can best advance State and local governmental productivity. Much of the review work was performed in conjunction with our overall evaluation of the National Center for Productivity and the Quality of Working Life (The Federal Role In Improving Productivity - Is The National Center For Productivity And The Quality Of Working Life The Proper Mechanism?, FGMSD-78-26, May 23, 1978). In our review of State and local productivity, our staff visited 46 State and local governments; a questionnaire was also sent to a sample of 851 State and local governments; interviews with Federal officials, public interest groups, and noted experts in the productivity area were also conducted.

The State and Local Productivity Problem

California's passage of Proposition 13 has sparked increased national concern for local government productivity. Low levels of government productivity may have been a source of taxpayer revolt, as expressed by the growing public disaffection with the efficiency and quality of public services. A recent survey by the Institute for Social Research at the

University of Michigan shows that 78 percent of the public feel that the Government wastes much of their tax dollars, an increase of 36 percent from a similar 1958 survey. Conversely, productivity improvement represents an important strategy for public managers to use in dealing with the fiscal consequences of taxpayers' revolts.

Our review of State and local government productivity throughout the nation indicates that the productivity of State and local governments is lower than it could be. Therefore, higher costs and/or lower levels of public services may result. Studies indicate substantial inefficiencies in State and local delivery of services in comparison with similar private sector operations. Furthermore, there are marked differences among jurisdictions in performance for the same services, e.g., differences of as much as 500 percent have been identified in refuse collection productivity among comparable cities.

These performance differences indicate that productivity in many State and local government services could be increased to at least the levels of more efficient State and localities. Productivity improvement programs have enabled many innovative State and local governments to increase service performance levels without commensurate cost increases.

Productivity improvement has been used as a strategy to relieve growing fiscal pressures faced by State and local governments. While the short-term dollar savings resulting from productivity improvement may not be enough to close large budget gaps or rescue cities from the brink of financial bankruptcy, the long-term savings accruing from productivity improvements may be sufficient to forestall prospective fiscal distress and slow the inflationary expenditure spiral.

Our visits to State and local governments confirmed the fiscal potential offered by productivity programs. For example:

--Los Angeles County's work measurement and methods improvement program has saved $35 million per year since 1965 by deleting budgeted positions.

--Niagara Falls, New York, credits its productivity improvement program for helping to save the city from threatened bankruptcy. Annual savings of $780,000 were realized and additional revenue was generated.

In spite of these potential benefits, most State and local governments do not have significant, comprehensive productivity improvement programs. Although many governments have programs to improve the productivity of selected services, comparatively few jurisdictions have systems to measure the efficiency of most services on a regular basis and to utilize these performance measures in key management decision areas, e.g., budget preparation, personnel evaluations. While 60 percent of State and local governments responding to our questionnaire indicated that they had a formal productivity program, less than half of these programs were used to manage personnel or budget for services.

More importantly, those local governments with the greatest need for productivity improvement, i.e., governments in fiscal distress, utilize this strategy least. In our survey, only 6 percent of local governments with fiscal problems reported using productivity improvement as their primary approach to deal with increasing costs, compared to 24 percent of local governments without fiscal problems. By contrast, 74 percent of those local governments with fiscal problems relied primarily on "budgetary belt tightening." There may be several reasons for this relative lack of interest in productivity improvement reported for fiscally troubled localities.

--Productivity improvement programs typically do not yield the immediate short-term dollar savings required.

--The initial expenses required to start productivity programs, e.g. hiring or training analytic staff, contracting with consultants, may be too prohibitive for local governments forced to economize on basic services.

<u>Process of State and Local Productivity Improvements</u>

In our study, we identified the process involved in initiating productivity improvement programs at the State and local level in order to explain the relatively limited use of this strategy by State or local governments. Productivity improvement does not come easily to State or local governments. State and local governments do not have the natural incentives to improve their productivity, e.g., profit motive and competition, that are available in the private sector. Because benefits derived are frequently long-range and diffuse, they are not adequately appreciated by the public while the associated fiscal and organizational costs receive inordinate recognition.

Productivity improvement is a major undertaking which shakes the basic management processes of the organization. As a result, productivity improvement is part of a broader management improvement process. Management systems and the capacity of State and local managers themselves must be improved in order to assure that productivity analysis is integrated into the ongoing management and budget process.

Major barriers preventing or limiting State and local productivity improvement programs include:

--limited rewards accruing to top managers;

--internal employee and bureaucratic resistance;

--large initial financial investment needed to start a program;

--limited capacity of State and local organizational systems, e.g., information systems, budget processes, excessive organizational fragmentation;

--lack of trained analytic expertise; and

--inadequate measures available to analyze service output.

To overcome these strong barriers, top management must become committed to productivity improvement to provide the sufficient impetus needed to surmount these barriers and sustain an effective ongoing program.

External assistance is not primarily responsible for initiation of State and local productivity improvement programs, but for the most part, plays a secondary or supportive role.

The secondary role played by both Federal technical and financial assistance is important, however, because the assistance accelerates or supports existing State and local management desires to start or broaden productivity programs. Most State and local governments, because of the limited availability of in-house expertise and information, need some form of external assistance to support program development.

THE FEDERAL ROLE IN STATE AND LOCAL PRODUCTIVITY

The Federal Government should have an increased role in State and local productivity improvement for two basic reasons:

--The national economy is strengthened by improvements in the productivity and fiscal prospects of the State-local sector, which accounted for 14.4 percent of the GNP in 1976.

--The costs of Federal grant and regulatory programs implemented by State and local governments, over $85 billion in FY 1979, are directly affected by the efficiency and effectiveness of those governments.

The main focus of our review was to assess how the Federal Government can best advance State and local productivity. Through our analysis of the impetus and barriers surrounding

33-595 O - 78 - 35

State and local decisions to embark on productivity improvement programs, we sought to identify the most promising Federal strategies available to help State and local governments improve their productivity. The two major roles identified were the Federal grants system itself and limited management improvement assistance.

FEDERAL GRANTS SYSTEM--THE MAJOR FEDERAL IMPACT

The Federal Government impacts most heavily on State and local government productivity through the Federal grants system which is expected to fund over 26 percent of State and local budgets in fiscal year 1979. Compared with the small direct Federal investment in State and local management improvement (estimated by a recent Civil Service Commission study at .1 percent of Federal grant outlays), the productivity implications of the Federal grants system are far-reaching.

The Federal grants system has a major negative effect on State and local productivity because of the various program structures and strictures imposed. This heavy Federal fiscal influence, however, can be harnessed and restructured to offer positive incentives to State and local governments for productivity improvement.

Negative Impacts Of The Grants System

Many Federal grants system components are a fiscal and administrative burden for participating State and local governments. Such factors as the paperwork burden, compliance with costly Federal standards, excessive delays involved in launching programs, requirements for grantees to maintain fixed levels of nonfederal spending, and the excessively narrow categorical nature of Federal assistance impose excessive costs and managerial problems on State and local governments. For example, the categorical nature of the Federal grants system fosters excessive organizational fragmentation, service inefficiencies, and burdensome administrative requirements at the State and local level. As such, the grants system retards State and local productivity levels and poses additional barriers to public managers intent on launching productivity improvement efforts. Indeed, it is ironic that many Federal grant requirements, e.g., merit standards, originally enacted to modernize and improve State and local administration of programs, have come to be viewed as obstacles to effective and efficient State and local management.

While some efforts have been made over the last decade to simplify grant administrative requirements, and consolidate some categorical grants into block grant programs, much remains to be done.

<u>Positive Productivity Incentives in the Grant System Are Lacking</u>

Although some Federal requirements, e.g., planning and merit standards, are ostensibly designed to improve State and local managerial competence, the Federal grant system seldom rewards grantees for efficient and effective performance in the aided functions.

When it comes to distributing money among grantees, most Federal funding formulae do not take grantee productivity levels into account. As a result, grantees receive no Federal recognition or benefit for achieving high comparative levels of efficiency. In fact, grantees achieving cost savings with Federal funds have been required to return all savings to the Federal Government.

In some cases, insufficient Federal program concern for performance and inadequate grantee incentives may cause overall grant program performance to suffer in comparison with other State-funded operations. In some instances, Federal grant programs operations are not subjected to the State or local productivity or management improvement programs. In Wisconsin, for example, the State's productivity program has generally excluded Federal funds from its purview.

To encourage more effective grantee management of Federal funds, the Federal Government requires matching as a condition for participation in over 60 percent of Federal grant programs.

A current GAO review of Federal matching requirements has found that, in most cases, match does not elicit greater grantee fiscal or management concern or control over the grant project because most nonfederal match is low and can be provided from existing in-kind resources. Low nonfederal match does not call forth the kind of fiscal effort needed to give grantees a natural stake in the operations of Federal grant programs. On the other hand, when nonfederal match required is high (approximately 50 percent) or is hard cash, serious distortion of State and local priorities and nonparticipation by fiscally troubled grantees can occur. Additionally, if the nonfederal match is high, the burden for grants performance is shifted away from the Federal Government onto the grantees. This may be inappropriate in programs where the grantee is helping the Federal Government to implement national policy.

Although most programs we examined had no explicit rewards for improved grantee productivity, we looked at several programs which included positive incentives. By offering financial rewards to grantees who improve their productivity, these programs seek to encourage more efficient management of Federal funds. For example, the Labor Department's Work Incentives Program (WIN) allocates 20 percent of new funds among the States based on their comparative performance in achieving program goals most efficiently, as measured by cost-benefit ratios for welfare reductions and recipient wages earned. Another 10 percent of the funds are allocated based on the extent to which each State achieves its own unique potential performance. In another case, HEW's Child Support Enforcement program (Title IV-D, Social Security Act) allows grantees to retain a certain percentage of Federal welfare savings from increased child support collections as an incentive for improved performance.

The inclusion of positive incentives attests to the feasibility of introducing productivity measures into the Federal grants system. But the widespread adoption of positive incentives may have been hampered by (1) the methodological problems encountered in establishing credible measures of grantee productivity, and (2) the lack of central management evaluation and direction over the grants system.

FEDERAL MANAGEMENT ASSISTANCE FOR PRODUCTIVITY IMPROVEMENT

In our review, we have identified some important ways in which Federal financial and technical assistance for management improvement can help State and local government productivity efforts. The Federal Government can help by providing:

--General management and capacity improvement assistance to support productivity efforts.

--Funds to defer start-up costs.

--Information on programs and techniques used by other jurisdictions.

--Training to develop State and local government analytic expertise.

--Information on comparative performance.

--Information on well-developed and tested measurement systems.

--Third-party forums for resolving labor-management conflicts.

State and local governments indicated that they rely primarily on their own informal and formal networks for technical assistance and information rather than on the Federal Government. The Federal Government should therefore provide technical assistance and information through these established networks and associations rather than directly to State and local governments.

Federal seed money grant funds for productivity improvement in some cases did serve as a catalyst for program initiation in those governments where top management was unsuccessful in committing local funds because of internal conflicts over the value of productivity improvement programs. In these cases, the Federal grants provided funds for startup costs thereby enabling State and local governments to initiate management innovations with long-term benefits but short-term costs.

Federal funds were especially important to fiscally troubled local governments where management analysis often loses in the competition for shrinking local dollars. According to our survey, these local governments, who are most in need of productivity improvement, are least able to afford the start-up costs and most dependent on Federal funding for financing.

Many individual Federal agencies and programs provide technical and financial assistance for management improvement at the State and local level. However, the management assistance that is available is oriented primarily to the needs of functional specialists, not to State and local central managers who are key to implementing productivity programs in the management process. In dollar terms, a recent Civil Service Commission study estimated that Federal assistance available for State and local central management is only a little over $80 million per year.

Need For a Stronger Federal Leadership

A Federal focal point is needed to assure a greater positive impact on State and local productivity improvement working through the two roles discussed above--the grants system and limited management assistance.

Recent Federal attempts to more effectively coordinate existing Federal financial and technical assistance programs for State and local productivity improvement have met with only limited success. In our earlier report, we concluded that the National Center for Productivity and the Quality of Working Life had insufficient resources and leverage needed to effectively lead or coordinate other Federal agency activites. Now that the Center is in the process of being terminated, the emergence of a stronger focal point for State and local productivity is even more critical.

Our review indicates that greater potential exists for more interagency cooperation and coordination so that:

--Information on Federal assistance available to State and local governments for management improvement and productivity can be centrally available and disseminated to potential State and local users.

--Duplication among the Federal agencies can be minimized and contact among relevant Federal program officials can be increased.

--Missed opportunities or gaps in program coverage to meet State and local needs can be reduced.

--Evaluation of incorporating performance incentives in the grants system can be performed at a central management level.

A stronger focal point could address these needs. Its mission would be to set policy and provide leadership for existing Federal research, demonstration, and capacity building efforts aimed at improving State and local general management and productivity. The focal point would also serve as a broker, reflecting the needs of State and local managers and attempting to change Federal programs and policies accordingly. Most importantly, a focal point could study and deal with critical Government-wide issues affecting State and local productivity, especially the impact of the Federal grant system. As such, the primary emphasis would be to institutionalize within the Federal Government a concern for productivity in the Federal Government's relationships with State and local governments.

CONCLUSIONS AND RECOMMENDATIONS

The Federal Government should be concerned about State and local productivity because of its interest in strengthening the national economy as well as its increasing role in providing funds to State and local governments for service delivery. Thus, the Federal Government should encourage and support State and local government efforts to improve their productivity.

Federal Assistance For General Management Improvement Is Needed

The development of a more effective Federal role in helping interested States and localities improve their productivity must be part of a broader program to improve the general managerial capacity of these governments. As part of a State and local management improvement program, the Federal Government should pursue the following strategies:

--Fund a limited seed money grant program for general management improvement. Since management innovation projects are often too risky or politically unrewarding to gain full initial local support, Federal grant funds can help initiate these projects, especially in jurisdictions with fiscal problems.

--Increase funding for national research and demonstration programs in public management. This would help satisfy the continuing need for development of better measurement systems, comparative performance statistics, and alternate approaches to the delivery and management of public services.

--Improve information available to State and local governments on management improvement and productivity through a clearinghouse as recommended in our prior report. Working through networks of State and local officials, the Federal Government can foster more effective dissemination of information on measurement systems, new management approaches, comparative performance data, and the productivity programs and problems of other jurisdictions.

Changes Needed in the Federal Grants System

Congressional and administrative officials responsible for formulating and implementing Federal grant programs should be more concerned over the impact of grant policies and procedures on State and local management and productivity. In spite of administrative efforts made over the last decade to simplify and streamline Federal grant procedures, fundamental changes in the structure of the Federal assistance system are still needed to remove the substantial disincentives to grantee productivity. Major grant system changes which should be considered to remove some of the negative impacts on State and local productivity include:

--Reduction of Federal reporting and paperwork requests and requirements.

--Standardization of Federal employment, nondiscrimination, environmental review, planning, and other "cross-cutting" requirements among all Federal programs, with designation of an appropriate Federal cognizant agency for certification of grantee compliance with each requirement.

--Consolidation of categorical grant programs into broader purpose block grants whenever feasible.

--Elimination of many detailed procedural requirements and controls over grants administration--e.g., personnel qualifications, structure of grantee operating agency, citizens participation--if accountability for program results based on quantitative performance standards is established.

There is a need to more widely incorporate performance measures and criteria in Federal allocation formulas and standards used to evaluate grantee performance. The concept of incentives and performance standards needs to be considered when grant programs are either created or reauthorized. The sorting out of Federal assistance programs along the lines contemplated by the recently enacted Federal Grant and Cooperative Agreement Act (P.L. 95-224) may identify the circumstances as to which programs should appropriately include performance incentives in addition to other factors for distributing funds. Applying performance incentives may be most appropriate, for example, in those Federal programs whose main purpose is to enlist State and local participation in achieving certain national priorities and objectives, e.g., provision of drug abuse services and water pollution control. In these cases, the intergovernmental relationship is somewhat contractual in nature. Conversely, performance incentives may not be appropriate for those Federal programs whose primary purpose is to financially help State and local governments meet their own priorities, e.g., fiscal relief and crime reduction. In these cases, the grant becomes more of a gift than a contract.

Federal Focal Point

A separate Federal focal point for State and local management improvement and productivity is needed to provide stronger leadership for existing Federal efforts and to promote increased concern for State and local productivity throughout the Federal Government.

In our prior report on productivity, we suggested that the Civil Service Commission would be the most appropriate location for the State and local productivity focal point. The Commission offers the advantages of organizational stability, familiarity and experience with State and local management improvement through the Intergovernmental Personnel Program, and an overview perspective that would enable it to better handle State and local government productivity problems that cut across existing line agency boundaries.

To enhance its role in this regard, the Commission should be given clear authority to serve as the lead Federal agency for State and local management and productivity improvement. Furthermore, it is important that the Commission be provided with adequate funding to enable it to assume this new responsibility.

Other Actions Needed

To ensure a stronger Federal role in improving State and local productivity, these additional actions are necessary:

--The Commission's Intergovernmental Personnel Program should be broadened to fund general management improvement projects for State and local governments.

--Funding should be provided to the Department of Labor's Bureau of Labor Statistics to measure State and local productivity trends. The Bureau measures private and public sector productivity, but there is no work being done specifically on measuring productivity of the State-local sector.

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410

ASSISTANT SECRETARY FOR
POLICY DEVELOPMENT AND RESEARCH

August 17, 1978

IN REPLY REFER TO:
TPC

Honorable Henry S. Reuss
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Reuss:

Thank you for your invitation to submit a statement on HUD's recent work in support of local government productivity efforts for your July 25 and 26 "Proposition 13" hearings record.

The enclosed statement summarizes HUD's current program direction and describes products developed over the past few years which have been, or are anticipated to be, particularly useful to local governments.

Sincerely,

Donna E. Shalala

Enclosure

HUD's Recent Work in Support of Local Government Productivity Efforts

The Department of Housing and Urban Development (HUD) recognizes the priority of productivity improvement with community officials as they attempt to respond to citizen demands for more and better services while cost increases outpace revenue growth.

HUD's earliest productivity efforts demonstrated that analytical tools and techniques could be applied successfully by local governments to improve productivity. These efforts were directed toward specific services, and many cities are now using the tools and techniques developed. Since those pioneering efforts, there has been a wealth of research and development--to which HUD has contributed--to support productivity improvement in specific service areas.

HUD's own productivity efforts have evolved from primarily supporting department managers to supporting policy and management personnel responsible for resource allocation among functional areas. Currently HUD's focus is on improving local government financial management. HUD identified priority financial management problems through a series of workshops and a national conference involving nine public interest and professional groups including about 100 elected and over 750 appointed local officials from almost 800 jurisdictions in 47 states.

Almost all of the priority problems identified fall into three broad categories: budgeting and financial management; accounting, auditing and reporting; and intergovernmental relations. The specific priority problems clearly underscore the importance of productivity improvement in financial management, and this will be a major component of HUD's program.

As stated, the program will be to help improve local government financial management. However, because state governments set the legal framework and requirements within which local financial management must operate, and because of the impact of federal grant and other program regulations, HUD plans a three-fold approach. In particular, HUD plans to:

- Expand opportunities for information sharing, training and technical assistance through state and regional organizations that provide such services to local governments; facilitate nationwide information sharing and training for problems requiring this perspective, and; provide a national focus for inquiries and information requests on local financial management problems. In addition, publications and training materials may be developed to fill existing gaps.

- o Encourage and assist state governments to revise and update legislation on local government financial management, and; encourage states to develop and expand their training and technical assistance services to local government in financial management.

- o Encourage federal agencies to reduce the burden and obstacles to improving local government financial management imposed through their regulations and requirements, and; encourage federal agencies to undertake research projects which may be useful to local officials.

This program will be built on the solid foundation of earlier HUD work, in support of service management and operation, resource management and allocation, and policy management.

Service Management and Operation

This category includes HUD's work in fire service productivity improvement. Specific products are:

- o Uniform Fire Incident Reporting System to collect, classify, and report fire incident data for immediate access by decision-makers. Approximately 35 jurisdictions are using UFIRS data to better analyze fire problems, budget expenditures, allocate manpower and equipment effectively, plan fire prevention activities, and provide better community protection. Manuals enable managers to install and use the system without enlisting outside expert assistance.

- o Fire Station Location Package of management level reports, organizational and training procedures, worksheets and computer programs to enable officials and fire service administrators to assess the feasibility, cost, and consequences of alternative fire station site locations and numbers (both current and planned). Over 110 jurisdictions use the step-by-step procedure to plan, select sites, and implement new policies to provide better protection at the same or lower cost.

- o Emergency Service Deployment Methods, a set of analytical techniques to help managers, planners and analysts assess alternative actions in providing improved emergency service protection--fire, police, and ambulance--and in reducing response time of manpower and equipment so as to increase the probability that they will be available at the times and places needed most. Case studies of how seven jurisdictions plan and implement new ways to more effectively use resources at lower costs, analytical tools, and training materials are available.

- Public Facility Location Package to provide officials and managers with a systematic approach in assessing the practical effects of alternative ambulance service and leisure service locations. Currently, 11 jurisdictions have used or are using the package to help in selecting the best locations to meet community objectives.

In addition, a fire service textbook is being developed which will integrate the results of HUD and other fire research.

Resource Management

This category includes:

- Streamlined Permit Application System. The State and three Oregon cities are developing and testing new techniques to coordinate and simplify existing separate State and local permit systems. The State is working with Eugene, Portland and Salem to transfer and implement streamlined permit systems in Oregon communities.

- Improved Work Scheduling of Urban Services. Six California Innovation Group cities--with Santa Clara as the lead--tested a new "proportional work scheduling" method to better match staffing levels to workload. The project covered those municipal services provided more than "eight hours a day, five days a week," such as ambulance, libraries, utilities, recreation, transportation and sanitation. Case studies and a handbook on work scheduling design are available.

- Improving Productivity in Neighborhoods. Washington, D.C. is demonstrating integrated use of neighborhood condition rating, performance measurement, work scheduling and citizen participation methods to improve productivity in several services that affect neighborhood physical conditions.

Policy Management

This category includes:

- Program Analysis and Evaluation techniques to help officials who are looking for better ways to improve the decisionmaking process in the allocation of scarce resources. These techniques are currently being used by about 20 cities.

- Productivity Improvement Handbook, presenting in one volume the fundamentals of various aspects of government productivity improvement, to help local government managers, department administrators and trained analysts find useful information on problems outside their immediate specialized field. Coverage will include characteristics of local government services, local government managerial environment, operational analysis techniques, modern management and administrative techniques, and representative data. The book was written and edited by nationally recognized experts. John Wiley and Sons, publishers, independently assessed the market for this handbook, found it highly favorable, and plan to publish and market the handbook with no HUD funds.

- Performance Measurement and Cost Accounting for Small Local Governments. The State of Rhode Island, working with five local governments, is producing a manual and forms to make performance measurement and cost accounting accessible to small local governments. A training course in cost accounting will also be developed and tested.

- Community Development Block Grant Budgetary and Financial Management. This guide developed by the Municipal Finance Officers Association consists of practical approaches to financial management of the Community Development Block Grant Program. Five key management functions are described in the guide. These are: program planning, budgeting, accounting, monitoring, and performance evaluation. Each of these management functions is presented at basic and advanced levels. The basic level is designed for small to medium local governments while the advanced description is drawn from successful management methodologies employed by larger units of government. The guide presents an overall process for the integration of the Community Development Block Grant Program into general local government management systems and contains a considerable number of sample charts and forms which a local government may choose to adopt. It is presented in a modular fashion which will make it easier for local governments to implement any or all of the management elements described.

National Center for Productivity and Quality of Working Life

STATEMENT BY

THE HONORABLE GEORGE H. KUPER
EXECUTIVE DIRECTOR

NATIONAL CENTER FOR PRODUCTIVITY
AND QUALITY OF WORKING LIFE

FOR THE

SUBCOMMITTEE ON THE CITY
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
U. S. HOUSE OF REPRESENTATIVES

15 August 1978

Mr. Chairman and Members of the Subcommittee:

I would like to respond to the generous invitation to submit testimony by departing somewhat from general custom and take advantage of the opportunity to convey not just my ideas but those of a very distinguished group of State and local government leaders. A committee listed in Exhibit I was convened three years ago by the National Center for the express purpose of exploring ways of responding to the underlying concerns of the citizenry for more and better services at lower cost as specified in the Center's enabling legislation, P.L. 94-136.

2000 M Street, N.W., Washington, D.C. 20036 (202) 254-9890

Exhibit I

PUBLIC SECTOR COMMITTEE*

Daniel J. Evans, Chairman
Governor of the State of Washington

Wayne Anderson, Executive Director
Advisory Commission on Intergovernmental Relations

Thomas Bradley
Mayor of Los Angeles (California)

Ruth Clusen, President
League of Women Voters

John D. R. Cole, Director
Bureau of Personnel Management Evaluation
U. S. Civil Service Commission

James E. Holshouser
Governor of the State of North Carolina

Mark Keane, Executive Director
International City Management Association

Winfield M. Kelly, Jr., County Executive
Prince Georges County, Maryland

James E. Kunde, Director of Urban Affairs
Kettering Foundation

Phyllis Lamphere
Seattle City Councilwoman (Washington)

Patrick J. Lucey
Governor of the State of Wisconsin

Marjorie Lynch, Undersecretary **
U.S. Department of Health, Education, and Welfare

James F. Marshall, Executive Director
Assembly of Governmental Employees

William H. McClennan, President
Public Employees Department, AFL-CIO

(Exhibit I, cont'd.)

Thomas Moody
Mayor of Columbus (Ohio)

Thomas Morris, Assistant Secretary, Administrative Services
Florida Department of Health and Rehabilitative Services

Chester Newland, Director
Federal Executive Institute

Jean Packard, Community Development Center
National Association of Counties

John B. Rhinelander, Undersecretary
Department of Housing and Urban Development

Bernard Rosen, Professor, American University
Former Executive Director, U. S. Civil Service Commission

Elmer Staats
Comptroller General of the United States

Wayne Thompson, Senior Vice President
Dayton-Hudson Corporation

Reuben Valdez, Speaker
Colorado State House of Representatives

John G. Veneman
Counselor to the Vice President of the United States

Jerry Wurf, President
American Federation of State, County, and Municipal Employees

Sam Zagoria, Director
Labor-Management Relations Service of the U.S. Conference of Mayors

Nancy Hayward, Assistant Director
National Center for Productivity and Quality of Working Life

* Organizational affiliations as of January 20, 1977

** Deceased

The frustrations of taxpayers at the difficulty public manager's seemed to be having in responding to this desire for increased effectiveness and efficiency erupted into a movement exemplified by the passage of Proposition 13 in California. Unfortunately, the "meat axe" approach to the concern that Proposition 13 represents only takes care of the input part of the problem because the public is also unrelenting in its demand for many of the services government provides. And well they should be because government services are - like it or not - a critical ingredient in maintaining the quality of life that we have come to insist upon.

Our Committee discussed these issues in terms of productivity improvement because, as you know, productivity growth is one means by which we as a nation can improve our standard of living. By improving productivity the real income of all individuals can be increased. Greater productivity enables us to produce affordable and competitive goods and services, while simultaneously increasing our leisure time and the resources with which to enjoy it. A mere 3 percent annual productivity growth rate will double our standard of living in only 24 years.

You have heard testimony of the experiences of a few local governments in their efforts to improve productivity. A growing number of jurisdictions are making coordinated, focused attempts to improve their productivity. These efforts are fragile and are in need of both substantive and political reinforcement. At the Federal level, recognition of the importance of improved State and local government productivity evolved slowly, and I fear, has now lost its momentum, despite increasingly clear indicators of need. I obviously am concerned that the Center's fledgling efforts will be abandoned along with the National Center. Full realization of the benefits that could be derived from these initial steps cannot be achieved until the individual initiatives are integrated into the ongoing processes of public service delivery by all levels of government.

The purpose of the following agenda for productivity improvement in State and local government was to guide the committee's work. More importantly, the participants hoped it would:

. establish a framework for integrating productivity improvements into government processes;

. stimulate efforts by all those involved in, concerned with, and affected by the productivity of our State and local governments;

. provide counsel to those charged with legislative and policy decisions which affect State and local government; and,

. help to focus debate on issues for which solutions are still being sought.

I hope you will note that this consensus, established long before Proposition 13 was proposed, is not a plea for additional Federal assistance but rather provides some specifics on how current Federal assistance can be better utilized. It also specifies actions to be taken by local governments themselves.

Part I places a context on our interest in the productivity improvement of State and local government; Part II outlines intergovernmental issues that could contribute to improved productivity in government; and Part III addresses local government's responsibilities.

At the end of Parts II and III I will offer my own observations as to how well we progressed along this agenda over the last few years.

The process from which this statement emerged was critical because it represents an important consensus amongst representatives of organizations often perceived to hold adversary positions on some of the issues raised. Although not all members endorse each and every point of the agenda, all have concurred with the central thrust and general approach I have the privilege of relaying to you here.

I

STATE AND LOCAL GOVERNMENT PRODUCTIVITY IN A NATIONAL CONTEXT

Government's productivity is its efficiency and effectiveness in delivering services which are responsive to the needs of the society it serves. This is a central concern in our society today.

In this country nearly 80,000 general and specific purpose State and local governments play a basic role in determining the quality of our lives and our ability to maintain a healthy and productive economy. The schools our children attend, the water we drink, the roads on which we drive and transport our food and material needs, a major part of our health and social services, and our public safety services - all of these are services of State and local governments.

The primary responsibility for administering tax dollars and delivering public services lies with States and localities. Public demand for basic services from State and local governments is increasing at the same time that governments are assuming expanded responsibilities such as consumer and environmental protection services. Federally legislated programs are increasingly designed for delivery and partial funding at the State and local level. Currently, over 80 percent of non-defense public expenditures for goods and services are made at the State and local levels.

State and local government expenditures have risen 2 1/2 times in the last 20 years as a result of the aforementioned service increases, inflationary pressures, expanded overall employment levels, higher wages and fringe benefits necessary to achieve comparability with the private sector, and increased proportions of professional and technical positions commanding higher salary levels. This rise in public costs is almost 15 percent greater than any other sector of the economy, and almost double the concurrent increase in consumer prices.

As a result, State and local governments represent a major sector of the economy - 15 percent of the Gross National Product. Only 20 years ago they represented 8.2 percent of the GNP. Surveys of public perceptions, although difficult to assess precisely, suggest that the quality and efficiency of governmental services have not risen as fast as their costs. To maintain our current standard of living, we must insure that public sector productivity keeps pace with increased costs.

In our democracy we have endeavored to keep government functions close to the electorate to assure that they reflect local priorities. One result is 80,000 governmental units with varying structures and often overlapping responsibilities. This complex, interrelated system of government units may operate less efficiently than might be the case under a more centralized government at a greater distance from the electorate. Further, in our form of government we seek to assure civil liberties and representative democracy through a sharing of responsibilities between executive, legislative, and judicial branches. While this principle may also lead to inefficient administrative processes, the basic tenents of separation of powers must be inviolate. Thus, our system creates certain inefficiencies which we accept in order to obtain certain overriding social goals. Our need is to learn how to operate as efficiently and effectively as possible in that context.

The authority and responsibility for improving government productivity rests primarily with officials of those governments, and with the citizens, institutions, and businesses they serve. These individuals and institutions must therefore demand and support systematic improvements in productivity. The linkages of authority and responsibility among our governments are extensive and their effects often unclear. State and local governments affect national productivity through their primary role in delivering services, and as the implementing arm for a wide variety of national programs. The Federal government, in turn, affects the productivity of State and local governments through legislation and regulations which affect State and local administrative processes both directly and indirectly. Similarly, State governments affect productivity in local governments through legislation and through State functions which interrelate to local functions.

The functions and services of State and local governments prescribed by all three levels of government are financed through a patchwork of taxes, user charges, intergovernmental transfers, grants, debt and other mechanisms, generated at all three levels. In terms of governmental productivity, this system of public finance permits the assignment and assumption of functions and services without full or adequate knowledge and consideration of service levels, costs, relative or absolute abilities to pay, or the sources of revenues. Thus, our current approaches to intergovernmental financing and assignment of responsibilities frequently distort our understanding of the relationships between needs and means - between what we spend and what we expect - and so impede our ability to hold elected and appointed officials specifically accountable for efficient and effective allocation of resources and delivery of services.

The intertwining of responsibilities and resources to deliver domestic services in the increasingly complex American intergovernmental system renders participation by the national government essential.

II

PRODUCTIVITY IMPROVEMENT OPPORTUNITIES WITHIN THE INTERGOVERNMENTAL SYSTEM

By virtue of the importance of both State and local services to our nation's well-being, improving their productivity is an effort of national significance and should be facilitated and supported by the Federal government, foundations, citizen organizations, and academic establishments. To improve productivity in the context of this intergovernmental system, attention and changes are needed in five areas.

First, the general direction represented by revenue sharing programs increases the accountability of local governments to their constituents. Revenue sharing has enabled some governments to achieve significant improvements in management and productivity. The revenue sharing approach brings decisions about service levels and the financing of those services together into bodies that can be held accountable for their performance through our democratic processes.

Second, The Federal government and State governments can make a substantial contribution to improving management and productivity in local governments by establishing a coordinated policy and organizational framework for the activities of those many agencies involved in supporting and regulating local government functions. The vast majority of the support provided to local governments comes, not as General Revenue Sharing, but in the form of transfer payments, block grants, categorical programs, research and development programs, loan guarantee and loan programs, training, and technical assistance. There is a continuing need and role for many of these programs, both as vehicles for implementation of national and state policies and because immediate conversion to revenue sharing is not feasible. The Federal government and States in administering these programs, must calculate and address the full current and future costs of such programs to all levels of government involved; recognize the effects of such programs on the productivity and revenue generating capacities of local governments; and recognize in financial terms the secondary effects upon the means and expectations of local governments. For example, current Federal efforts to stimulate the economy and reduce unemployment add to the overhead and managerial workload of both State and local governments. At the same time, jurisdictions are tightening their belts by reducing employment and services while unemployment is increasing the demand for locally distributed services. Further, these circumstances, together with inflation, resulted in local tax increases which conflict with the national effort to increase personal disposable income.

Third, administrative and substantive rules, regulations, and procedures between governments - as mandated both by legislation and by executive branches - must be simplified, streamlined, and exchanged, where possible, for alternatives less costly to both Federal and local administration. The administrative costs of intergovernmental programs are excessive and uncontrolled. Alternatives such as increased audit activities and performance-related goals and measurement systems offer potential for significant savings and productivity improvement, for accelerated service delivery, better manpower administration, and a higher proportion of existing resources provided directly to actual services.

Further, the regulations now used to implement national and State objectives and goals regarding work safety, the environment, energy, and so forth, may add substantially to the cost of both public and private production and service delivery, without adding proportionately to the quality of products or life.

There are reasons - and usually good ones - for the existence of most of the rules and regulations imposed by government. The problem, and the source of potential productivity improvement stems from an environment in which : (1) the original need or reason for a regulation may no longer exist; (2) regulation is often an inefficient and ineffective means of assuring we meet the real underlying need; and (3) alternatives exist which are more efficient and effective.

Fourth, since effective general management is critical to productivity improvement there is a great need to reallocate Federal resources in ways which support the improvement of general management in both State and local governments. Past and current Federal efforts generally pursue objectives based on functional needs (i.e., housing, law enforcement, health, education), usually without fully recognizing the role of local general governments as the source of authority and responsibility for local priorities and interfunctional relationships and linkages. Such general management concerns as finance and manpower are also frequently fragmented into functional efforts. As a result, past Federal efforts have often fallen far short of optimal impact. With the exception of the U. S. Civil Service Commission's Intergovernmental Personnel Act Program, Federal support for general management improvement is nonexistent, reflecting a significant lack of understanding of the importance of management in improving service delivery.

Past efforts to comprehend the fundamental role of local general government in federally supported efforts (including activities of the Federal Regional Councils, the Integrated Grant Administration Program, and others) have been mildly successful, but generally they have not been supported to the requisite degree by the responsible Federal departments. Many observers, including the Advisory Commission on Intergovernmental Relations, the Ash Commission, the major Public Interest Groups, OMB through various studies it has conducted, and the Federal Regional Councils, have at various times concluded that the designation of a focal point within the executive branch for the development of a strategic approach to general management improvement in State and local governments is an essential element of a more effective federalism.

Finally, Federal assistance to local management improvement efforts should seek supportive rather than directive roles in the improvement of general management. Recent evaluations by the National Science Foundation of innovations in local governments suggest that current approaches to Federal support and assistance are not compatible with conditions required for innovation in local government. Additional research and great care are needed in defining specific roles taken by the Federal government in efforts to improve general management capabilities in local governments.

33-595 O - 78 - 37

<u>Fifth, State and local governments must take steps to reform their own tax, revenue, and service structures</u>. Improved understanding of the specific relationships between needs and means, sources of funds and ability to pay will allow more rational and straightforward public management. Further, service revenues and property taxes, the main sources of State and local government revenues, lag behind inflation (in spite of annual reassessment now being used in many jurisdictions). In the short term, substantial improvements can frequently be obtained within existing structures and laws by modernization of property tax assessment processes, annual revisions of assessed values (which usually require prior modernization of assessment processes), and appropriate changes in property tax bases. In particular cases, local governments should explore ways to improve their financial health through such techniques as taxing land more heavily than improvements, taxing capital gains on land at moderate rates, and arranging special assessments to cover windfalls. The principal alternatives to property taxes - progressive income and sales taxes and user charges - need careful exploration. In many cases these alternatives promise to follow inflation more closely; in other cases, these revenue sources, and certain changes in property tax assessments (e.g., shifting taxes from business to residential properties) may contribute to damaging changes in the population of central cities.

The referendum process which is traditionally used to approve capital offerings in the public sector needs review, both because of counterproductive constraints which the process may currently place on some parts of the public sector, and because, in separating capital from operating decisions, the referendum process in many cases obscures the full cost of public functions.

The most important role in regards to reforming and modernizing State and local revenue sources rests with the State governments. There are relatively few approaches that the Federal government can take to deal with the problems involved. Also few actions can be taken by local governments, governed as most are by State laws with respect to their sources and quantities of general revenue. Legally and politically, States in most cases have direct access to local government structures, as well as to their own. A wide range of appropriate State level actions exist that can reduce cyclical effects, help revenues better keep up with inflation, and make taxation less regressive.

In addition, relatively little is known about the ways in which capital investments can or do affect productivity in the public sector. Productivity-related uses of public capital typically represent low priorities. Examination of these relationships may serve to raise their priority.

Finally, State and local governments must be fully incorporated into national discussions of the availability of capital resources. Without open and informed discussion, the Federal and private sectors may tend to "crowd out" State and local governments' long term financial needs, as future lenders perceive increasingly higher risks in these offerings than has been traditionally the case.

* * * *

Unfortunately, I cannot report significant progress in most of these areas over the course of the past three years. In fact, we are on the verge of moving backward with regard to support of general management assistance. Neither OMB nor the Congress have been willing during the Civil Service Reform deliberations to broaden the Intergovernmental Personnel Act mandate to encourage general management support despite repeated evaluations endorsing such action. Every year the IPA appropriation is in jeopardy despite strong local support and demonstrated success.

Within the past year and a half HUD has launched a program to strengthen local budget and accounting capacities. This beginning is definitely needed, but the Federal effort should be expanded in scope and support to include tax and capital questions which I have attempted here to relate to the overall problem.

The desire for an urban policy similarly reflects recognition of the need to coordinate Federal programs in this case contributory to improving the economic vitaltiy of cities. The Federal government addresses many other urban issues not covered by the proposed urban policy but carried out by the same Mayors, City Managers, and Department Officials. Conceptually it represents progress in the right direction, but we can't afford to stop here. However, most disturbing about the proposed Urban Policy is the total lack of concern for strengthening the capacity to improve the efficiency and effectiveness with which existing or new programs will be delivered. We must remember that what we can afford to deliver in the long run depends on how well we deliver it.

The White House Memorandum of September 1977 outlining improvements in the Federal administration of loans and grants and the Departments' ensuing actions begin to deal with some of the administrative opportunities to which the agenda refers. While the aggregate administrative costs incurred by State and local governments in delivering $72 billion of grant-in-aid are unknown, I expect you will concur, they exceed by many times the Federal costs for administration. These state and local administrative costs have been further increased, in part, because efforts to streamline Federal administration have passed on additional administrative requirements to lower levels of government. As current research in New York State and by the GAO indicates, the slack in this system which can be applied to the end purpose of the programs can best be isolated by incorporating incentives for improved productivity into the grant guidelines. The current disincentives to improved performance not only deadens the ingenuity of many talented local government managers but also wastes precious public resources.

The purpose of these hearings, as I understand it, is to unearth ways of making a finite pie of resources feed more demands. The grant-in-aid system is the single most direct method of positively influencing, without directing, public resource efficiency and effectiveness. It can save the Federal government money while it can expand the levels of local service delivery. At the same time management improvements applied to Federal programs would become integrated by local officials into the management processes of all local services - including those funded locally. Without tapping this opportunity, the Federal government is hard pressed to reflect to the citizens of America that they are really trying to both save money and improve the quality of service delivery.

III

LOCAL GOVERNMENT MANAGEMENT

For local government officials, the single most important opportunity to enhance productivity is to improve the management of public service delivery. By management we mean the process of allocating and directing resources - human, technological, and financial - to the needs and demands of consumers. Improved technology, more skilled employees and more appropriate financing can positively affect local government productivity only to the degree that their introduction, development and utilization are well managed.

As a nation and a people we must more directly hold public managers, elected officials, and public employees accountable for efficient and effective delivery of services. To begin with we must insist upon improved management in our local governments. We can thereby create a demand for better management as well as a social and political climate which is conducive to continued improvement.

The necessary first step toward creating the means for improving management in local governments is for responsible public officials to develop and distribute better information with which interested parties can hold their governments accountable. To begin improving management and productivity, each community needs usable information about the nature, cost, and effectiveness of current services; about effective practices and techniques used in other jurisdictions; about the relationship of current services to community needs; and about the needs, attitudes, and capabilities of public employees in the jurisdiction. Properly gathered, disseminated and applied, such information can serve many purposes. It can serve to focus constituent concern about government performance on priority problems, thereby increasing the likelihood of effective problem resolution and sustained commitment by public managers to improved management. Provided to elected officials, taxpayer and community associations, professional and employee organizations, and other groups who are in positions to hold government managers accountable for results, such information can promote accountability and attention to the inputs and outputs of government operations. In complex areas where answers, if they exist at all, are not clear-cut, such information can improve the factual basis of public debate, with the promise of more satisfactory results. In an era when citizens are demanding greater efficiency and effectiveness, these demands, coupled with information, can generate in public managers a commitment to improve productivity.

An assessment of current public services is also a necessary input to the development of practical objectives which delineate not simply "where we want to go", but from where we are moving, toward what we are heading, and the distance between the two. Capital investments, new program ideas, and changes in procedures and methods cannot be evaluated, nor can their implementation be designed without relevant information about current activities. Managers need to know the actual activities and costs involved in functions to be replaced, supplemented or changed. Thus, the process of assessing the present position is not only a first step which can affect the demand for improved management and productivity in local jurisdictions, but is also a valuable - even indispensible - input to a whole range of management decisions.

Information on the Nature, Cost, and Effectiveness of Current Services

Little information which reflects the nature and effectiveness of service delivery in local governments is regularly collected. Traditional approaches, showing broad functional categories and line items (e.g., police salaries), and more recent program-oriented approaches, showing goals and objectives (build 143 miles of class two streets), often fail to indicate the effectiveness or efficiency with which services are delivered. (Information gathered for more or less purely financial perspectives is discussed in the section immediately following.) While some work that has been done in a small number of jurisdictions can be studied and transferred to other jurisdictions, local governments, in general need to apply performance measurement techniques more extensively and more precisely. Each jurisdiction must tailor the techniques to their specific circumstances. From experiences to date, much has been learned about processes for developing and implementing methods for monitoring performance and measuring actual results. Some jurisdictions have set up elaborate systems; others use analysis for periodic and/or spot-checking approaches of measurement. Both of these approaches, and others, can be fruitful pursuits.

Managers and elected officials must develop straightforward methods of assessing public service performance. Appropriate Federal and State agencies, public interest groups, and professional associations need to help provide specific materials suggesting measures, and identifying questions for consideration by local governments which are concerned with and interested in measuring their efficiency and effectiveness and improving service delivery productivity.

Finance and Financial Information

Far more is known about how to develop useful information on local government costs - primarily through traditional budgeting, accounting, cash, debt, and other financial processes than is known about the measures of the nature and effectiveness of governmental services. Because of the results already achieved in a few jurisdictions and the relevance of existing private sector expertise, it is clear that substantial opportunities in the areas of finance and financial information exist whereby local governments can improve their productivity. To reap these benefits, which can be achieved in the short term, requires identification, documentation and effective dissemination of available ideas and techniques.

Budgeting: The fundamental process through which governments set service priorities is the budget. Budgeting should illuminate the real priorities and allocations among jurisdictional resources and thereby allow citizens, officials, and other interested parties to hold managers accountable for their actions.

There are several ways in which most local governments can substantially improve their ability to find and capitalize upon productivity opportunities as they go about deciding how much money to spend on what functions. Many governments find it useful to examine not only past and future expenditures but also unit costs and other efficiency and effectiveness measures in budget processes and documents. Such information can suggest areas where improvement is immediately needed, and can also suggest areas where further work - for example, analysis and exploration of what other jurisdictions are doing - might improve service delivery methods or service patterns.

Local governments should explore alternative budgeting processes which either force or allow complete annual programmatic assessment of service effectiveness and efficiency. Many governments are attempting to achieve this objective through a variety of mechanisms, including "zero-based budgeting", advanced program planning and budgeting approaches, "performance budgeting", and others.

Local governments should also explore alternative ways to integrate operating and capital budgeting activities to allow exploration of capital investments which may reduce near and long term operating costs, and permit public officials and others to comprehend the full current and potential operating costs of public programs. Capital expenditures in local government are not simply for construction and fixed assets. Vehicle and other equipment replacements are sometimes included as operating expenses while at other times they are shown as capital expenditures. For most governments, the current process is haphazard. It does not allow rational replacement and investment policies, and it obscures future implications of current commitments.

<u>Accounting and Auditing</u>: Accounting and auditing functions are equally important as budgeting to improved management and productivity. These functions provide real information to governments about how much money they have spent for what ends.

Local accounting and auditing standards and functions need revision to assure that they account for the full costs of services provided. Public pension programs, operating and maintenance costs related to capital expenditures, and overhead costs are examples of areas in which there are frequently severe problems. Further, paralleling the need to integrate capital and operating budgets, depreciation and amortization schedules must be developed to reflect the real costs of replacing and improving capital investments in the public sector.

Uniform State-wide accounting standards are needed as a first step toward providing regular and meaningful comparisons of performance from jurisdiction to jurisdiction. Such comparisons are potentially very valuable, having the capacity to increase public demand for better management and also to provide insights into those areas in which local governments might usefully strive to improve costs and methods.

In accounting and auditing functions, as in budgeting, there is an opportunity to identify potential productivity improvements by relating costs to results achieved. This opportunity should be explored, building upon methods developed by the General Accounting Office and a number of States and localities. Performance-oriented accounting and auditing functions can at least partially offset the need to impose extensive administrative regulations. For example, where a government is able to show complete, current information on what it has spent, for what functions, within the last month, the last quarter, the last year, other organizations and governments with supervisory and/or oversight responsibilities may feel less need to impose cumbersome rules and regulations. The converse - the imposition of regulations when faced with little or no information about what money is being spent for - has been the experience of most local governments. Administrative regulations, installed to insure appropriate activities and expenditures, are frequently damaging to the productivity of local governments. Attempts to achieve accountability through regulations are frequently stifling to local creativity and result in slow and delayed implementation processes, as well as being expensive.

The Relationship of Current Services to Community Needs

A better understanding of the many interrelations between citizens and their government directly result in improvements to service performance and productivity. These interrelations include, but go considerably beyond voting, tax collection and responsiveness to citizen requests, inquiries and complaints.

Public problems are almost always a combined responsibility of government and citizens. For example, dirty streets may result from inefficient sweeping, streets so rutted they cannot be swept clean, littering, or some combination of the three.

The classical boundaries of citizen involvement are voting, paying taxes, making suggestions or complaints to public officials, working through political parties, and perhaps standing for office. More recently, as demands for service have increased in complexity and scope, participation has expanded to far more activist, organized and institutional strategies for involvement. Many governments have moved from reliance on the classical feedback mechanisms to a greater scope and intensity of interaction through advisory panels, citizen surveys, and efforts at administrative decentralization and neighborhood collaboration. A few governments have experimented with citizen-based planning outside of the direct control of the government itself.

In government, managers must pay attention not only to efficiency, but also to issues of equitable distribution and the maintenance of political support. The desired objectives of public programs are complex and judgmental. This complexity, in an extremely political and bureaucratized environment, makes it particularly important to gather better information on the behavior and needs of citizens, and citizens' satisfaction with existing services.

Further, in this time of constrained revenues and increasing costs, local governments can ill afford to spend money delivering inappropriate or unneeded services. Better "consumer" information can be used to design and deliver more carefully tailored services.

Information on citizen behavior, needs, and satisfaction can be obtained through wider use of a variety of tools now used extensively in the private sector and in a few governments. Consumer and market survey research, distribution planning, and price and demand analysis are all techniques which have been well developed and successfully applied over many years to private sector service delivery. These tools will need refinement and further development for public application but their use can provide important productivity gains.

Further, there is a need to develop a consumer orientation throughout public organizations. Management must be more sensitive to consumer issues and must take responsibility for gathering better information. Employees must be trained and provided with incentives which underscore the relationship of their organization to citizen needs.

The Needs, Attitudes, and Capabilities of Public Employees

The people who work for government are the single most valuable resource. People constitute the largest and fastest growing part of government costs. They are the single most important direct source of ideas for governmental productivity improvement.

The most significant opportunity for improvement in productivity in local government in the human resources area lies in improved employee-employer relations. Both employees and management can and must benefit from improved productivity. To achieve these benefits managers and non-managers must work jointly to achieve higher productivity. Managers have a responsibility to efficiently allocate all public resources - including labor - for effective service delivery. Public employees must contribute to the development and support the implementation of productivity enhancing practices and processes. Cooperation between employees and their managers is built on the understanding that the participation of each is essential to continued successful improvement in productivity. It requires better methods of communication to insure that both management and employees participate in a variety of decisions which affect their working conditions. Government must develop and use new mechanisms, such as labor-management committees, as vehicles to achieve joint assumption of responsibility for productivity improvement.

Because it is of paramount importance to employees, management must insure job security to the extent possible through improved work force planning, job retraining at local, regional, State, and national levels, and improved personnel mobility, lateral entry, and pension portability. At the same time, unsatisfactory employees whose performance does not reach acceptable levels after reasonable training or reassignment to more suitable positions should be separated from the service.

33-595 O - 78 - 38

Governments must look broadly and deeply at the quality of working life in their organizations. The capacity and motivation of the workforce appear to be tied to the atmosphere in which work is conducted in our local governments. Employee training and career development programs must provide for the development of individual employees. Management must provide tools and resources necessary to the effective accomplishment of each employee's job. Employees' safety and health must be safeguarded in their employment through comprehensive safety programs and appropriate health benefits. Simultaneously, employees must strive to avoid erecting barriers to implementation of changes required to improve productivity.

Local governments must establish personnel methods and procedures which efficiently and effectively support the delivery of public services, including improved hiring and advancement approaches. Better data is needed on State and local employment compensation at both regional and national levels to facilitate the establishment of fair pay in a timely manner.

Finally, in jurisdictions where employees are organized, managers and labor leaders need to work together to develop agreements which positively affect working conditions and enable productivity to be improved. Both managers and labor leaders require training and improved skills to more effectively and efficiently bargain and resolve impasse situations.

* * * * *

I am happy to be able to report to the Committee that substantially more progress toward exploiting these opportunities is currently underway - in most part due to local initiatives pursued in the face of the myriad of obstacles identified earlier.

As the cities of Cincinnati, Dallas, Savannah, and Seattle testified before you, the desire and capability of local officials to measure and improve productivity is growing rapidly. In addition, experiments in Colorado, New York and North Carolina have proven the feasibility of collecting interjurisdictional comparative performance data and have gained management and labor support to do so. The availability of this data both motivates improved performance and indicates sources of ideas for improvement. Obviously, no single jurisdiction can afford the time and costs of collection alone, hence State, Federal or private support is essential.

As the competition for scarce resources has heightened - governments have sought increasingly precise information on citizen expectations; service delivery responsiveness and effectiveness; and service delivery outcomes. Multi-agency funding of research into outcome monitoring is beginning to allow jurisdictions to know what they have accomplished for their expenditures in mental health, social services, economic development, transportation and prison services. Experiments in several cities have generated interest in government's ability to aggressively market their services and policies including conservation; inner city housing; citizen assistance in reducing litter, stray dogs, weeds and other factors which diminish community attractiveness but are expensive for the government to correct; and increased transit ridership. As a result these cities are meeting public needs by providing leadership so that all community resources are applied to service delivery at the lowest public cost and are fully utilizing investments in facilities, people and equipment to better serve the public.

Despite increasing newspaper coverage to the contrary, in a growing number of jurisdictions labor and management are jointly attempting to improve productivity and quality of working life. The American Federation of State, County and Municipal Employees testimony before your Committee clearly indicates support for these initiatives. The increasing concern over public employee job security has stimulated joint efforts to improve service quality and efficiency so that citizens will begin to feel they are receiving their tax dollar's worth in public services. One example of their growing consensus is a nucleus of eight jurisdictions including New York City that have formed a rapidly expanding network to share experiences of labor-management committees working jointly toward productivity improvement.

All of these efforts, meant to be illustrative rather than comprehensive, were started with local initiative and leadership. Where Federal assistance existed it was supportive of local desire. Outside help to soften the initial risks until a track record of success could be established was often required. The results clearly demonstrate that the capability exists to significantly improve local government performance and to, at the very least, warrant an objective of raising all performance to the level of the currently best known. Comparative studies to date suggest that such an objective would, conservatively stated, generate an immediate 10% reduction in cost nation-wide with the same or better service delivery.

CONCLUSION

To achieve the level of productivity growth necessary to sustain a rising standard of living it is imperative that nation-wide concern for enhanced governmental productivity focuses on those areas which represent the most significant inhibitors to and opportunities for achieving results. Despite the progress that has been achieved to date, there is still a significant untapped potential. In each area, the work to be done is broader than any one organization or unit of government. The first objective must be to gain a consensus among agencies of the Federal government, State government, local governments, labor, public interest groups, and the public at large on the priority of these productivity goals. On the strength of such a consensus, I am confident that joint efforts can be undertaken which will help to better meet the continuing challenge to deliver more, high quality public services at reasonable costs.

Thank you.

Public Employee Department AFL-CIO

815 SIXTEENTH STREET, N.W., WASHINGTON, D.C. 20006 • (202) 393-2820-21

WILLIAM H. McCLENNAN
President

JOHN A. McCART
Executive Director

KENNETH T. BLAYLOCK
Treasurer

STATEMENT OF THE PUBLIC EMPLOYEE DEPARTMENT, AFL-CIO,
TO THE HOUSE SUBCOMMITTEE ON THE CITY
(Proposition 13: Prelude to Fiscal Crisis or New Opportunities)

JULY 31, 1978

Mr. Chairman and members of the Subcommittee:

Thirty international unions representing 2 million employees of city, state and federal governments and the Postal Service comprise the Public Employee Department. They have a vital concern, not only as public interest organizations, but also as representatives of government employees, in enhancing the quality of indispensable services they provide for the public.

In June, 1975, the Department was afforded an opportunity to present our views on the financial survival of city and state governments to the Subcommittee on Commerce, Consumer and Monetary Affairs. Much of the testimony offered at that time is applicable today. The concepts included in that presentation and our current statement apply to counties, states, school and special districts as well.

Our population is concentrated in municipal and contiguous areas. Cities are centers of manufacture, trade and financial transactions. They foster cultural life and contribute mightily to medical and scientific research. Thus, municipalities play a vital role in the life of the nation.

PROPOSITION 13

Last June, however, a political earthquake struck California, when the voters approved Proposition 13 by an overwhelming margin. And the shock waves have expanded throughout the country, with a significant reaction here in Washington. The tremors will continue to be felt in a number of states through referenda in the November elections and in other commonwealths in future years.

The decision in California represented citizens' irate reaction to skyrocketing property taxes, to be sure. But it reflected also their disillusionment about the efficiency of government activities generally. The existence of a sizeable budget surplus in Sacramento simply aggravated the situation.

Public employee services in the local jurisdictions are feeling the effects. More than 9,000 have been laid off. Summer school cancellations removed opportunities for almost 32,000 persons to continue employment outside the regular school year. These figures relate to July 10, 1978. In the weeks and months ahead, we anticipate additional personnel reductions. These additions to the ranks of the unemployed have occurred despite the distribution of more than $4 billion to local communities from the state surplus.

Experience at times gives bitter lessons. But we can realize now that steps could have been taken in past years in California to avert the calamity forced by Proposition 13.

Various proposals to limit state and local government spending or to reduce property taxes are pending in other states, and will be decided by the electorate in November.

SOLUTIONS

If there is any single lesson to be learned from Proposition 13 and the distress of voters in other states over property taxes and other government activities, it is that officials at all levels -- federal, state, county and local -- must act promptly, rather than simply react after the voters have made a decision.

Since governmental entities, just as their constituents, are the victims of inflation and unemployment, unremitting efforts to achieve a healthy economy must be pursued at the national level. We all recognize that inflation contributed heavily to the cost of government, which, in turn, precipitated the rise in property taxes to a large degree.

If local governments are to make their appropriate contribution to the well-being of the nation, the economic and social climate must be conducive to devising realistic solutions to their problems. The recent fluctuations in the national economy have been reflected in uncertainty by local government officials in extending their services to the communities they administer.

At the same time, the federal government must continue to afford incentives to state and local jurisdictions to provide needed services. Aid to education, transit, revenue-sharing, countercyclical assistance, welfare reform, CETA and a federal urban bank must be continued and augmented in order to aid local governments in these critical times.

Cities can survive crises. A few short years ago, New York City was tottering on the brink of economic disaster. Assistance by the federal government and stringent measures by elected officials, unions and the citizens generally to improve financial management give us strong hope today that the municipality will not only survive, but will prosper once again.

Public service generally has a substantial effect on the national economy. Almost 15% of the gross national product is generated by state and local governments. More than 15 million persons are employed by those jurisdictions.

From these facts alone, it is clear that the vitality of local governments is essential to a healthy national economy.

Limitations on revenues or expenditures are not inherently bad. Based on an index formula related to economic growth within a state, exemptions to cover emergencies and significant tax reform, the end product may be favorable to both citizens demanding tax reductions and quality public service.

Use by state governments of their broader revenue-raising ability to help local jurisdictions meet needs for public improvements and fairer tax structures, especially in those localities responsible for financing high levels of public services from eroding tax bases, would extend sorely needed assistance to local public services.

State and local tax systems must be made equitable and productive. States should continue to increase their reliance on income taxes, while closing loopholes and basing their income tax systems on the principle of ability to pay.

Efforts must be undertaken to minimize the inequities of sales and property taxes. Items such as food and medicine should not be taxed. State tax credits and rebates should be used to ease the burden of sales and property taxes on low and moderate income groups. Unjustifiable exemptions should be discontinued, and the maladministration of local property taxes must be corrected.

A federal income tax credit for state income tax payments should be enacted to replace the present method of deducting such taxes from taxable income. This would encourage the states to improve their tax structures and add equity to the federal tax system.

Effective modernization of state and local governments is essential, including elimination of obsolete and restrictive constitutional restraints, consolidation of inefficient local units of government and a greater commitment by states to local government needs and problems. In all efforts to modernize state and local governments, the job rights, employment conditions and other benefits of affected workers must be protected.

Tax abatements as an inducement to business to locate in specified areas simply shift the tax burden from commercial sources to individual homeowners.

Careful scrutiny of current tax enforcement procedures is in order. Evidence indicates that dollars spent strengthening tax enforcement efforts result often in significantly increased tax revenues.

These are some of the steps which can be taken to meet the electorate's demand for tax reform.

PRODUCTIVITY

The past decade, marred by unemployment, recession and inflation, has seen a significant decline in productivity nationallly. Attaining productivity gains have become important goals in controlling inflation and reducing joblessness. High levels of efficient performance by government jurisdictions are just as important as in private industry.

Care must be exercised, however, to make certain that government workers' traditional skepticism of "productivity" as a code word is not strengthened by using reductions in service, increased workloads, or both.

In the minds of many public managers, "productivity" means simply saving dollars. It is a catchword, which is supposed to supply a panacea for all of the fiscal problems confronting local governments. We view it as "doing the job better." If that is accomplished, tax funds can be saved, without personal adverse effects on the careers of public employees.

The traditional definition of productivity involving inputs and outputs just cannot be applied to public service. How can one measure the productivity of a teacher, whose class has been expanded from 25 to 35 students?

Despite these difficulties, PED is convinced that unions and public managers cooperating closely through the collective bargaining system can devise better ways of performing public functions, with an opportunity for workers to participate in the savings resulting from new methods of doing business. One of the key elements to upgrading the quality of government services is involvement of workers. The most obvious place to commence this participation is during the negotiation of agreements authorized by statutes, ordinances or executive orders.

The National Center for Productivity and Quality of Working Life reported this spring that 55 labor-management committees are functioning in public service. Thirty-eight of the panels exist at the local government level. The remainder are divided between state governments and federal agencies.

We have been advised about the demise of the Center in September, 1978. Assignment of its functions elsewhere in the Executive Branch is uncertain. A recent report of the General Accounting Office advocates dispersion of the Center's operations among four or five existing federal agencies with a coordinating council to integrate the work of the agencies. Our Department believes this approach is piecemeal, and may very well represent a diminution of commitment to help stimulate improved performance by industry and government in our economy.

One aspect of the Center's mission, which has received scant attention, is the quality of working life. That subject warrants careful scrutiny in government service, because it holds the hope of improving significantly the conditions under which government employees complete their tasks.

Mr. Chairman, we commend you and your colleagues for your intense interest in the plight of local governments. The Department is confident that solutions for their seeming insuperable problems can and will be found.

STATEMENT BY JAMES FARMER

Executive Director
Coalition of American Public Employees

California homeowners have informed Sacramento, 49 other state capitals, a few sundry thousand City Halls, and Washington, D.C., that taxes are too high. The message was delivered in the form of 2 to 1 approval of Proposition 13, a state initiative that drastically cuts property taxes and makes it enormously difficult to increase _any_ state tax.

Because of this, an estimated 75,000 public employees may join the unemployed in time for Christmas, which leads me to offer my interpretation of the affair.

Some Political Turkeys Come Home to Roost

The passage of Proposition 13 was more than a protest against high taxes and government spending. It was a harvest of the distrust against government that has been sowed and cultivated by public leaders. It has become high political fashion in recent years for candidates to run against "government", to villify public employees as public leeches.

Scapegoating is a campaign standby that never ends on election day. Who misconceives and misdesigns public programs? Elected leaders. Who gets the blame when they don't work? Streetsweepers and school teachers. So it was in California.

The same inflation that ravaged homeowners and municipal budgets there also contributed a $5 billion surplus to the State treasury, clear enough verification that something was badly wrong with the state's tax structure.

The governor and legislature had ample time to devise property tax relief for hard-pressed homeowners, but did too little, too late.

At first, California Governor Jerry Brown opposed Proposition 13 as bad business. But Brown has elevated changing horses in mid stream into a political art form. Once sure it would pass he was Born Again. Like I said, he said, it's what I've been saying all along.

How California's Voters Kissed a Pig in a Poke

Don't think that the pols deserve all the blame. The voters passed Proposition 13 but flunked an elementary civics test. The tax-payers had been looking for tax relief in vain when lo, up rolled a medicine show peddling that popular right-wing snake oil, "Simple Solution." And they bought it without bothering to look behind the calliope, where several pigs were concealed in a poke.

- According to the polls, middle-income voters were out to gut social services. These are financed mostly by state and federal governments, but to make a point, the property owners crippled the means to pay for such local benefits as police and fire protection, street lighting and repair, water treatment, sewage disposal, and schools. In effect, the voters demonstrated against Sacramento and Washington by blowing up City Hall.
- Again according to the polls, these same voters want government to be closer, more responsive, something to snuggle up with. To accomplish this, they made their City Council a political paraplegic further dependent on the will of the State and national capitals.
- In voting to cut public services, the protestors carefully dodged deciding who gets hurt. The voters were quite willing to leave that bit of dirty work to the government they distrust, probably safely assuming

that Guess Who will get it in the neck. (Affirmative action is the big loser --- women, blacks, Chicanos are the last hired, first fired).

- One of the fattest pigs in Proposition 13's poke was fathered by Howard Jarvis, a Coolidge populist and the initiative's principal architect. Jarvis has the touching faith that businesses will pass along tax savings to the consumer (which is akin to believing that a giant tortoise supports the Earth). Accordingly, while all those property owners thought they were giving themselves a break, they were handing business a golden windfall: 65 per cent of the estimated $7 billion in first-year savings, and an increasing share after that --- all on top of the local tax breaks that most businesses already exploit.

All in all, it was a sorry run at populism: The middle class fired at the poor, wounded themselves, and the wealthy just sat back and laughed.

On Garbage Pickup and
Jefferson's Condition

On the same day that Proposition 13 passed, voters in three Ohio cities elected to abandon their responsibilities to public education. Each such victory is an exercise in self-mutilation. The comfortable will not tolerate cuts in services that benefit them, so more regressive forms of taxation will multiply. There will probably also be a trend towards cities selling off such marketable housekeeping functions as garbage collection and street maintenance with customers up and down the block paying costs plus profit.

As public services dwindle, so will public jobs. The right wing applauds this, but has neglected to figure who will pay the cost of this additional social dislocation.

Bigger cities, struggling to revitalize core neighborhoods, will lose the federal revenue sharing funds necessary to accomplish this. Municipal bonds for financing capital improvements are already pariahs on the security market.

Beyond this, tax limitations further benefit the well-off, who do not depend on public services to begin with. The middle class can celebrate its temporary relief with a cookout before anteing up in other forms of tax and complaining about all those bums and potholes on Main Street. As for all the rest --- poor, old, or disabled --- let them take comport in that recent wisdom from the Rose Garden: That's life.

This leads to depressing questions. Has the credo for our time become "I've got mine, Jack...?" Do the Me's not have it? Does "pragmatism" outpoint compassion and idealogy outweigh ideals?

Jefferson believed that the people's judgment could always be trusted --- but on the condition that judgment was informed; this responsibility he assigned to public leadership. Ten years have passed since two public leaders who lived this belief were shot to death. Neither man, Kennedy nor King, believed in a philosophy of limitations, either in responsible and compassionate government or in the human spirit government should express.

Given that, I think it is time that those who listened then act together now to single out and support like-minded public leaders. And we had better do it soon, because if not, we are all condemned to re-explore some darker reaches of recent American history.

Public Citizen

Revised
July 20, 1978

DISCUSSION PAPER

State and Local Tax and Expenditure Limitations

This paper was prepared by Diane Fuchs of the Tax Reform Research Group to provide those interested in developing a strategy to counter the growing state and local government limitation movement with preliminary information about tax and expenditure limitations, the tax limitation movement, and tax reform alternatives.

The paper is composed of four parts. The first two sections provide an overview of the current limitation movement and a description and analysis of the Jarvis-Gann initiative. Part three describes some of the elements of an equitable tax reform program that should be put forth as the alternative to the Jarvis "solution." Part four briefly describes various types of limitations, where they have been implemented, or where they are pending and receiving serious, immediate attention.

TAX REFORM RESEARCH GROUP • 133 C STREET, S.E., WASHINGTON, D.C. 20003 • (202) 544-1710

DISCUSSION PAPER

State and Local Tax and Expenditure Limitations

I. Overview of Limitation Movement

The recent success of the Jarvis-Gann Initiative, Proposition 13, is closely linked with factors unique to California. Contrary to the repetitive media refrain predicting its adoption in every part of the country, mass duplication of such an extreme measure as Proposition 13 is unlikely. Only 15 states have initiative mechanisms by which voters can place constitutional amendments on the ballot, and in all but six of these, the procedure is more difficult than in California. In addition, very few states have property taxes as high as California, and no other state has such a large, undedicated surplus. Nevertheless, passage of Jarvis is an accurate indicator of a climate of anger and frustration throughout the country. This anger focuses on rising property taxes as well as inflation-caused increases in other taxes such as the income tax. In addition, citizen anger has been expressed increasingly at government itself. A general attitude of distrust prevails as well as a lack of satisfaction with the efficiency and quality of government programs. For these reasons there will be a great deal of activity in the near future among the electorate and in the legislatures to cut spending and taxes at all levels of government.

The organizing forces behind the movement for government limitation are well funded chambers of commerce, the National Tax Limitation Committee, and the National Taxpayers Union. Seizing on what they accurately believe to be the national tenor of discontent, they have managed to link the anger at the property tax with distrust of government, its activities, and expenditures, and are successfully guiding this fusion in a direct assault on government per se, government employees in particular and the recipients of aid programs. Thus, the traditional platform and goals of conservative politicians, to minimize government and expenditures especially those for welfare and other services, is being sold to the people of this country as the solution for high taxes and as the vehicle for tax relief.

By tying the excessive spending issue with the issue of high taxation, limitation proponents in California and now in several other parts of the country have obscured the real issues: how to achieve fair taxation and how to make government less wasteful, more efficient, and responsive to human needs.

Cutting taxes - or slashing them with a meat ax, the popular metaphor for the effect of Jarvis in California, does not make taxation more equitable. It does nothing to redistribute the civic obligation to pay taxes in such a way that taxpayers pay according to their abilities and that none escape their obligations. Furthermore, simply cutting taxes across the board for all does not necessarily provide relief. Yet this is obviously what most taxpayers want and think they will obtain with a vote for a tax or expenditure limitation measure.

Although high levels of government spending certainly contribute to higher taxes, it is not simply the amount of money available to government that causes inefficiency or waste. Cutting revenues by 60%, as the Jarvis Initiative does, fails to address the reasons for the underlying deficiencies in government and does nothing to correct them. Drastically limiting the amount of revenues available for public expenditure only helps to cripple the provision of services to the public and hurts those who are most dependent on those services, middle and low income families. Public schools, special disability programs, libraries, police and fire protection, public welfare and medical assistance, and the providers of these services will be the first targets of the cutbacks.

Pro-limitation rhetoric perverting the notion of tax reform to mean tax cuts is carrying many well intentioned, hard working individuals in the wrong direction because it does not ask the right questions: why people are paying so much in taxes and why government is often wasteful or inefficient. Certainly the answer is not simply excessive government spending, as the proponents of limitation would have us believe.

II. Jarvis-Gann Initiative

The Jarvis Initiative, passed in California on June 6, 1978, by a 2 to 1 popular vote places a severe lid on increases in the state's major local revenue source, the property tax, and effectively eliminates the tax as a source of revenue. It will cut property taxes by 60% reducing revenues by an estimated $7 billion from $11.4 billion. Over half of the $7 billion is money earmarked for public school districts.

Property taxes in California are among the highest in the country and property values have risen astronomically in recent years. Assessment methods are up to date and provide assessments that are unusually accurate. Unlike legislatures in several states, the one in California failed after 18 months of deliberation to pass a comprehensive and targeted form of property tax relief for the residential sector. Not surprisingly taxpayers were furious with politicians who allowed a $5 billion state surplus to develop.

1. What It Does:

Through the mechanism of a state constitutional amendment, Jarvis sets a maximum property tax rate on all (business as well as residential) real property of one percent of full cash value. It sets the full cash value at the county assessors' 1975-76 valuations, to be adjusted upward by two percent annually. When property is newly constructed or changes ownership, the assessment freeze is lifted and the property is assessed at its new current value. Thus, at sale, assessments are allowed to rise to reflect current property values.

The proposition also severely limits both state and local governments in raising other taxes or implementing new ones. It requires a two-thirds legislative vote to raise state taxes or two-thirds voter approval to raise local taxes rather than the simple majorities usually required.

2. Who Are The Major Beneficiaries:

The major beneficiaries of the substantially lowered property taxes will be businesses and property owners who aren't homeowners. Because the measure applies not just to residential property, but commercial and industrial property as well, homeowners will receive only about one-third of the $7 billion reduction. Pacific Telephone and Telegraph, for example, will save 130.2 million annually, while Pacific Gas and Electric will save $90.6 million.

In addition, business property will bear increasingly smaller portions of the total property tax burden in future years. This is because the initiative allows assessments to rise more rapidly than 2 percent per year when property is sold or newly constructed. Since residential properties are sold more frequently than business properties, assessments on the latter sector will remain lower than on the former.

3. Who Are The Major Losers:

California is in the unique position of having a large state budgetary surplus which has accumulated over a four year period. After the passage of Proposition 13, the legislature and the Governor passed emergency legislation returning the surplus to the localities to compensate for their revenue losses. As a result, the harsh effects of Proposition 13 on schools, services and public employees have been cushioned for the time being and the impact delayed for another year or two until the time when the surplus will be exhausted.

Despite the distribution of the surplus funds to the localities, many have cut back on important services. Summer schools have been closed in most places, and county services such as health centers, hospitals and welfare benefits are being reduced significantly. Furthermore, the legislature refused to approve annual cost of living increases for state and local employees and recipients of AFDC.

Renters will undoubtedly be the biggest losers under Jarvis. They receive no relief under the property tax freeze provision because there is no compulsion on a landlord to pass the tax savings on to tenants. Landlords in San Diego County, for example, will save about $110.6 million annually or 62.3% of their total property tax liability.

Many experts attribute about 20% of the rental cost to the payment of property taxes. It is unlikely that the voluntary rent freeze programs proposed by Governor Brown will restore to tenants anywhere near the amount that landlords will save through reduced taxes. Furthermore, as is likely, should it be necessary to increase other state and local taxes, license fees or charges in the future to cover the loss of local property tax revenues, renters will bear the burden of these increases without sharing with property owners the reduction in the property tax.

The state and localities must maintain a degree of expenditure sufficient to function effectively. Thus, there is a limit on how much expenditure and revenue cutting can actually take place. After the surplus is exhausted, revenues will have to come from other sources, most probably increases in other state and local taxes. The California State Assembly Revenue and Taxation Committee estimates that to replace the lost property tax revenue, either the sales tax will have to be raised from 6 to 12.25 percent, or a 109 percent surcharge will have to be imposed on top of the present income tax, or the corporate tax rate will have to be increased from 9 to 27 percent.

If there were substantial increases in sales and income taxes, those in the moderate and low income brackets would be hit the hardest. The sales tax is already the most regressive tax taking larger percentages of family income as income decreases. The state income tax is not as progressive as it could be because of its loopholes favoring the wealthy and the fact that it is deductible from federal income tax liability.

Wealthy people who generally itemize, can reduce their federal taxes by up to 70 percent of the amount paid to the localities and states in property, sales, and income taxes. This considerably diminishes the burden of these taxes for the wealthy. Because few lower income families itemize on their federal returns, (only 25 percent of all federal taxpayers itemize) they receive no state tax relief from the federal government. Those in the lower brackets who do itemize, however, still receive a much smaller benefit than those in high brackets.

Thus, by reducing property taxes across the board, the Jarvis initiative eventually will shift revenue raising to other, state taxes that will continue to hit those in moderate and low income brackets the hardest.

In addition, because the limitation measure does not prohibit the imposition of fees and user charges, it is likely that local governments may come to rely more heavily on such measures for a source of revenue.

Already many localities have begun to impose fees for various services including library and recreation facilities, and sewage and garbage disposal.

To the extent that fees are imposed for services and facilities used primarily by the wealthy, such as for moorings and boat storage at harbor facilities, the burden will not be felt by moderate and low income families. However, it is more likely that most of these fees and charges will fall on services and facilities used by rich and poor alike. An extensive system of fees and charges will therefore tend to impose an additional burden on those most dependent on public facilities and services and least able to afford the additional cost of this pay-as-you-go revenue system.

4. Additional Problems:

Localities receiving federal revenue sharing funds will lose large amounts of federal revenue because those funds depend on local revenue raising capacity crippled by Proposition 13.

In addititon, it is likely that localities will have secondary revenue problems as well. Redevelopment agency bonds could go into default. Redevelopment financing is based on the expected increases in the assessment value of redevelopment land. The new constitutional provision holds down these increases to a low 2% per year. Furthermore, it will be difficult if not impossible to float general obligation bonds because they will now have to be approved by two-thirds of the electorate.

III. Components Of Tax Reform - Alternatives To The Jarvis "Solution"

It is true that many residential property taxpayers are reaching their breaking point and need relief. This issue should not be confused with an excuse to drastically cut government spending. While taxes may be too high for some, providing relief does not require that taxes be slashed for all or that government programs essential to the well being of many citizens be eliminated.

The problem is that too small a piece of the pie is being used for too much and too many are not paying their fair share. It is not that the property tax is a bad tax but that it has been so narrowed as to fall primarily on a necessity, housing, while many other types of property, such as intangible wealth, are virtually untaxed.

Non-used or underutilized revenue sources if tapped, combined with better tax enforcement and collection, would provide more than adequate revenues to reduce the property tax burden for all and provide larger relief to those with the greatest need.

1. Intangible Property

There is a virtually untapped and untaxed source of revenue: intangilbe wealth. One percent of the population owns 70 percent of the nations' corporate stock without paying a dime's worth of taxes. In 1968, the Securities and Exchange commission estimated intangilbe property to be worth $3.9 trillion. If this intangible property were taxed at a modest rate of only one-fifth to a quarter of the average rate applied to real property, the tax could be used to reduce property taxes by 20-30 percent on the average and 45-50 percent in some states.

2. Exempt Property

About one-third of all real estate is exempt from taxation. This exempt property is valued at about $800 billion and results in an annual revenue loss of $15 billion. The tab is picked up by the average taxpayer who pays an extra $310 per year in property taxes, one quarter of the typical family's tax bill.

A growing portion of this exempt property comes as a result of granting property tax abatements to business in exchange for their promises to relocate or expand within the jurisdiction. These are unjustifiable direct subsidies to business at the expense of all other taxpayers. Traditional and recent studies clearly demonstrate that state and local taxes, a very small percentage of the overall cost of doing business (only 1 to 3 percent), play little or no role in relocation decisions. Nevertheless, state and local governing bodies continue to grant abatements at an increasing rate.

Significant property tax losses also occur as a result of unofficial policies which result in the underassessment of a large percentage of commercial and industrial property. Cook County, Illinois, for example, loses approximately $200 million annually due to the underassessment of business personal property.

3. Tax Enforcement

Poor tax enforcement also cost billions in lost revenue each year. Property tax delinquency reached $570.8 million at the end of fiscal 1976 in New York City and is about $50 million a year in Boston.

The largest multinational firms often totally avoid their tax liabilities by using their complex corporate structures to hide profits or to juggle their books so that profits show up in low tax states or abroad. Corporate shenanigans cost millions, and some say billions each year. Getty Eastern, for example, operates its multimillion dollar refinery in Delaware City, Delaware without paying a penny of state tax and even shows losses of $31 million since its incorporation there in 1972.

Many states are attempting to improve their corporate tax enforcement. Those that have joined the Multistate Tax Commission, an organization of 19 member states, and participate in the joint audit program of the Commission, are picking up 30 additional dollars for each audit dollar spent.

4. Tax Expenditure Budgets and Sunset Legislation

Billions of dollars in state and local revenues are lost each year through loopholes that are never reviewed and tax exemptions that are forgotten. Annual or bi-annual review of all tax breaks is an ideal way to end loopholes and exemptions that are no longer achieving the policy goals for which they were implemented. California, for example, prepares an annual state tax expenditure budget along with its direct appropriations budget. In this way, legislators are forced to review indirect appropriations as they make direct appropriations.

Some states are considering measures such as sunset laws on state mandated property tax exemptions.

5. Sales Tax

Although the sales tax is clearly the most regressive tax, it is the least hated because it is paid in small incremental amounts. The tax, an excellent source of revenue, may be structured in such a way as to be a more progressive source of revenue taking a smaller percentage of family income as income decreases. This can be done by extending the tax to cover services purchased primarily by business and the wealthier sectors of society, such as those services provided by advertising and consulting firms, architects and lawyers, to name a few.

6. Targeted Tax Relief

If all these revenue sources were tapped to their fullest, states could reduce such heavy dependence on residential real property and could also provide relief to those in need of it. Amply funded circuit breaker programs for both renters and homeowners covering all families within targeted income and wealth categories could be implemented. Taking this a step further, comprehensive tax credits and rebates for all state taxes could be easily administered through an income tax and targeted to those most in need. This would provide needed benefits while redistributing the burden of the regressive state and local tax system so that those in moderate and low brackets are not compelled to continue to carry the heaviest percentage burdens.

IV. Types of Limitations, Where Implemented Or Pending

Despite the apocalyptic language used by some in the media to describe the coming and the spreading of the tax limitation movement, tax and spending limitations have been around for a long time. Many currently on the books were precipitated by the exigencies of the Great Depression. During the past ten years other states have quietly placed one form of fiscal limitation or another on the books.

Depending on state requirements, some limitations are statutory and others are constitutional. Some can be implemented by popular vote through initiative activity, while most states require the legislature to initiate the activity.

1. State Limitations

Limitations are of several varieties. There are caps on state fiscal activity which limit state revenue raising or expenditures. The most common type is a limitation on state spending geared to increases in state personal income. In 1977, the Colorado legislature passed a statutory 7% ceiling on the rate at which state spending can grow. This closely approximates the rate of inflation. The Delaware legislature recently passed a bill which limits state spending to 98% of anticipated revenues. In New Jersey, increases in the state budget are tied to total personal income of the state's residents. Voters in Tennessee put a lid on that state's fiscal activity, in March of this year, by passing a constitutional amendment prohibiting the state from taxing or spending at a rate greater than the state's actual growth rate (the growth rate is to be defined by the legislature).

Placing some kind of limitation on state revenues or expenditures is not inherently bad. Limitations must be geared to a realistic fiscal indicator and not be so inflexible as to tie the hands of legislators in an emergency or perpetuate inappropriate policies when the complexion of state fiscal activity changes. Implementing limitations through constitutional amendments unfortunately fixes fiscal policy in cement.

Lastly, limitations should not be an excuse for failing to reform state tax structures in the ways outlined above. Reasonable and flexible limitations can be a justifiable adjunct to a comprehensive tax reform program. They should not be an excuse to avoid true tax reform which redistributes the tax burden equitably to insure that all pay a fair share.

A number of constitutional state limitation measures will be submitted to the electorate for popular votes in November. In Colorado, some taxpayers were not satisfied with the 7% legislative ceiling on state spending. Enough signatures were collected to place a similiar constitutional limitation on the November ballot.

The Arizona legislature recently passed a proposed constitutional amendment to limit state revenues to 7% of personal income. The Proposal will be on the ballot in November.

A constitutional amendment limiting state spending increases to 5% has qualified for the November ballot in Nebraska.

In Michigan, an initiative petition has been filed with the state and is very likely to be certified in early August for placement on the November ballot. It would constitutionally limit increases in state spending to increases in personal income.

An initiative proposal (known as the King Amendment) to constitutionally limit state spending to 9% of all personal income received enough signatures to compel the legislative, sitting as a constitutional convention, to review it. The Amendment received the required affirmative vote from 25% of the legislators. The next session of the legislature must also approve it in order for the measure to go on the 1980 ballot.

Legislation to limit state expenditures is already pending or likely to be introduced in the next legislative session in: Connecticut, Florida, Georgia, Hawaii, Maine, Maryland, Missouri, Montana, Texas, and Washington.

2. Local Limitations

Limitations on local fiscal activity either limit local revenue and spending generally or limit a specific revenue source such as the property tax. The Jarvis-Gann Initiative is an example of the latter type of local limitation.

Again, these limitations are not new. Forty-seven states have some form of local limitation. Only Connecticut, Massachussetts, and New Hampshire have none. The limits are of four main kinds: limits on property tax rates, freezes on assessment levels, limits on the amount of revenue that can be raised by local taxes, or the amount that can be spent in any one year.

A fifth type of limitation measure, "full tax disclosure", does not rely on state imposed explicit tax or spending lids and avoids tying local governments into undesirable arbitrary spending limits. Rather it provides for an automatic reduction in property tax rates whenever assessments rise as a result of increases in property values. The method requires the establishment of a property tax rate which when applied to the tax base will produce revenue equal to the prior year's property tax levy. Thus, the method requires an automatic rate roll back so that no more than the previous year's revenues will be produced. This established rate can be exceeded only by the explicit vote of the local governing board after a public notification and hearing procedure on any proposed increase. Tax disclosure leaves control of local finances completely in the hands of the locality and is therefore preferable to other types of local limits. Florida, Hawaii, Montana, Maryland, Virginia, and the District of Columbia have adopted the method.

A number of states have recently imposed local limits:

Indiana	There has been a state imposed property tax freeze on local governments and school districts since 1973.
Iowa	1976 legislation limits the growth in certain property tax areas to 6% annually.
Maryland	The 1978 legislature voted to roll back property tax assessments by 10%.
New Jersey	As part of its 1976 tax reform package, the state infused the localities with property tax relief funds while simiultaneously placing spending lids on local government. Cities and counties are limited to 5% increases while school district increases are covered by a formula based mainly on the amount of taxable real estate for pupils in districts.
New Mexico	In 1977, the legislature imposed a 10% ceiling on the annual increase in residential property taxes.
Washington	In 1972, voters approved a constitutional amendment limiting property taxes to 1% of market value but still allowing special levies for school districts.

In the wake of Jarvis there was a flury of activity in a number of states to qualify Jarvis-like petitions for the November ballots. The Jarvis-like measures in Arizona, Colorado, Florida, and Washington failed to receive enough signatures to meet the November ballot deadline.

In Idaho and Oregon, however, voters will have the opportunity to approve constitutional measures similiar to Proposition 13.

In Nevada, a Jarvis-type proposition has until August 9 to receive sufficient signatures.

In Michigan, a section of the state limitation measure described above also limits local property tax increases to the comsumer price index. It is highly likely that this measure will be certified for the November ballot. Another constitutional property tax limitation measure (known as the Tish Amendment) may also appear on the November ballot.

The Nebraska legislature has approved a consitiutional amendment which will limit increases in local government spending to 5%. It will appear on the November ballot and is likely to pass.

There is significant legislative activity to limit local taxation and spending in Alabama (limit property tax increases to 20% annually); Maine (limit increases in local spending to changes in the cost of living); Massachusetts, Michigan, Texas (45 measures are pending); and Washington (similiar to the measures that did not receive enough signatures for the November ballot).

In Nebraska, a special summer session of the legislature approved a bill limiting property tax increases to 7% and allowing local governments to impose spending limits.

The legislature of South Dakota has approved for the November ballot a constitutional amendment indirectly limiting state and local fiscal capacities. It requires a 2/3 vote of the legislature or local electorate to raise taxes or impose new ones. This is similiar to the requirement in the Jarvis proposition.

The following states require that amendments to their constitutions be made by the initiative process. They have been targeted by the national limitation groups for initiative efforts: Arizona, Arkansas, Colorado, Florida, Illinois, Massachusetts, Michigan, Missouri, Montana, Nebraska, Nevada, North Dakota, Ohio, Oklahoma, Oregon, and South Dakota.

It should be noted that limitation activity will be facilitated in Texas, Maine, Nebraska, and Alabama where Governors have called special summer sessions of the legislatures to consider limitation measures. A constitutional convention is in progress in Hawaii.

TAX AND EXPENDITURE LIMITATIONS:

A Plea for Governmental Reform*

INTRODUCTION

Tax payer's revolt is this year's headline. Proposition 13 and its relatives have appeared in a number of states. However, even more prolific has been the written analysis of what each of these propositions means, why they may pass and why we should expect many more.

However, there is irony in all these analyses, because in fact, local governments had begun to respond to fiscal pressure. We read endlessly that public purpluses, high taxes and wasteful unresponsive government were the root causes. Yet if one looks closely, during the past three years the growth of local government expenditures as a percent of total GNP has declined. This is after a quarter century of increase. Operating surpluses of $18.1 billion in the 4th Quarter of 1977 are expected to be entirely expended by the 4th Quarter of 1978. And the increase in taxes has largely been caused by inflation and less because of wauton behavior of locally elected officials.

Stepping back from the turmoil, other patterns can be seen. Rather than projecting the California experience, one needs to view the variety of tax and expenditure limitation proposals. If one uses a deductive rather than inductive approach, citizens can be seen requesting different actions from government! They also are requesting equity of taxation as much as less taxation. And clearly and constantly they are requesting governmental efficiency. Additionally, there is strong evidence that public discontent is with government at all levels and not simply local government.

---

*This paper was prepared principally by Francis Viscount of the Office of Policy Analysis and Development at the National League of Cities: Assistence in collecting information on TEL proposals was provided by Paul Clark, an intern at NLC for the summer. The paper does not necessarily represent the policy of NLC, which may be found in the National Municipal Policy.

This paper will serve as a summary of the main characteristics of tax and expenditure limitation proposals actively being formulated in many states. The proposals vary significantly and prognostications about their effects and effectiveness do not come easily. However, as one surveys the variety of proposals, one notes that most will not radically restructure how local governments conduct their affairs and many include reforms that will be beneficial to local governments and have been promoted by some state leagues.

The basic elements of the TELs are provisions to restrict future government growth, both state and local, to adjust the limit in emergencies, to soften the burden of particular taxes and to adjust service burdens between levels of government by restricting the use of mandates without funding. A few TELs have provisions to roll back taxes, restrict the creation of new taxes and require extraordinary majorities or referenda to raise taxes. These provisions are both severe and destructive to a sound governmental system at the state and local levels.

This paper is in three sections. The first will describe the general provisions found in the different active proposals. An active proposal will go before the voters in either 1978 or 1979. The second section will discuss the implications of the most common elements. The final section will offer a discussion of some options that might be helpful in constructing a strategy to avert the passage of a Jarvis-Gann type proposal in your state. The strategy, not surprisingly, is basically governmental reform to improve state and local tax systems, reduce overlapping jurisdictions and restrict mandates.

Description of Common Elements.

When viewed in a broad analytical context, current tax and expenditure limitation proposals (TELs) can be divided into three basic categories: (1) those that limit state or local government revenues; (2) those that limit state or local government expenditures; and (3) those that specifically limit property tax revenues. The manner in which each of these proposals limits government's fiscal resources is different; with the exception of Oregon's carbon copy of Proposition 13, no two are instead. The attached chart categories six important features of concern for proposals from twelve states. A synopsis of the provisions is included in the appendix to assist with analyzing these complex fiscal reforms.

With the exception of the property tax reform proposals, such as Proposition 13, TELs attempt to curtail government growth by limiting its fiscal resources to an established annual rate of increase. The most common choices are either a designated rate of growth, the Consumer Price Index, or the state's personal income growth. New Jersey, for instance, limits local spending to a 5% increase over the previous year. In Colorado, a proposal on the November ballot would prevent state and local government per capita expenditures from growing faster than increases in the Consumer Price Index. Both Massachusetts and Michigan have proposals pending which would tie state revenues to state personal income. In Michigan, the proposal is to use state tax revenues as a percentage of state personal income in determining their state revenue limitation.

Property tax modification proposals seek the same goal as proposals aimed at limiting general government revenues, and expenditures prevent government growth and relieve the tax burden. Proposition 13 is really more severe for two reasons--it prevents future growth by limiting annual assessment growth to a maximum of 2% and cuts back revenues by lowering and freezing the rate at 1% and rolling back assessments to their 1975 level. Idaho and Oregon have followed suit by offering similar proposals on the November ballot, though Idaho's measure does not roll back taxes and is only statutory rather than constitutional. Massachusetts and Colorado both have measures which would freeze the property tax rate at 2.5%. A different approach was taken by the Nebraska legislature when it recently enacted a 7% limit on increases in portions of local budgets funded by real property taxes.

The chart also demonstrates that other than the three Jarvis-Gann type initiatives in Idaho, California, and Oregon, most TELs are setting limits in a reasonable fashion. The fact that most are constitutional amendments indicates the public is emphatic about its goals and has some skepticism about legislators' self-restraint.

A reasonableness in the approach of most TELs is represented by the number with variable rates of growth, by provisions for overriding the limit, and by limiting state mandating of costs on local governments. A rate of growth attached to an individual's capacity to

RECENT TAX AND EXPENDITURE LIMITATION (TEL) PROPOSALS

STATE	LIMIT	GROWTH	LEVEL OF GOV'T.	LEGAL	OVERRIDE	MANDATE
Alabama	R	F, V	L	C		N
Arizona	E	V	S	C	Lg	Y
California	R	F	L, S	C	Rf, Lg	N
Colorado						
Initiative #1	R	V	L, S	C		N
Initiative #2	E	V	L, S	C	Rf, Lg	Y
Idaho	R	F	L, S	St	Rf, Lg	N
Maine	E	V	L, S	C	Rf	Y
Massachusetts						
Initiative	R	V	S	C	Rf, Lg	Y
Legislation	R	V	L, S	C	Rf	Y
Michigan	R	V	L, S	C	Rf, Lg	Y
Nebraska						
Initiative	E	F	L	C	Rf, Lg	N
Legislation	R	F	L	St	Rf, Lg	Y
New Jersey	E	F	L	St	Rf, Lg	Y
Oregon	R	F	L, S	C	Rf, Lg	N
Tennessee	E	V	S	C	Lg	Y

Key to Chart

Limit = Type of limitation placed on the unit of government.
R = Revenue E = Expenditure
Growth = Type of growth rate allowed to a unit of government.
F = Fixed percentage
V = Variable, e.g., CPI, personal income, economic growth, etc.
Level of Government = Units of government affected.
L = Local S = State
Legal = Legal impact of proposal.
C = Constitutional St = Statutory
Override - In what manner the limitation can be exceeded.
Rf = Referendum Lg - Legislative action
Mandate - Is there some form of reimbursement to local government for new or increased services mandated by state government or the courts?
Y = Yes
N = No

pay, e.g., personal income growth or real economic growth, or inflation with a one-year lag will generally assure that taxes will not increase faster than real income. The provision for overriding a limit is a public admission to its lack of clairvoyance, especially when it comes to predicting future service needs, either ordinary or extraordinary. Generally, though, overrides require more than a simple majority, and are tied to expenditure limits as well as new taxes. Requiring extraordinary majorities to enact new taxes has the practical effect of eliminating them as an option.

The inclusion of restrictions on a state mandating costs without providing funds is a very positive step toward protecting local governments from onerous burdens. That so many TELs address this issue shows a public awareness of how, with sleight of hand, government can grow with no one accepting responsibility. Provisions restricting mandates will increase the effectiveness of TELs.

Now we can turn to consideration of the implications of each of these elements; keeping in mind a major difficulty. Whereas each element can be analyzed, the impact of the combination of elements in a particular proposal is very difficult, because it depends upon the state involved and its specific economic, social and political conditions and traditions.

Implications.

The implications of the Jarvis-Gann constitutional amendment can be usefully grouped into three broad categories--governmental, fiscal, and economic. In the governmental category, TELs will affect different levels of government decision making as they carry out their traditional functions of allocating public resources and providing public services. Alternately, the fiscal category refers not to the ability to make decisions but to the capacity to execute them. The third dimension is the impact these proposals will have on the local and state economies. This final dimension is especially important because there are many who argue that reducing the public sector will be painless because of increased economic activity. The objective of this section is not to analyze the impact of the California initiative, but rather to identify the general implications of the most common characteristics of TELs.

Governmental Implications. The governmental aspects of the California initiative are important for two reasons; first, because the rollback in property tax revenues will require many significant decisions about which local services are eliminated and reduced, and secondly, because the initiative, in an indirect manner, will place a veto power over those decisions in the hands of a minority. In many instances, the level of service locally will be decided by aminority not heavily dependent on services that will refuse to approve tax revenues to replace those lost in the property tax rollback.

The most potentially troublesome aspects are those which affect the ability of representative democracy to work. These are the requirements for extraordinary majorities, two-thirds of the state legislature to pass new tax bills, and a two-thirds majority of "qualified electors" at the local level to create new, or raise existing, taxes. In effect, these provisions put significant veto power into the hands of a small minority. The use of plebescite to decide local issues (it will have to be used often because either new taxes or significant reduction in the levels of services will be necessary to avoid deficit spending) will not only slow down local decision making, but also may thwart the majority.

In the state legislature, the use of the extraordinary majority to pass new tax bills is devastating to the likelihood of passing new taxes. Although a greater-than-simple majority was required to pass appropriation bills in California, the pork barrel process of adding a little something for everyone allowed the building of a constituency. This process will not allow legislatures to build support for any tax bill

The second result of this combination of restricting decision-making capacity at the local level and making future revenue sources unlikely is to give greater authority over local affairs to the state. If the state and local levels are affected differently by a TEL, then the "power of the dollar" will shift decisions to the level restricted the least. The California experience shows that as the state provides large sums of money to local levels to help offset their deficits and to maintain higher service levels than otherwise possible, it put restrictions on how that money may be used. The current bail-out bill has restrictions pertaining to the maintenance of school education and public safety. This will limit a community's ability to establish its priorities and define satisfactory levels of public service.

It is clear from the debate surrounding the California initiative that what the public wants is only generally discernible. It is seeking financial relief by reducing taxes or limiting their growth. In addition to this, there are many individuals and small groups saying antigovernment things. However, the general lack of articulation of what is desired should alert local and state government officials that the public is not going to help decide what services should be cut or projects eliminated when revenues or expenditures are limited. It would seem prudent then to encourage review of the basic functions of each level of government and to shift funding responsibilities as deemed appropriate. This can be accomplished most reasonably before a limitation is in place because the initiative may alter governmental decision-making processes.

Fiscal Implications. The main fiscal impact will be reduced revenues and expenditures at the local level. The following techniques will cause this result: tax rollbacks, limits on the rate of growth of future revenues or expenditures, and restrictions on the introduction of new revenue sources. The impacts of these provisions will vary, depending on whether all or just one or two of them are adopted. These effects will vary in degree, depending on whether a specific TEL limits revenues, expenditures or both.

The ability of local governments to retain, gain or lose aid from the state or federal government will either improve or exacerbate their fiscal situation. It is unlikely that increases in such transfers will offset a local limitation entirely. In particular, matching requirements, maintenance of effort and tax effort provisions will all work to cause losses of federal or state revenue.

The rollback of the property tax is the most austere form of limitation. It will cause an immediate reduction in revenues, particularly if coupled with limitations on enactment of alternative sources of revenue or raising rates of existing taxes and fees. It will trigger the loss of federal and state dollars, because of maintenance of effort and local matching requirements. No offsetting gain in the level of economic activity will be able to occur quickly enough to pump up alternative existing revenue sources, e.g., sales taxes.

A rollback, because of the character of local-government fixed expenses, should reduce social services and cultural, recreational, park, and capital expenses. Service cutbacks will be made relative to their "essentialness" and amenability to conversion to service charges. This latter consideration isn't too bad if the service beneficiaries are clearly identifiable and the local government can stop performing income transfer functions.

The rollback may also cause layoffs that depress the local economy and make local government a less attractive employer, thus requiring higher wages in the future to hire good people. Additionally, it will either cause the postponement of many necessary projects, the costs of which will be inflated when they can be done or encourage excessive early retirements, exacerbating both immediate cash shortages and straining pension fund solvency.

Although the rollback creates special problems, the existence of a limit on the growth of revenue or expenditures also is fraught with negative possibilities. Generally, TELs have two types of growth limits, fixed or variable. The fixed is a flat percentage each year; e.g., in California, it is 2%. Variable rates, however, are those tied to changes in the state or local economy. In Tennessee real economic growth is used; in Michigan growth in per capita personal income is used; and in Colorado growth in the Consumer Price Index is used.

The use of a variable growth rate will allow local and state governments to have some flexibility in responding to new or different public service needs. A tight fixed limit on revenue growth, particularly one significantly below the current rate of inflation, should cause a real decline in the level of services in future years.

A tight revenue limit can be softened by altering how governments raise their funds. In many cases, this means shifting the cost of services to other levels of government. In California two examples of this are the state's assuming full responsibility for welfare and the imposition of new user fees at the local level, i.e., shifting the cost of services to the sector of the public that uses them. In this way, tax funds are reserved for the most basic and essential services.

A tight expenditure lid is a very different problem. If expenditures are limited, then provision of new or different services can only be accommodated by substituting them for existing services or programs. This type of limitation can be especially troublesome if a community is experiencing rapid or even steady population growth. The increase of population will require one-time capital expenditures that will overshadow the regular service demands. The community will have to reduce service levels if the limitations only permit growth at the rate of inflation or less.

A final problem limitations present is how to cope with uncontrollables. Population growth is one type, but mandated costs and federal program requirements are two others. Generally, unless legislative protection can be established, communities have to absorb mandated costs by reducing other programs. The tightness of the limit will determine the significance of each substitution of mandated for voluntary services.

Federal programs have been mentioned briefly. They represent substantial local resources, especially if one considers the "fungibility" of federal funds. Two requirements of most federal programs, maintenance of effort and local match, will restrict local governments from receiving these funds if they have limitations on their future budgets.

Since a major objective of many federal grant programs is to stimulate additional overall spending on certain activities, many programs seek to avoid substitution of federal money for local money. These requirements are set out in federal legislation in terms to mean that dollars of expenditure at the local level must be at least equal to that of the immediate prior year. Maintaining existing levels of service will increase in difficulty as the allowable expenditure or revenue growth rate approaches the inflation rate.

According to an Advisory Commission on Intergovernmental Relations report, "Nearly two-thirds of federal grant programs accounting for nearly four-fifths of federal aid dollars include some nonfederal matching requirements." If federal grant programs support services on which the recipients place a low priority or if other items, such as mandates or fixed costs, are too great, local governments will not spend the matching dollars and the service reductions will far exceed the local budget savings. Such decisions are most likely to occur if the match requirement is large.

The response of local government to limits on its authority to increase expenditures or revenues is further hampered by the many fixed costs that have become part of each year's budget. These fixed costs, pensions, debt service, leases, and fuel costs, as well as mandates, have reduced the fiscal flexibility of local governments. Limitations will reduce it further, and the result will be to diminish or eliminate many social service programs, capital projects and maintenance of infrastructure. These programs will be affected first because each nonmandated social service program has a small clientele, and the cost of reducing infrastructure maintenance and capital projects is usually externalized to some future date. Social service programs generally benefit those least able to pay for them and thus are least amenable to the introduction of fees. But most importantly, social service programs are labor intensive and with personnel costs being 70% of total costs at the local level, the only way to save significant funds is to lay off personnel.

Economic Implications. The economic implications of TELs should be examined with respect to the effect on aggregate economic activity in the states, the effect on existing business and the effect on future investment in California. Analyses of the first two effects in the short run are straightforward: aggregate economic activity will decline; many types of business will receive a windfall which they will pass on only if compelled to do so by competition; and businesses owning real property will be inclined to stay in place longer than under other circumstances. However, predicting the effect of TELs on future investment is much less certain since the quality of public services, the stability and the solvency of the local government weigh heavily in investment decisions. The incentive of lower taxes is a positive factor, but its relative weight in many decisions is unknown and varies with different types of investments.

The aggregate level of economic activity in the state of California will decrease because of Proposition 13. In general, the reasons are applicable to any state that significantly reduces the amount of revenue going to the public sector. There are three reasons for this phenomenon, and in the short run, they will not be offset by some increased level of investment and growth in the private economy. The first reason is that private purchases of goods by private individuals contribute to the economic activity throughout the United States because these goods are generally manufactured all over the United States and not exclusively within California. Secondly, the public sector which would be receiving the money in the form of tax revenues will spend all its income, whereas private individuals tend to save a proportion of their income. Although savings is important for counting future investment, it does not increase net aggregate economic activity in the short run. A third factor is that, of the $7 billion of property taxes returned to property owners, only $4 to $4 1/2 billion will end up as disposable income. The balance will, in fact, be paid to the federal government and state government because of the increased tax liability due to lower property tax deductions. Of this $4 to $4 1/2 billion, some will accrue to property owners who do not live in California, particularly large business corporations, and they are not necessarily inclined to invest that balance back into the state.

What will be the implications for businesses that stay in California? In general, the main impact will be that if they receive a benefit from reduced property taxes, their willingness to relocate will be reduced in some proportion to that benefit. In other words, because new plants and changes in ownership will cause property assessments to be increased to their current market level, over time, both residential and commercial interests will have very high incentives to stay in place. In fact, this may be a boon to central city locations that have experienced some relocation of industry.

Two other effects will be a decrease in the mobility of capital and in levels of maintenance of existing capital. From a theoretical economic point of view, decreasing the mobility of capital has harmful effects because it discourages the most efficient use of that capital and therefore makes it less productive and reduces its net contribution to overall economic activity in an economy. The impact of this phenomenon will be felt only over time, and the total effect may be hard to estimate. On the other hand, the willingness of landlords and businesses to maintain facilities will be directly influenced by the determination of the courts as to what level of maintenance is sufficient to cause buildings to be reassessed at current market values.

Although property taxes have many profound effects on economic decisions because real property is involved in almost every productive enterprise, limitations on other taxes also will influence economic behavior in a variety of ways. For example, sales and income taxes reduce disposable income and reduce the level of retail demand that would otherwise be present. The main point is not that taxes affect economic activity, but that generally because the United States is an open economy, the effects will be similar in every state.

The last consideration is the question of future investment. There have been a number of economic impact studies showing both growth and decline within the economy of California as a result of a significant reduction of property taxes. These, however, do not tend to be convincing nor do they give one a careful analysis of the impacts of changes in the character of public services that are likely to result from tax and expenditure limitation. In particular, the inability to maintain public infrastructure, the political instability that results from radical changes in governmental decision-making processes, and the change in the relative importance of different taxes all affect the investment environment.

The change in the ability of the local government to raise revenue will in some ways affect the attitudes of local governments toward different types of development. If sales and income taxes become more important, e.g., a local piggyback is created, then competition for retail development and wealthy citizens will occur. However, if the distribution of aid to local governments is done by formula and collected through a statewide system, then the attitudes of local government will be selective about attracting particular types of low-service demand growth.

The restriction in the amount of expenditures at the local level, either through the reduction of local revenue-raising capacity or an expenditure limit, will affect the ability to create long-term capital goods as well as maintain existing capital facilities. For example, the inability to invest in new roads as well as a reduction in the quality of existing infrastructure will influence the attitudes of potential investors. One of the primary causes for the exodus from central cities has been the condition of infrastructure in cities and its inability to accommodate modern production and distribution methods.

The reduction in the other public services, particularly those affecting the quality of life, such as education and social services, will also influence the evaluation of a community by investors, although it may not be as significant for existing firms which plan to expand. Certainly, the reduced tax burden will help existing firms in their competitiveness with other firms outside of California in the near term, but in the longer term the possible creation of new fees with a high incidence on business may mitigate that advantage.

The likelihood of future investment is also going to be affected by the stability or instability of the governmental system. The restrictions on the decision-making capacity of local government will not encourage new investment. Generally, investors seek to find stable environments in which to invest, and California at this point in time cannot be considered stable. There will probably be a number of years of significant governmental reform that will occur as a result of Proposition 13; in fact, the cloud that hangs over the public fiscal sector is so dark that new bonding activity is nonexistent.

In summary, then, although tax rollbacks provide a short-term boon for most businesses by the reduction in operating costs, in the long run other factors--new taxes aimed at businesses, the politically and perhaps socially unstable environment caused by significantly reduced public expenditures--tend to make the future outlook for business growth not quite as rosy.

Strategy. This section of the paper lists and briefly discusses a series of options which, if encouraged, may reduce public pressure for a restrictive TEL and accomplish some basic reforms beneficial to cities. These options include reform of local taxation authorities and specifically property tax reform, reassignment of financial responsibilities for some services to different levels of government, reform of the intergovernmental system and structural reforms of local governments. If these reforms are undertaken, an indirect, but critical, change in public attitudes toward government may occur and some confidence may be restored. It is ironic that the basic reforms that many have been encouraging for so many years actually are at the roots of the causes of heavy tax burdens.

It is important not to be distracted by economic considerations when pursuing specific reforms. The governmental and fiscal consequences of some TELs can assure that stimulative effects of a lowered tax burden will occur in another state or possibly another country because they cause an unstable local economic and social environment. Local governments, more than state or federal governments, create the environment for local economic activity. Therefore, it is critical that reforms promote a strong local government as well as reduce tax burdens.

High property taxes in California is one of the most often cited reasons for Proposition 13. One major activity that would be extremely salutary in this situation is to institute a significant property tax reform. This reform should incorporate managerial and governmental improvements by using professional appraisers, create an effective state equalization process, provide simple notification of value, establish a standard procedure for annually setting rates, carefully structure a program of exemptions and relief for certain income or age groups so that their burden is not disproportionate and have state financing of such relief and exemption proposals, and remove nonessential services from property tax funding.

The institution of these reforms, well documented by many students of the property tax as well as the Advisory Commission of Intergovernmental Relations, would allow that tax to be less onerous in many situations where it has become too high a percentage of personal income. A number of state proposals have established a limit in terms of a fixed percentage of personal income so that the property tax burden cannot become too great in the future. Such a limit addresses the question of ability to pay, which is the main rationale for exemptions and circuit-breaker provisions in most states.

A necessary element of property tax reform is an examination of which functions are supported by the property tax, and the broader question of which functions are supported by local government as opposed to state or federal government. The absorption of welfare and education by the state or federal government may be likely in the future. The courts have ruled in many states that financing education with property taxes is unconstitutional, and Carter's welfare reform proposal increases the financial responsibility of the federal government for the program.

Mandating of programs and their associated costs is also an issue that must be addressed. It is the friction between a limited tax base and the uncontrollable imposition of expensive programs and services by other levels of government that has so distended the property tax and other local taxes. Not only must all mandates be reexamined and funded by the appropriate level of government, even if they are carried out by local governments, but, in addition, future mandates must not be permitted unless full funding is provided.

The next major reform is structural. Local fragmentation, either by the use of special districts or many forms of incorporation, has limited the power of responsible, general-purpose local governments to achieve better local economies of operation and efficient development. California has 3800 units of local government, of which 3300 perform limited functions, but still have independent authority to tax local citizens.

The fourth option is reform to improve the credibility of public institutions. One major problem with the California system was the generally held belief of the public that there was no way to influence local government decisions and achieve an effective limitation of its growth. The ACIR has made a number of proposals that it has labeled "Truth in Taxation." These proposals seek to inform, in an understandable fashion, the public that the local government is making decisions affecting taxes. In turn, they make the holding of public hearings mandatory and the method of advertising straightforward enough to capture the attention of a large segment of the population. Current use of legal notices very often fulfills legal requirements, but doesn't accomplish the intention of informing the public.

Other reforms include simplified citizen participation arrangements so that the local government could take care of GRS, CDBG, etc., in a fashion that increases rather than limits a citizen's ability to impact on decisions. Currently, the multiple citizen participation requirements for various federal, state, and local programs minimize broad representation because of their frequency and variety and the complexity of issues that must be considered.

Conclusion

It has been the attempt of this paper to discuss the characteristics of tax and expenditure limitation proposals, the governmental, fiscal and economic implications of those characteristics and some options that might satisfy public reform goals without a radical restructuring of state or local government operations. The common theme of TELs is limiting the growth rate of future governmental revenues or expenditures. Proposition 13's success may indicate that people are willing to accept fewer services.

Because each proposal affects only one state, it will have varying consequences. The effect on local governments will depend on the specific type of limitation, future allowable growth rate, the provisions for overstepping the limitation, and whether it affects state or local budgets or both. The current extremes are the very tight limit in California to the rather loose state expenditure limit in Tennessee.

When designing a TEL proposal, the following points should be kept in mind. Both levels of government, state and local, should have similar limits based upon them within the proposal. Without treating both levels of government similarly, there likely will be a shift of power to whatever level of government is less restricted. A state with expenditure limitations will reduce the amount of aid to local government and force more burdens on limited local resources. If the local government is more limited, the states may provide additional funds, but will impose restrictions on their use.

A third element should be restriction of mandates, unless they are fully funded by the state. The need for this is abundantly clear. A final recommendation is to favor expenditure limits over revenue limits. Without expenditure limits, demands for services will continue to expand and local governments will continually have to enter new fields of endeavor. If frustration with government is a motivation for a TEL, then reducing the possibility of allowing local government to expand will assuage the frustration. Revenue limits may not address the problems of burdens that exist currently and may reduce future flexibility in restructuring local revenue-raising structures.

The provision of escape clauses or exemptions in tax and expenditure limitation proposals is desirable from a local government point of view, but also affords opportunity for abuse. Should the provisions be abused, future referenda may create more stringent limitations on local government options. One major reason for exemption procedures is that migration and new economic growth and their requirements for new capital investments are irregular from year to year.

There are many other TELs in various stages of proposal, but the mere threat of a popular initiative may encourage states to pursue the same reforms the initiative proposes. For example, Proposition 8 in California was a more moderate version of a TEL. The most important consideration is to ensure that there is governmental action now rather than after a TEL is enacted. It is true that many TEL provisions are reasonable and useful, but local government will lose a measure of its authority even under the best of the proposals.

Sources

Cuciti, Peggy, et. al — Proposition 13, Its Impact on The Nation's Economy, Federal Revenues and Federal Expenditures; Washington, 1978, Congressional Budget Office

Zimmerman, Dennis — "Proposition 13: An Economic Analysis" Washington, June 15, 1978, Congressional Research Service

California State Legislature — "Facts about Proposition 13"; Sacramento February 1978

Shannan, John — "Case For Fiscal Fair Plag" Intergovermental Perspective, Vol 3 No. 3 Summer 1977, Washington, D.C

Petersen, John — "Propositon 13, What it is and What it means" Speech to U.S. Conference of Mayors, July,1978 Atlanta, Ga.

A P P E N D I X

PROVISIONS OF RECENT TEL PROPOSALS

Alabama

- Constitutional amendment
- 20% local property tax revenue lid on each political subdivision in the state
- Conslusive presumption that land is currently at its highest and best use
- Was defeated in the legislature this year, but will be brought up again

Arizona

- Constitutional amendment
- Expenditure of state tax revenue is limited to 7% of state personal income
- May only be exceeded by a 2/3 vote of the membership of each house
- Tax rates of political subdivisions may be increased if a program is transferred from state to local government
- On November ballot

California

- Constitutional amendment
- Places 1% limit on real property tax rate
- Assessments are rolled-back to 1975 level and may not increase by more than 2% per year
- The state cannot increase or create taxes without a 2/3 vote of the legislature and no new ad valorem taxes may be placed on property or the sale of property
- Local government can impose special taxes with the approval of 2/3 of the qualified voters
- Enacted in June, 1978

Colorado

Initiative #1

- Constitutional amendment
- Tax on non-owner occupied property cannot exceed 2.5% and tax on owner occupied property cannot exceed 2.5% or 5% of total family income, whichever is less
- The limitation may be exceeded to pay the principal or interest on bonded indebtedness
- Did not reach November ballot

Initiative #2

- Constitutional amendment
- The per capita expenditure of state government and each unit of local government cannot exceed the per capita expenditure of the previous year by more than the increase in the CPI
- May be exceeded by a majority vote of the populace in an election held prior to the beginning of the fiscal year. Only one election may be held per year
- The state may not impose costs of new or increased services on local government without full reimbursement
- Aggregate funds from state to local government are guaranteed for the year following enactment
- State and local legislative bodies, with approval of the executive, may declare an emergency by a vote of 2/3 of the members in order to exceed the limit
- Court ordered transfer of programs from one unit of government to another increases per capita expenditure of transferee and decreases that of transferor
- On November ballot

Idaho

- Statutory
- Maximum rate of any property tax is 1% of actual market value
- Assessment may not increase more than 2% per year.
- No increases may be made in state taxes without a 2/3 vote of all members of both houses. Special taxes may be imposed by local government after a 2/3 vote of qualified electors. No new ad valorem taxes may be imposed
- On November ballot

Maine

- Constitutional amendment
- No unit of government may increase its annual appropriations from one year to the next by more than the increase in the cost of living
- Each unit of government may establish an emergency fund with excess revenue
- The state must provide full funding for any new or expanded program mandated for local government
- The proportion of state appropriation to local government cannot be decreased after enactment
- The limit may be exceeded by a majority vote of the electorate
- In the draft stage

Massachusetts

- Constitutional amendment
- Establishes a state revenue limit by averaging gross state budget for the three years preceding enactment and dividing by average personal income for three years preceding enactment. The quotient is multiplied by the average total personal income for the previous three years to achieve the state revenue limit. /Freezes the budget as a percentage of personal income and allows the budget to increase only as state personal income increases/
- The limit may be exceeded if the legislature, by a 2/3 vote, places a referendum on the ballot which receives approval by a majority of the voters
- An emergency fund may be established. Use is contingent upon 2/3 vote of the legislature and approval of the Governor
- No new or increased services may be imposed by the state on local government without compensation
- Local government's proportional share of state revenue before enactment is guaranteed for one fiscal year following enactment
- Needs approval of 25% of the legislature once before 1980 to reach the ballot

Legislation

- Statutory
- The tax rate on real property cannot exceed 2.5%

- The State may not enact a new law imposing additional costs on cities or towns without a vote of and appropriation by the City Council or Town Meeting, 2/3 vote of the state legislature, or state assumption of funding.

- Pending before the legislature

Michigan

- Constitutional amendment

- State revenue may not exceed the ratio of FY 1979 state revenues to 1977 state personal income multiplied by personal income of Michigan for the previous year or the average of the last three years, whichever is greater. /Freezes revenue as a percentage of personal income and allows growth only by increases in personal income./

- Excess revenue greater than 1% must be returned on a pro rata basis. Up to 1% may be kept in a stabilization fund

- The Governor may request a declaration of emergency for one fiscal year. Must be approved by 2/3 of elected memebers of the legislature

- The state may not impose new or increased services without reimbursing local government

- The proportion of state spending to local governments in FY 1979 cannot be reduced

- Local government revenue is frozen and may increase only commensurate with increases in the CPI unless approved by a majority of the qualified electors in the jurisdiction

- On November ballot

Nebraska

Initiative

- Constitutional amendment

- Political subdivisions of the state may not increase their budgets by more than 5% over the previous fiscal year

- Population growth in excess of 5% allows an increase in the budget of 1% up to 10%. Thereafter every 1% of population growth will equal .5% of budget increase

- The state legislature may suspend the limit by a 4/5 vote

- The governing body of the subdivision may call a special election where a majority of voters can approve a limit increase

- Court mandated programs are not counted in the budget limit
- On the November ballot

Legislation

- Statutory
- Political subdivisions may not increase portions of the budget funded by ad valorem taxes by more than 7% per year or the average increase over the previous three years, whichever is greater
- Local legislative bodies may call special elections to increase the limit. Majority approval is sufficient
- Enacted in 1978

New Jersey

- Statutory
- Municipalities and counties may not increase their final appropriations by more than 5% over the previous year's appropriations
- The limit may be exceeded by a 2/3 vote of the local legislature and local finance board or a local referendum
- Expenditures mandated by federal or state law after the date of enactment are exempt
- Enacted in 1976 on a three year trial basis

Oregon

- Constitutional amendment
- Limits tax rate on real property to 1.5% of full cash value
- Assessments are rolled-back to 1975 level
- Assessments may not increase by more than 2% per year
- State taxes may not be increase or created without a 2/3 vote of all members of the legislature. Local government may impose special taxes by a 2/3 vote of qualified electors. No new ad valorem or sales tax may be placed on property
- On November ballot

Tennessee

- Constitutional amendment
- Expenditures for any fiscal year cannot exceed the state's revenues and reserves for that year
- Appropriations from state tax revenues cannot increase from one year to the next more than the estimated rate of growth in the state's economy
- The legislature may exceed the limit by a majority vote
- Any new program must be appropriated first year funding and the state must share the cost of expanding existing programs
- Enacted in 1978

Special Report:

National League of Cities July 31, 1978

National Meeting Discusses Local Financial Management

This report was funded through a grant from the U.S. Department of Housing and Urban Development and was prepared by Todd Areson, director of the Financial Management project for the National League of Cities. Thanks are gratefully expressed to the participants in the four NLC workshops who helped shape the NLC priorities for the National Conference.

How Conferees Saw Local Governments' Finance Management

1. Financial management has been viewed as a technique rather than a matter of policy and management.

2. Local governments lack the ability, information, and techniques to adequately project future revenues (particularly federal and state) and expenditures.

3. Local governments fail to analyze and consider the fiscal impact of their decisions, and are generally unable to establish a local fiscal policy.

4. There is an inability to tie performance measurement and evaluation, budgeting, and accounting to hold agencies accountable for service outlays.

5. There is a need for capital improvements programming to accurately reflect the total priority capital needs of communities (including housing) and the impact on the operating budget.

6. Reliable indicators are not used or available for evaluating the performance and impact of local government services and activities.

7. It is difficult to respond to public resistance to increasing local property taxes brought on by rapidly rising expenditures.

8. Cities are experiencing a decline of the central-city tax base at the same time as they are forced to compete against suburbs for revenue.

9. Federal policy is needed to attack private development practices such as redlining.

10. Local governments do not have the capacity to obtain the appropriate insurance coverage at a reasonable cost.

11. Increase the capacity of public sector management to better use financial management tools available.

12. Improve employee relations with both labor unions and civil service.

13. Carefully developed, valid, and accepted standards for evaluating municipal financial condition, including unrecorded and unfunded liabilities, are needed.

14. There is a lack of understanding of how to assess data processing needs, how to analyze different computer applications, and how to determine the costs and benefits of automation.

15. Improve methods for funding pensions.

16. State and federal oversight and control of local government financial management are sometimes contrary to good financial management practices.

17. Local governments lack the ability to cope with both the fiscal and administrative impacts of federal- and state-mandated costs.

18. Some financial management requirements of federal (state pass-through) grant programs are contradictory to accepted local government financial management practices. Non-uniform application, reporting, and auditing requirements associated with federal grants place a burden on the staff of urban governments.

19. Federal grants distort local priorities. Federal guidelines prevent innovative integration of programs to achieve local goals.

20. There is a lack of coherent federal policies that recognize the particular problems of small and middle-sized governments (10,000 to 50,000 population).

21. There is a lack of targeting grants to black and brown populations which is necessary if any form of equity is to be achieved in needed public services and facilities in minority communities.

Shortly after passage June 6 of Proposition 13 in California, the Department of Housing and Urban Development (HUD) sponsored a two-day national conference in Washington, D.C., on the financial management problems and needs of local governments.

This conference was the outgrowth of a major winter and spring effort by nine public interest and professional groups to have their constituents define their financial management problems. The groups sought to offer effective practices for use by other jurisdictions in addressing the designated problems, and suggested directions for HUD to assist in improving local financial practices. As a result of holding forty-nine workshops, conducting case studies, and surveying their constituents, the groups submitted ninety problem statements from which forty-one problems were culled for discussion at the national conference.

Participants at the conference clarified and expanded the forty-one problem statements to forty-four, voted on their priorities, and broke into five groups to discuss further the problems selected (see box). In the discussions, the focus was on defining the nature of the problems, identifying some of their causes, and proposing possible solutions and specific actions for HUD. Five areas were used to subdivide the types of problems: budgeting and financial management; accounting, auditing and reporting; treasury, debt and pensions; state-local relations; and federal-local relations. However, the groups were assigned problems in more than one functional area.

Basic Problems Considered

Statements 1, 2, and 3. The first three statements were viewed in group discussions as basic problems in financial management. While information needed to manage fiscal matters is available, participants agreed there is a lack of knowledge about methods for measuring variables, such as the cost of living, and predicting revenue sources such as Comprehensive Employment and Training Act (CETA) or anti-recession funds.

Forecasting was seen as a problem for two reasons: There has been no evaluation of good models, and the uncertainty of federal and state funds and their amounts is not convenient. Problems are also created as a result of matching requirements and increasing pressure for public disclosure.

Solutions Suggested

Participants recommended numerous suggestions. Officials said they need to know how to determine where to allocate analysts' skills in revenue and expenditure forecasting (i.e., in what areas) and how to determine the amount of precision required. Elected officials and policymakers said they must be educated for possible solutions and the long-range impact of decisions, including acceptance of federal programs. Officials said solutions must be politically sensitive to the elected officials. Local officials said they need techniques for making revenue and expenditure forecasting understandable to the general public. Modifications to certain specific federal programs are necessary, officials said, because they have imposed a heavy burden on local government. CETA constraints and regulations, in particular, are unreasonable. There also emerged a need for a new definition of the role of the finance director. Budgeting in a policy analyst sense, as opposed to accounting, should be the primary skill. The role of other government officials and how they affect financial management should also be defined. Different media should be better used to inform the public. There is a further need to upgrade university curricula to educate better public financial managers and develop local government internships.

Actions for HUD

Local officials suggested several areas in which HUD could help. They said officials and citizen groups must be made aware that financial management is a priority item. Information on guidelines, techniques, resources, and approaches should be made available to local governments. HUD, along with other federal agencies, should provide an information exchange. Training and development should be provided to financial officers to develop and maintain their skills. Part of the community development block grant (CDBG) funds should be mandated for financial analysis. Elected officials should be encouraged to motivate their financial officers to develop their skills and establish affirmative action programs in local, state, and federal governments. "How to" manuals should be developed. Information provided to local governments should be on a "peer match" basis. Cooperative technical-assistance efforts between state and local governments should be instituted for local governments. Local universities can supply some of this assistance. Federal regulations and legislation should be assessed to eliminate problems caused by the different fiscal years of local governments and the federal government. Multi-year federal funding commitments are needed.

Summary Action for HUD

HUD should make a strong commitment to train and develop financial managers and staff and produce a specific program for working with individual states and regional areas. This should be an ongoing process, not a one-year effort.

Performance & Accountability

Statement 4. The main problem results from the lack of integration of the budget with the accounting and performance functions. Other problems include lack of knowledge of what constitutes a good system, lack of resources, and state restrictions.

Actions for HUD

Provide models of integrated systems for various-sized jurisdictions. Develop case studies on how managers have integrated systems and achieved useful results. Use existing federal audit requirements and other financial management tools and skills for guidelines. Conduct or fund seminars for communities of like populations, utilizing existing national networks, state or regional organizations. Such seminars should help elected officials recognize good financial management systems and programs and how they can aid policymakers. Provide a self-assessment manual and checklists to local governments. Provide initial funding for a "circuit rider" (traveling) financial expert for smaller communities, and then phase out funding from HUD. Encourage technical assistance for improving financial management methods of local governments by state departments of community affairs, professional associations, leagues of cities and counties, and others. This technical assistance should lay out principles of integration of evaluation, budgeting, and accounting and show how they can build toward integration.

Statement 5. Capital planning is not usually integrated with the operating budget for several reasons. Capital planning is viewed as long-range, it is difficult politically to "sell" large expenditures to the citizens, and most people need to see results in the short term.

Solutions Suggested

Participants suggested there is a need for both knowledge and technology transfer. Networks need to be developed where the successful can share with others. There is a need for better public relations programs to make citizens aware of what capital improvements are needed, why, and how they will be funded. Where legislative changes are needed, push for such changes.

Actions for HUD

Provide funds to foster networks for the dissemination of information, and underwrite the cost of distributing some of the literature of the local government associations and professional organizations on this topic.

Statement 6. Reliable indicators are not available for some services, while local officials have not been able to use those which do exist for others. National norms should be avoided except as guidelines. What is needed is the local development of performance and program efficiency. Causes include the lack of knowledge about where to go for information about indicators, as well as a lack of resources to develop and implement the indicators. Of course, groups like unions don't want indicators.

Solutions Suggested

Participants suggested establishing methodology on how to develop indicators of both technical performance (employee, systems efficiency) and total service and program effectiveness; conducting citizen surveys of service effectiveness; and funding demonstration projects with built-in transfer of techniques and wide dissemination of results (perhaps using CDBG funds). Also, establishing skills and information banks including catalogs, manuals, information and referral by phone, and case studies; and exchanging information on how various measures can be used by managers and policymakers.

Actions for HUD

Assist in information sharing. Transmit techniques among jurisdictions. Educate policymakers and managers about various uses of indicators. Assist in establishing a national skills and information bank where officials could trade experience and information with comparable jurisdictions. Require communities to do a self-assessment of their capacities through CDBG (some is being done through the public interest groups). Develop case studies of successful and unsuccessful local experiences in implementing measures for use in policy and management decisions.

Rising Taxes & Public Resistance

Statement 7. This statement was seen as incorporating what, since Proposition 13, we euphemistically refer to as the "taxpayers' rebellion." Local government's taxes are easier, in fact, to strike at and control directly than are those of the federal and state governments. This attitude has a number of causes. A major one is continuing inflation, coupled with increased demand for services and an overdependence on the property tax as the main source of revenue. Associated causes include the existence of overlapping taxing jurisdictions, constitutional and political limitations on other sources of revenue, public apathy, lack of public understanding of how property taxes are allocated, fast-rising property values, and recent legislation limiting use of property taxes.

Solutions Suggested

Educate the public about the composition of the property tax, in understandable language. Use public interest groups in an educational role. Local governments need to look for alternative ways to raise revenues as well as ways to improve on current rates of delinquency. There is a need for greater coordination among taxing jurisdictions such as city, county, school, and special districts. The equalization of assessments is difficult but necessary.

Actions for HUD

Find successful ways of cutting back programs. Integrated budget systems and general fiscal management are two ways. Develop a "how-to" manual on refining budgets and accounting systems to assist in the cut-back process. Develop a model to determine the costs of state and federal mandates which add to local government costs of local governments. Fund a study to analyze the California vote and upcoming votes on tax issues: who voted, and what is their share of the property tax burden. Do a follow-up study on California cities and their services after the tax cut, and publicize these operational consequences. Convene a workshop with public officials and media to foster a better understanding of the property tax system, such as repeat the national conference at the local level. Develop a manual on how to analyze local revenues and where the tax burden falls for each revenue service. Compile information on existing legal limitations on the property tax to show this experience around the country. Expand training in fiscal management.

Facing Cities' Declining Tax Bases

Statements 8 and 9. These statements were handled as part of a larger problem—essentially, a local responsibility to rebuild the cities. This effort will require changing federal policies to support urban revitalization, rebuilding cities through both public and private interests and funds, and stimulating investment in the central city while also reducing such debilitating practices as redlining.

Solutions Suggested

With the rental delinquency rate in central cities so high that redlining results, one solution is direct subsidized rent payment to landlords for welfare recipients. Another solution is to use subsidies for direct payment of the landlord's property taxes. Code enforcement should be cautious since such enforcement also causes relocation problems. Alternatively, enforce the code stringently and let the landlord abandon the units; then rehabilitate and sell them by lottery. Local governments should create incentives to encourage landlords to live on the premises. Public policy must be based on civic and motivational factors, an area's strengths rather than weaknesses. The strategy to attack the problem must involve all levels of government and the private sector. Renters should be given an income tax break. Reverse-incentives for suburbs or pro-incentives for cities need to be developed to keep and attract business. The changing role of cities must be recognized and encouraged in a positive way. Cities originally had an industrial base, but this has changed. Each city should build upon its uniqueness, culture, historical districts, etc., to attract and keep residents. Funds should be made available to encourage urban design studies to help citizens make long-range plans. Smaller communities in particular need assistance for urban development strategies.

Actions for HUD

HUD should serve as a clearinghouse when a city requests funds from several agencies for a comprehensive program. Devise a strategy to encourage state statute changes on subjects such as annexation restrictions and tax incentives. Institute a program to change federal regulations and legislation in the area of tax code and income tax deductions. Assess technology for its applications to the problems of local governments. Encourage city-county consolidation through grants.

Statement 10. Local governments are not viewed as good liability risks because they have been the highest costs to insurance companies recently. As a result of recent court decisions, local government's liabilities have broadened.

Solutions Suggested

Undertake strong loss-prevention programs. Implement safety programs. Get legislatures to restore immunity. Have insurance companies make training programs available. Develop national insurance for local governments — pool insurance. Educate the public about what they are paying for in large insurance awards. Promote programs for the self-insurance of local governments.

Actions for HUD

Establish a national municipal self-insurance program. Offer consumer education programs. Reevaluate agency requirements and regulations concerning risk management. Politically, force insurance to be taken from the lowest bidder. Produce a manual on safety procedures.

Statement 11. Described as financial nearsightedness, this problem arises because financial management is often conducted in a fragmented manner. Decisions are short-term. Long-range goals and prioritities are rarely set, and the budget is not related to community priorities. Most local governments do not follow a set of financial management standards. Some of the causes include lack of qualified people to staff finance offices, low salaries for finance personnel, relative unimportance of financial management to the public, and low visibility for its function in local government.

Actions for HUD

Develop short-term information materials and training programs for the several audiences who work in local government. Support and encourage rewards and incentives at the state level for people in the financial management field. Support specific training in accounting systems, auditing, budgeting, reporting, and policy and standards. Encourage states to mandate "generally accepted accounting principles" (GAAP). Compile a "reader's digest" of existing publications on financial management from the public interest groups.

Improving Employee Relations

Statement 12. The main problem here is their impact on spiraling personnel costs. Also, their presence tends to restrict financial options and productivity, the latter occurring when unions overemphasize the protection of employee rights. Inflation, employee dissatisfaction, union regulations, and rigidity in the civil service system all contribute to the problem, too. Essentially, there is a lack of good management of human resources and of career development programs in local government.

Solutions Suggested

Develop a computerized cost-assessment system for use in the process of labor negotiations. Dismiss the myth that government employees are paid less than employees in private industry. Publish information showing comparisons between public and private jobs, salaries, benefits, and between localities. (Some doubt was expressed at the feasibility of this idea.) Establish incentives and reward mechanisms for management efficiency regarding labor costs. Establish information systems which describe performance, efficiency and include cost-conscious attitudes. Pursue "quality of work" programs to alleviate the push for all rewards to be quantified.

Actions for HUD

Assist in the dissemination of information about what works from the solutions suggested above. This could be in case studies, descriptive materials, models, problem-solving workshops, and "how-to-do-it" manuals.

Statement 13. The problem results from a failure to recognize that a management concept is involved and that such standards either don't exist, are weak, or are not used. Generally, there is a lack of understanding about exactly what is involved in determining good or bad local financial conditions. At the same time, there is a lack of historical data from which to derive appropriate indicators. Having been growth-oriented for many years, most jurisdictions do not recognize the need for either sound indicators of fiscal conditions or long-range financial planning until their growth periods cease.

Actions for HUD

Through the public interest groups and universities, HUD should study ways to develop financial indicators and standards. HUD should work with the private investment community in determining the concepts and techniques for evaluating financial conditions of local governments; disseminate investment techniques and train public officials in techniques; look at special and general purpose districts which also need assistance with this problem; establish standards for risk management, deferred maintenance on capital investments, and actuarial standards; and conduct joint workshops between budget analysts and local governments, including appropriate public interest groups and courts.

Making Computers Work for Cities

Statement 14. Data processing, computers, and automation are just like electricity — nobody knows how they work, just what they do. Employees are afraid of them since computers might take their jobs. Because of the constant improvement of computers, communities are hesitant to invest because something better may come along soon. Also, high cost overruns and delays frighten off communities which have not yet automated. However, with all of their attendant problems, data processing, computers, and automation are the tools of modern will have to begin using them. Information on the more common accounting, budgeting and payroll integrated systems is needed also.

Solutions Suggested
Develop and use information networks to share failures and successes. Develop an in-house "user's committee" in local government.

Actions for HUD
Fund a training program in computer technology and use. Support the development of training packages. Publish a systems development handbook. Develop a model contract for rental or purchase of data processing systems. Emphasize to communities the need for long-range planning. Develop criteria to assess the effectiveness of data processing systems.

Statement 15. A major problem is that information on how to fund and manage liabilities is lacking. Also, those who develop pension programs and benefits are not ultimately responsible for providing the benefits. How to hold legislative bodies accountable in this regard is a problem. Some of the causes include the assumption that pensions are the sole source of support for individuals; the time gap between generating pension liabilities and due dates on payment; the lack of a "pay as you go" approach.

Solutions Suggested
The federal government should stop inflation and balance the budget. Develop non-fixed, variable benefit plans and other innovative pension approaches which are reviewed by actuaries. Bring about full disclosure concerning pension liabilities. Develop and promote general standards for actuarial studies of pension costs.

Actions for HUD
Develop information (models, case studies, descriptive materials, workshops, manuals) on the solutions suggested. Support a resource center in a professional organization like the Municipal Finance Officers Association (MFOA) for technical assistance to practitioners.

Statement 16. Local governments believe the states request more detail than is necessary and are unwilling to adjust to modern budgeting techniques. For example, many local governments have shifted from line-item budgeting to program budgeting and yet, frequently, states continue to require line-item budgets. As a result, local governments have to keep two budgets and two sets of records. Also, consistency within a state is a bigger problem than uniformity among the states.

Actions for HUD

Encourage states to review their budgeting procedures and adopt more modern methods (except for zero-based budgeting, which was not looked upon favorably). HUD should produce model state legislation to streamline accounting and reporting requirements. Assist local governments in getting states to reduce the amount of information required. Review HUD requirements in grant reporting in order to focus only on information that is genuinely needed.

The Problem of Mandated Costs

Statement 17. Local governments do not have the revenue to administer federal- and state-mandated costs. As a result, they "find" the money by skewing local priorities. Administrative requirements are excessive and are not clearly based in well-founded objectives. Further, federal and state legislators do not analyze thoroughly the mandated costs of programs and, therefore, are not fully responsible in passing along these unspecified costs to the state and local levels.

Solutions Suggested

Before federal or state legislation is passed, there should be a fiscal impact statement on the mandated costs of the program. Congress and the state legislatures should allow local governments to recover the costs of mandated programs.

Actions for HUD

Make other federal and state agencies aware that mandated costs are a problem and a concern to local governments. Establish a unit that will estimate what mandated costs of a program will be. Develop case studies, manuals, models, etc., showing how to estimate mandated costs. Develop a mechanism for quick reply to financial impact statements. Assess the mandated costs of its existing programs and urge other agencies to do the same. Trace the costs of existing mandates in case studies. The research results should provide a base for model state legislation requiring fiscal notes and other reforms.

Federal Requirements & Local Practices

Statement 18. There needs to be a national standard of auditing and reporting procedures to which local governments conform. Yet both the federal government's auditing requirements, which are different from standard accounting principles, and the variation in fiscal years among local governments make it difficult to develop these auditing standards. Federal agencies have different funding cycles and accounting requirements; even within an agency there can be different requirements by different offices working on the same program.

Solutions Suggested

There needs to be vigorous enforcement of the Federal Grant and Cooperative Agreement Act. Revive the integrated grant application program to eliminate conflicts so that grants can be negotiated with cities.

Actions for HUD

Encourage development of accounting, auditing, and financial management standards. Require local governments to meet standard accounting practices developed by the Municipal Finance Officers Association, not by HUD. Apply such standards in its own programs. Require local government compliance concerning accounting, auditing, and financial management standards. Coordinate auditing and reporting requirements within HUD's own programs. Coordinate and support negotiations similar to "annual arrangements" between local jurisdictions and HUD regional offices relative to various applications, beginning with the CDBG application.

Statement 19. Many local governments have not set their own priorities using instead federal priorities of a program where funding is available. Local governments can't do much long-range planning because of the two- or four-year electoral process which tends to discourage setting long-term goals and priorities. The on-off nature of federal grants is a problem. When a program gets set up, citizens get used to the services. But when the program is cut off, many jurisdictions choose not to apply for federal funding.

Finally, national priorities set by Congress can become distorted in two ways. Federal agencies

33-595 O - 78 - 42

might have their own, possibly different, agenda when writing regulations, and local government priorities which are not addressed in the national priorities can get addressed through the operation of the grant.

There are at least three models of federal funding. First, there is the General Store. This is where a federal official finds a program in which the local government funds a local priority in an integrated grant approach. Second, there is the Supermarket in which a local official must wander through a maze of categorical programs and try to find a fit with local priorities. Finally, there is the Mail-Order House. This can be a block grant which provides substantial, flexible funds to be applied to local priorities.

Actions for HUD

Determine if and how the grant process is being addressed on the national level. Develop a body of knowledge on how grant funds are used at the local level, what costs they involve, etc. This information could ultimately affect legislative changes. Track the effects of its programs on local governments. Develop a better system to assess local government needs. Priorities should be set at the local level and used as a basis for HUD to develop its programs. This system would force communities to establish their own priorities first. Continue to review the value of block grants versus categorical grants. There are important advantages and disadvantages to each, and more research is needed. Develop a pilot project seeking out communities which can benefit from the success of other communities in the use of federal grants. Identify local models of successful grant use. Share information in conferences and workshops in peer group relationships. Reemphasize the importance of federal regional councils.

Federal Policies & Smaller Communities

Statement 20. Essentially, the federal government shows a bias against smaller communities. The allocation of federal funds to them is arbitrary. Furthermore, the criteria for awarding grants or contracts to them are often inappropriate. The elderly housing requirements for CDBG, for example, become unrealistically high when applied to smaller communities.

Solutions Suggested

Spread out block grants among the various sizes of local governments. Expand the amount of general revenue sharing, use local university expertise and resources—particularly those of the land-grant institutions.

Actions for HUD

Set aside a fixed percentage of funds in each grant program for units of governments with populations under 50,000. Provide funding at the sub-state level for technical assistance and grants to smaller jurisdictions. Formalize the relationship between smaller governments and HUD regional staffs to enable the former to utilize the expertise available in the regional offices as technical assistance.

Statement 21. Two main problems were raised here. First, there was the lack of directing federal and state grants to minority communities which face greater problems of the disadvantaged than other communities. Second, however, was the problem of ensuring that once federal funds were allocated they were, in fact, applied to the problems faced by the disadvantaged. Some members of the group thought the latter problem more a problem of resource allocation than of financial management.

Solutions Suggested

Set aside funds for the use of minority groups. Conduct analyses of the impact of federal grants which link performance and financial data to ensure appropriate use, such as where and how were grant funds spent. This will require an improvement in the capacity of local governments to measure performance.

Actions for HUD

Increase the capacity and capability in area and regional offices to monitor its programs more effectively. Provide technical assistance and support to local governments for carrying out this contractual function.

The Conference's Accomplishments

In retrospect the conference fulfilled its purpose by selecting twenty-one statements of priority to local governments in financial management. Now it is HUD's task, and a formidable one, to address these statements and clarify how it will respond to them within the limitations of its institutional capacity. While HUD may not be able to address each priority, it will explain why it is not able or has decided not to address those it excludes from the program of assistance planned for this fall. □

How NLC Members Contributed to the Conference's Decisions

. . .through regional workshops

The four NLC workshops held during the past spring were fundamental to the formulation of the problem statements submitted as NLC's priorities for consideration at the national conference. Without the workshops and efforts of the participants in defining their local problems and needs in financial management, however, the statements submitted for the national conference could not have reflected the concerns of local elected officials as they were intended to do. Furthermore, only through the efforts which these participants made was it possible for ten significant priorities to evolve from the workshops as clearly as they did.

The approaches used in the four workshops to produce a list of problems and needs of priority to the participants varied, depending on the workshop. In the first two workshops, the ones for the Small Cities and Effective Government Sterring Committees, the format involved small-group sessions in which problems of concern were explored by topic. Topics were: accounting and auditing, budgeting, cash and investment management, debt management, federal-local relations, local fiscal and economic policy, pension management, and state-local relations. In the May Atlanta session, the format included presentations on two topics — the local elected official's role in budgeting, and cash and debt management, which stimulated a discussion of problems faced by those in attendance in these areas.

The June Washington workshop was for the review and modification of the ten priorities derived from the first three workshops. Out of the series of four workshops, then, came the priorities identified and agreed upon as representative of the local elected official's concerns in financial management. The statements of each priority are included here for inspection by themselves and for comparison with the priority statements selected and discussed at the national conference.

Upon reviewing the ten NLC priorities and the twenty-one priority statements designated at the national conference, it is apparent that nine of the ten NLC-designated priorities have been addressed wholly, or incorporated in part, in one or several of the twenty-one priority statements produced at the national conference. That is, NLC priorities 1, 3, 6, 8, and 9 are national conference priorities 2 plus 5, 6, 10, 15, and 17, respectively; NLC priorities 4, 5, 7, and 10 are addressed in the combined National priorities 3 and 11, 3 and 4, 4 and 1, and 16 and 18, respectively. Only NLC priority 2, involving a budgetary process and format which directly address policy-related issues, is not directly addressed by one or several of the national conference priorities. Yet, even here, if the perspective presented in national priority 7 were reversed (and financial management approached from a policymaking and managerial perspective), the budgetary process and document would, by definition, support the various policymaking and managerial decisions required of local officials.

. . . through a survey of local officials

In early May, we sent out a survey on the financial management problems of city governments to 1,200 cities across the country. The questionnaire listed fifty-six potential problems and requested that the respondents indicate the degree to which each represented a problem for their cities, ranging from little to major.

Over 300 responses were received and analyzed. Survey results represent the problems of greatest concerns to officials, elected and appointed, in the more than 300 cities which completed the questionnaire. Because of the nature of the sample, the results should not be interpreted as representing the financial management problems faced by cities in general or by cities of the particular size and form of government which responded to the survey.

With this warning in mind, then, 60 percent of the cities responding had less than 50,000 in population, while 40 percent had more than 50,000. As for the form of government, 44 percent were mayor-council cities, 50 percent council-manager cities, and 5 percent commission-run cities. The respondents were 65 percent nonelected officials and 35 percent elected — essentially a two-one split.

The data were analyzed in several ways. First, the responses to each question were ranked to show the relative priority among the fifty-six problems. The top twenty priorities are listed in rank order in the box above. Second, the results for each question were reviewed for relative importance of the problem when viewed by cities smaller or larger than 50,000 population; by form of government (mayor-council versus council-manager); and by role of respondent (elected or nonelected official). The main conclusion is straightforward: There was no difference of perception on the financial management problems facing cities that could be distinguished by city size, form of government, or role of the official responding to the survey. These financial management problems, then, represent the generic municipal financial problems that apply to cities regardless of the three factors we used to check for differences.

The next matter worth examining is the relationships among the results from the survey, the NLC workshops, and the national conference. We have already established that the results from the NLC workshops were almost completely accounted for in the priorities designated at the national conference. If we can show a similarly high correspondence between the survey results and the NLC priorities, then it follows that the survey results correspond to the national conference priorities. And, in fact, only four of the twenty survey priorities are not addressed, in a substantial way, by the NLC priorities—numbers 2, 4, 18 and 19. The other sixteen statements correspond directly to one or several of the priorities established through the NLC workshops.

The consequence of this correspondence among the financial management problems identified through the national survey, the NLC workshops and the national conference is significant. While three different forums have been used to define the financial management problems and needs facing local governments, the problems and needs identified have, nevertheless, been agreed upon — and with a high degree of correspondence. It seems safe to conclude, then, that as best we can determine, the problems selected as priorities at the national conference adequately and appropriately represent real municipal financial management problems. We should, as a result, feel comfortable that as long as HUD is planning a program to address financial management problems — a program based upon the problems and issues specified as priorities at the national conference — cities' needs should be well addressed.

This conclusion does not ignore the fact that some cities have already effectively addressed some of the problems which, for local governments as a whole, are of great concern. Solutions to the financial management problems expressed will have to be drawn from two sources: existing practices which have proven effective already and can be transferred to other jurisdictions; and the development of new solutions, tools, and practices which, we assume, will prove to be effective.

Where Do We Go From Here?

As mentioned earlier in this article, the next step after the national conference is HUD's response to the twenty-one priorities designated at the conference. In particular, HUD is preparing an analysis of the priorities and the general and specific actions provided it at the conference, and, based upon this work, is preparing a draft of its proposed program of assistance for the fall. In the draft, HUD has committed itself to "address the identified priority problems and needs in local government financial management and indicate how the program will respond to these." Further, while its program may not be able to address all of the problems identified, its task will be to explain its decisions.

Once we at NLC receive and review a copy of this draft, we will put together a project which follows up and capitalizes on this initial assessment of municipal financial management needs. We expect the project to include such activities as providing technical assistance through the state leagues and other associations, training local officials in new techniques in financial management, preparing "how-to" handbooks, and helping link communities that have a specific financial management problem to communities that have demonstrated an effective solution.

For those interested in reviewing HUD's draft of its proposed fall program and in discussing NLC's potential role in providing assistance through a follow-up project, please contact Todd Areson at NLC, (202) 293-7635. □

NLC's Fiscal Management Priorities

THE FISCAL MANAGEMENT PRIORITIES IDENTIFIED IN NLC WORKSHOPS

1. There is an inability to estimate both medium- and long-term revenue requirements and availabilities, including capital improvements.

2. Many cities need a budget process and format in which policy-related issues and questions such as spending and service priorities, are addressed directly.

3. Reliable indicators are not available for evaluating the performance of municipal programs and activities, or for comparing the costs of programs and activities with their outcomes.

4. There is a lack of knowledge of which policies (particularly in small cities) city officials need to assess, reassess, or determine — and how, with what "tools."

5. There is a general inability to evaluate the tax burden to the impact of services provided to different areas such as neighborhoods, council districts of the city.

6. Cities don't have the capacity to get appropriate insurance coverage at a reasonable cost.

7. Few systems provide timely, reliable information appropriate to federal, state, and local accounting requirements, and useful for managing and for policymaking.

8. There is an inability to estimate future costs of pension benefits in order to gain better control over pension funding.

9. Cities lack the ability to cope with both the fiscal and administrative impacts of federal- and state-mandated costs.

10. Local problems resulting from federal and state grants-in-aid include the administrative and reporting requirements, the common incompatibility between federal or state financial management standards and local financial management practices, and the lack of standardization for basic data which must be reported to agencies at both levels.

NLC's Survey of Financial Problems

Top 20 Financial Management Problems in City Government, 1978 NLC Survey

1. Providing insurance coverage for the city is unreasonably expensive

2. Determining whether your city is getting a "fair share" of federal-state funds

3. Forecasting the amounts and timing of federal-state assistance payments.

4. Becoming overly dependent on federal-state funds

5. Doing multi-year forecasting

6. Evaluating program performance

7. Needing a systematic approach for replacement of capital equipment

8. Selecting priorities in budget planning

9. Determining which capital expenditure requests can be funded

10. Obtaining long-term cost estimates on fringe benefits

11. Forecasting expenditures

12. Obtaining long-term cost estimates on labor contracts

13. Making federal financial management standards compatible with local financial management systems

14. Forecasting revenues

15. Determining the number of people needed to maintain city services

16. Meeting federal financial control and reporting requirements

17. Financing pension benefits

18. Assessing departments' budget estimates

19. Coordinating legislative review and citizen input

20. Having difficulty getting insurance coverage for the city

Behind the Conference

Helping Local Government Face the Fiscal Future

Local government financial management problems are becoming acute as local government responsibilities increase while resources decrease with inflation. Local government officials are increasingly aware that managing their resources well is essential to the government's stability and their own political survival. Moreover, local governments are experiencing increased difficulties in creating and using financial management information to support sound policy- and decision-making. Poor financial management practices contributed to the fiscal crisis in New York City. In recent years there has been increased attention to a number of other problems such as the inability of local governments to project adequately future revenues (particularly federal and state) and expenditures. There is also a lack of reliable indicators to evaluate the performance and impact of services and activities; a lack of adequate means to estimate future costs of pension benefits; and an inability to cope with both the fiscal and administrative impacts of federal- and state-mandated costs.

In the past year, the Office of Policy Development and Research of the U.S. Department of Housing and Urban Development (HUD) has developed a programmatic response to the increasing problem areas facing local governments in their financial management practices.

The problem areas in local financial management include accounting and auditing, budgeting, cash and investment management, debt management, federal-local relations, local fiscal and economic policy, pension management, and state-local relations. One factor aggravating problems is that federal and state aid brings with it numerous spending strings, including extensive accounting and auditing requirements. Another factor is that investors in municipal securities and bond rating firms are pressing for increasing disclosure. Local elected officials further find they sometimes must make complex policy decisions based on incomplete, inaccurate, or short-ranged financial data. Municipal auditing firms recommend changes in accounting procedures while municipal auditing and accounting standards are under revision by the responsible professional organizations.

HUD's response to the financial management problems plaguing local governments was fashioned as a result of consultations with various local government officials, public interest groups, and other groups familiar with local financial problems. The first phase of the program has been operating since early spring. Phase I incorporates several elements involving three main groups — state and local government officials, the cognizant public interest groups, and the appropriate professional associations.

The three elements of Phase I are: identifying the problems and needs, sharing current effective practices, and addressing how HUD can assist in improving the practices identified as problematic.

There are three major questions which come from these elements. First, what financial management problems and needs do local officials consider most important to address in a national effort? Second, what solutions to these management problems and needs are already being employed effectively, or might be employed as potentially effective? Third, in what specific ways can HUD and other organizations and levels of government, including your own, assist in improving these current, less effective financial management practices?

Underpinning this first phase of the program is HUD's recognition that there is no one right solution to the problem or need as defined by many local governments. Many of the solutions sought by one jurisdiction very likely exist similarly in another local government.

Having established what and how it wanted to address the financial management problems and needs of local governments, HUD sought the involvement of the public interest and professional groups which helped to design the assessment process for the local governments—their constituents. The organizations which carried out Phase I of the program have been: the National League of Cities (NLC), the United States Conference of Mayors, the National Association of Counties, the International City Management Association, the Council of State Community Affairs Agencies, the Urban Consortium of Public Technology Inc., the Joint Center for Political Studies, the National Association of Housing and Redevelopment Officials, and the Municipal Finance Officers Association.

The means for assessing problems and needs were left up to the organizations through different sessions of workshops, conferences, seminars, case studies, and surveys. A combined total of forty-nine local sessions were held during the spring to ferret out the specific financial management problems and needs of each group of local officials. Each organization was then responsible for synthesizing its most important problem statements and submitting them for the National Conference on the Financial Management Needs of Local Governments, held June 7-9 in

Washington, D.C., and attended by representatives from each organization that participated in one of the earlier workshops. This conference served as a forum for the continued discussion, modification, and selection of the problems, effective practices, and directions to HUD, and other agencies and levels of government. Its proceedings will serve as the basis for HUD's draft of the priority problems and needs in local financial management and for HUD's determination of how it intends to respond to each of the designated priorities. This draft of the conference proceedings was scheduled to be completed by mid-July, then to be submitted to the conference participants and organizations involved in the program for comment. The entire program of assistance to local governments will begin with the new fiscal year, October 1.

NLC's role in the initial phase of this HUD-funded program has been to assess and present to HUD the specific problems and needs of local elected officials in financial management. The project undertook this responsibility by conducting four workshops, a national survey of financial management problems and needs, and preparing this special summary to describe the details and results of this initial phase of the program to NLC constituents.

Our first workshop was held April 13 in Kansas City, Mo., with the steering committee of the Small Cities Advisory Council. The second workshop was held April 21 in Washington, D.C., where the steering committee of the Effective Government Policy Committee met. Third was May 19 at the Atlanta Regional Conference. Finally, there was the June 6 meeting in Washington with selected participants.

The workshops were to have the participants set priorities among the problems and needs they face as local policy officials. This was done by discussing topics of concern in each of the eight functional areas listed previously.

HUD suggested several forms of assistance such as conferences, workshops, and training sessions conducted by local government groups and professional associations. Local officials then would meet to discuss issues and exchange possible solutions to common problems. HUD also suggested establishing a resource center to provide information on financial management systems and other technical issues. The department offered to fund existing assistance networks, and expand and improve the level of technical assistance it provides in financial management. It also offered to fund the development of materials for training and technical assistance efforts through existing organizations involved in providing in-service training and technical assistance to local government.

HUD further offered improved state financial management legislation through improved communications between state legislatures and local officials. HUD is working to determine the boundaries of state oversight of local finance, and the amount and type of state aid and technical assistance provided to localities. HUD is looking into working with interested non-governmental groups on using local government financial management data. The department is interested in working to develop an interagency effort to simplify federal agency requirements for local government financial reporting.

The national survey consisted of fifty-six statements of potential problems to local government officials. The survey required a judgment as to whether the statement was a little or a major problem, or somewhere in between. A total of 1,200 questionnaires were mailed out in early May; over 300 were completed and returned. The analyses of data are presented as a major section of this summary. □

THE TAXPAYER REVOLT: AN OPPORTUNITY TO MAKE POSITIVE CHANGES IN LOCAL GOVERNMENT

Selma J. Mushkin
Frank H. Sandifer
Charles L. Vehorn
Charlie G. Turner

Public Services Laboratory
Georgetown University

Prepared for:
Subcommittee on the City
Committee on Banking, Finance and Urban Affairs
U.S. House of Representatives

THE TAXPAYER REVOLT: AN OPPORTUNITY TO MAKE POSITIVE CHANGES IN LOCAL GOVERNMENT

Introduction

There has been an almost steady outpouring of analyses and reports in recent months on the immediate effects and consequences of Proposition 13 and other taxpayer rebellions. As is often the case, the published reports on the phenomena have been almost as fascinating as the events they purport to analyze. We have seen, for example, dire predictions of dreaded consequences from Proposiition 13, rosy predictions of beneficial consequences, and middling predictions of muddled consequences--some good effects and some bad effects that may offset one another.

This paper is not another analysis of Proposition 13's effects. Nor is it an assessment of whether the tax-cutting movement exemplified by California's Proposition 13 is either good or bad for the country. Rather, it starts with the recognition that Proposition 13 already is law in California, and there very likely will be tax cuts, tax limitations, or spending ceilings in other States as well. Thus, this paper begins with the *fait accompli* of Proposition 13 and addresses the question of how local governments will respond to their changed circumstances.

The taxpayers' revolt, as it is frequently called, provides the occasion to take a hard look at a number of governmental options that have not perhaps been considered seriously enough before. It also provides a strong impetus to make changes in the way local governments operate. For example, it will necessitate even better management of governments than before, particularly better management of government workforces. Furthermore, the tax reduction movement is an incentive to revise the ways that government services are financed. Certainly general taxes like the property tax are a valuable means of producing needed government revenues. However, in many cases there are alternatives, such as user fees and charges, that can be fairer and provide more citizen involvement in determining what services should be produced, in what quantities, with what qualities, and at what cost.

We wish to present some of these alternatives, also, to offset the kind of budgetary game-playing that can and frequently does occur in governmental decisionmaking. When any substantial reduction in taxes or budgets occurs, there is always likely to be much over-reaction as well as under-reaction. Some government officials will want to take immediate and drastic steps to cut costs and, in the process, have severe negative effects on vital services. Others will want to do nothing in hopes that the cuts will be restored, perhaps delaying action so long that many valuable alternatives become unfeasible.

In the Federal Government, there is a well known budget process that is sometimes called the Washington Monument Game. The name is taken from the archetypal ploy, attributed to the National Park Service, of outlining politically undesirable consequences of proposed budget cuts--in this case, suggesting that the first step the Park Service would take to accommodate a lower budget level would be to close down the Washington Monument to visitors. The Monument is, of course, a prime attraction to visitors, most of whom are the constituents of Congressmen (who must vote on the budget). Some local government officials in the debate preceding passage of Proposition 13 in California demonstrated their acumen for the game as well. There were plenty of hints and outright claims that police, fire, and education services would be drastically curtailed. The whole idea in this game is to suggest to the voters that their actions will result in the curtailment or cutting out of the services they are likely to view as most vital.

The following sections of this paper will discuss some of the alternatives that are avilable to government managers and elected officials in responding to citizen demands for reduced taxes. Section One is a general discussion of economic considerations that are at work in the political process when tax cuts are being forged, as well as some of the economic constraints on governments' responses to tax cuts. Section Two focuses on the concept of "public prices for public goods," based on the premise that many government services, like private services, can be priced and consumers can signal their demands through purchase of the services. Section Three deals with improving the management of local governments' largest operating cost item--personnel--particularly ways that personnel costs might be reduced without resorting to drastic measures like general layoffs and ways that personnel productivity can be enhanced without substantially increasing revenue demands.

SECTION ONE: GENERAL ECONOMIC CONSIDERATIONS REGARDING PROPOSITION 13

It is useful to think of the taxes cut through passage of Proposition 13 and other measures in terms of three separate, but highly related concepts: First, the cuts represent taxes saved to the citizens who would have had to pay them; second, they represent reduced revenues, which either are lost completely or must be made up from other sources; and third, they mean reduced expenditures unless the revenues are replaced.

If citizens vote to reduce property taxes, they may be voting for one or more different aspects of tax reduction. They may be voting to reduce public expenditures because they believe the levels of some services are too high given the costs of those services. This could be caused partly by an adjustment lag in adapting services to changes in community needs. The school system may now be larger and consist of more highly trained staff than is required for the reduced number of students today. Any institution, public or private, has difficulties accepting and adjusting to adverse conditions. Part of the vote may be against certain local programs that are mandated at a higher level such as welfare programs. To the extent that the voters prefer a lower level of services, it is necessary to re-evaluate existing programs and, if warranted, adjust them to the desired levels (if possible).

33-595 O - 78 - 43

Another aspect of the vote for Proposition 13 could be a demand for greater efficiency in government. It is widely believed that government workers are overpaid and underworked. Even if this is not true, those who believe it will probably vote for a tax reduction in the hope that expenditures can be reduced without a proportionate reduction in services. Of course, any organization has some inefficiencies in it--both management and workers become accustomed to performing services in a particular fashion. Proposition 13 may provide the jolt that speeds up changes toward more efficient operation. However, there are limits to the increases in efficiency that can occur within the context of a given technology. Increased intensity of work or smoother coordination of efforts can move government toward efficient operation, but these are likely to be one-time changes rather than the annual productivity changes observed in manufacturing. Nevertheless, in addition to the task of determining where reductions in services should be made, public managers should accept this opportunity to improve the efficiency of local government.

Some voters may support a tax reduction in order to shift the incidence of taxation in a way favorable to them. Some of the voters simply would want to avoid property taxes because they pay a relatively larger share of property taxes than of sales or income taxes. However, many citizens are probably of the belief that too much public service is being provided out of general tax revenue. They do not believe that the value they receive from such services is worth the tax share that they pay. Howard Jarvis has stated frequently that property taxes should be used only to finance property-related public services, although his definition of the "property relationship" may be much narrower than others.

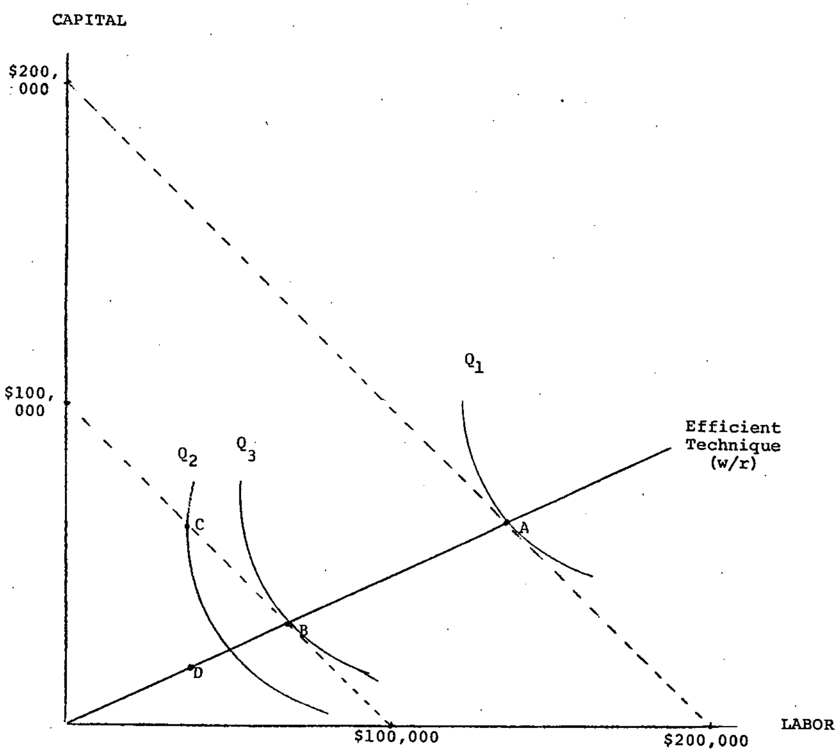
Some public services can be provided through user charges. If such charges were levied on all citizens in a fashion similar to property taxes, then the name would have changed, but presumably citizen desires would not be served. However, if user charges are designed to allow for citizens to choose varying levels of service and for those receiving the service to pay for it, then a shift to user charges should increase community welfare. The readjustments to Proposition 13 present an opportunity to supply more of the public's desired amount of services through user charges.

Dynamic Adjustment to Reduced Levels of Public Expenditure

Adjustments to expenditure reductions will generally be less efficient in the short run than in the long run. Efficiency means providing a given level of service with the least costly combination of inputs (labor and capital) given the prices of those inputs (rents on capital and wages of labor). Part of the short-run inefficiency is due to extended contract provisions, and some of it is due to non-reversible capital expenditures.

There is some evidence to suggest that local government services are produced with technology that yields approximately constant returns to scale.[1] Thus, half the service can be provided at half the cost--provided that the service level is known far enough in advance to be efficiently planned. If a city is forced to operate with half the budget but must retain all of the capital that was previously efficient, then less than half the previous service can be provided. A simple diagram makes the point (see Chart 1).

Chart One. Production Under Reduced Budgets



w = the wage rate
r = the rental rate on capital

Q_1 = the level of output before the budget cut

Q_2 = the level of output immediately after the budget cut

Q_3 = the level of output after long-run adjustments

Eventually, Point B on the chart can be reached (after building and equipment depreciate and are replaced as needed), and Service Level 3--which is half of Service Level 1--can be provided at one-half the cost. However, an initial (unexpected) cut of expenditures from $200,000 to $100,000 would result in Point C, which is less efficient and overly capital-intensive. If the technology that is used to produce the service does not allow substitution between capital and labor (i.e., the technology has fixed coefficients or fixed proportions of capital and labor), then Point D is reached. It uses the initial technique at the level determined by the amount of the most scarce factor, in this case labor. Many economists believe that production technology is largely of the fixed coefficient type once the physical plant and machinery are purchased and set into operation.[2]

Local government produces many different services, some of which can be produced with differing capital to labor ratios and some of which are close to the fixed coefficients model. The first type might be the public library system. Reduced staffing may make for less productive use of the building, equipment and books, but such non-personnel expenses will for the most part still provide benefits to the public. The second type might be the police department. There is little benefit to the public of extra police cars if there are 200 cars and only 100 police officers.

Should the government dispose of the excess equipment and property? Yes, if there is little difference between the disposal price and the price one would have to pay to purchase additional equipment. However, the main adjustment problem is that there usually is a wide gap between purchase price and resale price--for example, between what the city pays for police cars and the price at which it can sell comparable cars. Depending on this price differential, the rate of interest, the maintenance costs, the difference in effectiveness between new and older cars, and the rate of depreciation of police cars, it may be more cost-effective to store unneeded police cars until older ones are retired.

Personnel Reductions

From a simple efficiency standpoint, government workers (given their pay) who are most efficient to use in the changed circumstances should be retained (or hired) and everyone else let go. However, for contract and other reasons, that is seldom possible. This causes inefficiencies that are similar to having excess capital. The city may have more senior-level personnel than is efficient. Also, if layoffs are necessary, many of the people who must be retained (because of seniority, for instance) will be paid a higher salary than those who are laid off. These higher paid personnel may be efficient under normal operations, but not necessarily under the new conditions. For example, a fire marshal may be excellent at his normal job of investigating the causes of fires, but he may be less efficient than a lower paid fire fighter at normal fire station duty.

An additional problem is low morale. When people's livelihood is threatened, they are likely to be depressed and have lower performance on the job. This may be offset in part by the stimulus to greater effort from the fear of losing one's job, but it probably has a negative effect. In addition, various retaliatory measures (e.g., work slow downs and insolence to the public) may be undertaken by employees as a group or as individuals. This is most likely to happen if the public employees see the public or public leaders as the "enemy."

Such factors are likely to make the effect of a sharp reduction in public expenditures worse than anticipated in the initial stages. A strong argument can be made for a phased reduction in expenditures to the new desired level, even granting that present levels of spending are too high. In California, the state budget surplus has effectively allowed local governments the time to reduce expenditures in a series of steps. Assuming that next year's state surplus will be lower but still substantial, the cities and counties have two more years before they must have their budget in line with their reduced tax revenue. Of course, this assumes the state will once more distribute its surplus to the local governments. If measures similar to Proposition 13 are adopted in other states or cities, long-term efficiencies will be enhanced if they reflect the lack of such large revenue surpluses and make provision for phased reductions in expenditures.

Nevertheless, if immediate reductions are mandated, there are some ways to minimize the adverse effects. All employees should be consulted about the options available and asked to express their preferences. Careful analysis of areas of cost reductions to maintain the highest level of service commensurate with the new expenditures level, rather than imposing across-the-board cuts, should help to minimize the impact of the reductions.

SECTION TWO: ACTION ON REVENUES--OPPORTUNITIES FOR USER CHARGES

There are three major sources of local government revenue: local taxation, intergovernmental grants, and user charges. When the public revolts against property taxes and forces a reduction in that source of revenue, local government officials can either reduce their expenditures proportionately, look to higher level governments for larger grants, establish or raise non-property taxes, or place public prices on public products. Not all local government services, however, are amenable to the pricing mechanism. Some public services have a redistributive characteristic; it would be inappropriate to charge the poor for consumption of services designed explicitly for their benefit.[3] Some public services have characteristics that prevent exclusion of non-payers. Control of communicable diseases and the maintenance of public safety are examples of such services. When beneficiaries can be identified, however, user charges provide a means of rationing government output, while allocating the burden of payment to those desiring the service.[4]

Rationale For More Reliance on User Charges

Most economists have long been in favor of giving greater emphasis to user fees and charges. Three of the major reasons are the following:[5]

- They can improve efficiency in choice and public resource allocation.
- They can improve government structure.
- They can be more, rather than less, equitable in certain cases.

In each community, citizens now express their demands for local public goods through the voting mechanism. But this mechanism results in a supply of public services that is not sensitive to variations in demand by individual citizens. For example, there are often divergent interests between the elderly and families with young children. Some divergences among individual citizens do not yield efficient outcomes, except in very special circumstances. A price for a public service, in contrast, permits different citizens to record their preferences by purchases of the quantity and quality of services desired.

Under present public resource allocation practices, the wrong product is sometimes produced in the wrong quantity, and with inappropriate quality differentiation. "Wrong" is used here with the special meaning of different in type, quantity, and quality from that which would be produced if rigorous analysis were made of comparative effectiveness at the given budget level. It is also being used to describe the volume and quality of production that is lower than it would be at market prices under competitive conditions.

Analysis of a public service or activity may give new emphasis to uncertainty about the consumer or voter's response to the public product being produced. If the government sets a price on the product --thereby opening up a market through which consumers can register their vote for or against, by either paying the price or not consuming the product--this could help guide the city in the production of its services.

Local governments currently are structured in ways that centralize authority for spending decisions. But there are many enterprises under the local government umbrella. Conceptually, it could be more efficient to decentralize by allowing various enterprises to operate on a fee-for-service basis. This structure would be beneficial to consumers because it would give the government enterprises the opportunity to compete with enterprises that privately provide similar services. Such competition should foster greater efficiency.

Decentralization would allow public enterprises to operate as separate entities, generate their own funds through user charges, and place only their profits into the local government general fund. Rates for fire protection, for example, could be based on a variety of pricing rules that take into account property value and fire hazards on the property, with lower rates for less hazardous occupancies.[6] Part of the monies paid in as fees could be set aside in a separate account to provide low or no-interest loans to property owners for improving the fire risk of their structures.

Greater Fairness

A fee or public price could be a fairer source of revenue than the property tax, since it may be that poor families now pay more through the economic effects of the property tax than under some alternative arrangement. If prices were used instead of the tax, some of the poor families might choose not to have the priced services, and those who did presumably would benefit in proportion to the prices. Analysis of current "use" of a service by income class or age may disclose a heavy concentration among middle income individuals, rather than poor individuals. In this case, the low income families would be partially subsidizing the middle income families under the present financing system. Relative income effects are at issue, as well as the distribution of benefits among age groups.

Prices for services may also achieve greater fairness because payment would be made only by those who benefit. Prices can be used to discourage some users and to encourage others (for example, by negative prices). If uniform charges would be more regressive than an alternative revenue system, it is possible to devise a fair pricing method by use of eligibility tests to determine ability to pay. This method typically has been used in financing health care service, in financing certain welfare services, such as family counseling, and in school meal programs. Such a technique gives the subsidy to those who need it, while making the benefits of the service available to all those who desire to purchase it.

Limitations to Increasing User Charges

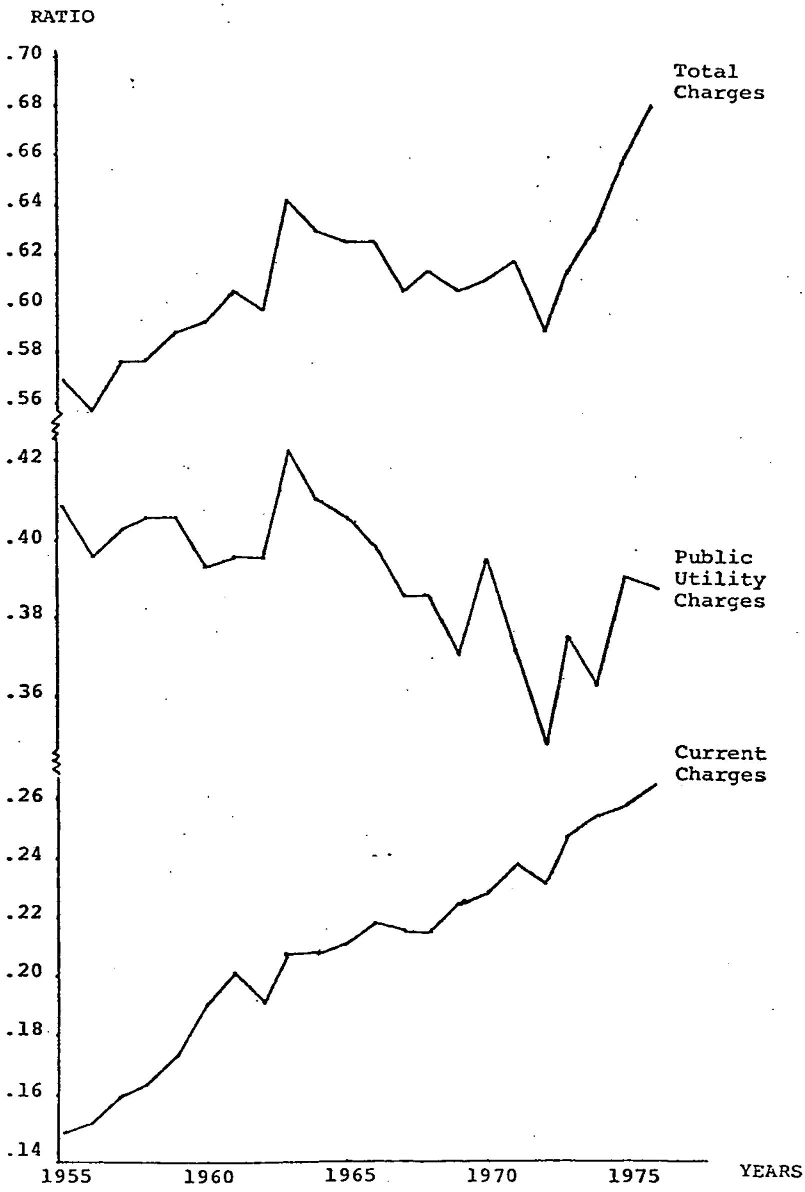
One difficulty in extending user charges is that many fiscal officers feel the political constraints are too binding;[7] another is determining the appropriate price to charge. Local policy-makers who indicate a political reluctance to extend user charges may be doing so because they are unaware of the potential of public prices. A recent Rand report suggests that policy-makers, many of whom have been schooled in the judiciary process, are more familiar with regulation as a tool.[8] However, public pricing can alter people's behavior, perhaps even more efficiently than regulation. For example, charging for a public service can discourage misuse of that service.

A good illustration is the fees for emergency ambulance services that some local governments, including the District of Columbia, now impose. Part of what the fee does is to discourage requests for ambulances in situations that are not really emergencies.

Once a decision is made to rely more on public pricing, the next complication is in establishing the appropriate price for a given service.[9] When a price less than the appropriate price is charged, a subsidy is given to the person purchasing the service. The Advisory Commission on Intergovernmental Relations has suggested that states provide consultants and technical assistance to local governments to determine the appropriate price to charge. However, many states currently do not possess a capability to offer soundly based advice on the pricing of public services.[10] Even with this limitation, it would be possible to set a price, assess demand, and then reset the price if the first price was inappropriate. This incremental procedure could help in overcoming the difficulties in determining price elasticities for public goods.

Although there are obstacles to more reliance on public pricing, municipalities slowly are becoming aware of the revenue potential from charges. One way to illustrate the relative growth in charges is to look at movement in the fee intensity. The fee intensity is simply the ratio of fees to each dollar of taxes. Both fee and tax revenue have been growing, but if fees are growing faster than taxes, then the fee intensity is rising. A greater reliance on tax revenue, by way of contrast, would show up as a decline in the fee intensity. The fee intensity for total charges has shown a cyclical pattern over the past 20 years, but this is largely due to fluctuations in public utility charges (Chart 2).[11]

Chart 2. Ratio of Current, Public Utility, and Total Charges to $1 of Taxes, 1955-76.*



* Current charges are amounts received from the public for goods and services benefiting the person charged (excluding public utility charges). Total charges is the sum of current charges, public utility charges, and liquor store revenue.

When the fee intensity for current charges is considered separately, a pattern of relatively steady growth emerges. Municipalities gradually are placing more emphasis on public prices. If this trend continues, what will be the impact on future revenues?

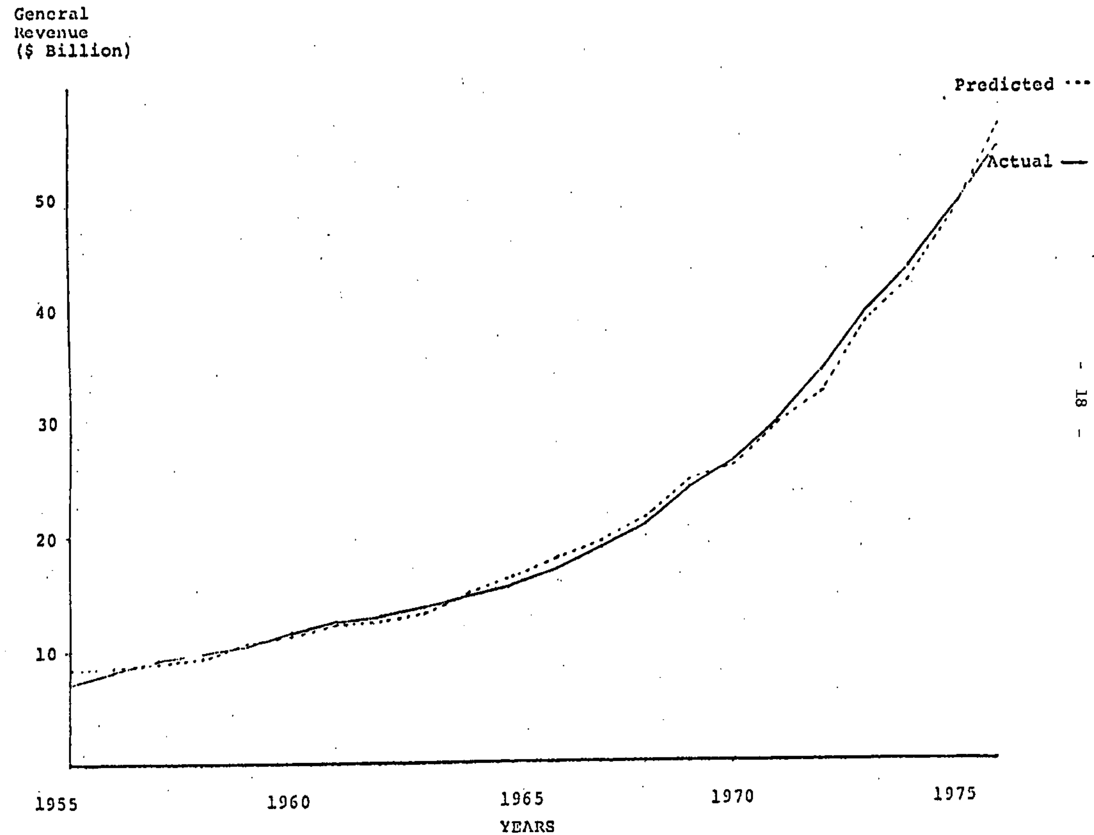
Projecting Local Government Revenue

In the last decade, a number of projections have been made on the state and local sector of the economy.[12] A period of steady growth in state-local expenditures has forced public officials to consider fiscal planning for the future. There also is an increased awareness of the key development roles played by the public sector--most notably in the areas of highways, water supply, energy supply, education, and airports. Through the use of projections, public officials can adapt continuously to economic events that affect revenue sources, rather than changing policies only after the full force of the impact is realized.

Many researchers have examined how tax revenue changes in response to changes in other economic variables.[13] But the question of what happens to revenue if municipalities turn to stronger reliance on public prices has received less attention. A regression model similar to models in previous studies, except for the inclusion of a fee intensity variable, is used here to make revenue projections to the year 2000.[14] Chart 3 illustrates the close relationship between the actual and predicted values of municipal general revenue during the 1955-76 period.

In order to make projections for the year 2000, it is necessary to obtain some estimate of the independent variables. The MIT-PENN-SSRC (MPS) model of the U.S. economy has produced estimates of real income

Chart 3. Actual and Predicted Growth in General Revenue for Municipalities, 1955-76.



and prices. Real income per capita is projected to rise from $3,750 in 1976 to $7,345 in 2000. Lagged prices, using 1967 as the base year, will rise from an index number of 14.7 in 1975 to 368.5 in the year 1999. It is more difficult to obtain projections of the other independent variables, so various scenarios are illustrated (Table A). One scenario assumes no change in the share of intergovernmental aid and the share of taxes, excluding property and sales taxes, but lets the fee intensity (for current charges) vary from the 1976 level of .265 to 1.0. The other scenario allows for an increase in the share of grants from 40 percent to 50 percent.

Depending on the assumption of aid share, Table A illustrates that general revenue foregone by cities in the year 2000 will be of the magnitude of $101.9 to $116.8 billion if the fee intensity ratio does not rise from .264 to .50. The potential of user charges as a revenue source and a policy-making tool has been largely untapped. If revenue from charges equaled tax revenue, then general revenue in the year 2000 could be somewhere between $527.7 and $604.9 billion, depending on the growth in the share of aid. Once again, it must be emphasized that forecasting is certainly an inexact science. At best, these revenue projections should be taken as an indication of the opportunities available to local governments, if public officials simply relied more heavily on user charges to finance the provision of government services.

One limitation of the simple regression analysis is that the growth in revenue bonds was not considered. This method of local government financing fosters greater reliance on public prices because pure revenue bonds are secured solely through user charges. The

Table A. Projections of City Government General Revenue for Year 2000.*

(Amounts in millions)

	Assumes no change in share of tax revenue (excluding property and sales taxes); and no change in share of aid	Assumes no change in share of tax revenue (excluding property and sales taxes); but share of aid is increased from 40 to 50 percent
Assumes no change in fee intensity	$271,382	$311,078
Assumes fee intensity increases from .264 to .50	373,303	427,908
Assumes fee intensity increases from .50 to .75	457,073	523,931
Assumes fee intensity increases from .75 to 1.0	527,679	604,864

* These projections are based on results from regression analysis, and are reliable in so far as the regression model is correctly specified.

July 31, 1978 issue of Business Week indicated that experts see opportunities for more revenue bond financing with the passage of Proposition 13. If this expectation is correct, more reliance on user charges will certainly occur. Banks, under a section of the Glass-Steagall Act, are not allowed to underwrite revenue bonds. But already they have stepped up their lobbying efforts to reverse this section of the Act because of expectations that the revenue bond market will be booming soon.

There are several favorable aspects of a shift towards more revenue bond financing. Revenue bonds secured by user fees should encourage greater attention to efficiency because local government enterprises will have to meet the demands of participants in two separate markets--consumers and bond holders. Another favorable aspect is that prices will be charged for use of equipment. Currently, many user charges cover operating costs but neglect capital costs. Revenue bond financing will facilitate setting appropriate prices that include both operating costs and rent for capital equipment or facilities.

It should be noted, also, that this model demonstrates in a rough sense the revenues that could be available through use of public prices and user fees. Projecting increased revenues would mean also projecting increased expenditures, but that is not the point that should be derived. Rather, what we are talking about is a different mix of revenues from different sources to finance the services that the citizens want. Many services that presently are financed through general taxation like the property tax could be financed more efficiently and equitably through user fees. General taxes could be used to finance truly collective goods and services.

SECTION THREE: ACTION ON COSTS--THE OCCASION FOR IMPROVED PERSONNEL MANAGEMENT

Thus far we have concentrated mainly on the tax and revenue aspects of the Proposition 13 movement. However, as noted earlier, reductions in revenues require reductions in government costs. Correspondingly, lower costs mean less revenue is required. Thus, action on the costs of government also is a central part of governments' response to the current demands of the citizenry. In Section One, we briefly described some of the economic constraints on governmental action to reduce costs. In this section, we want to focus on an aspect of cost for which governments do have considerable flexibility to achieve reductions--personnel costs.

Perhaps governments could have recognized the sentiments of the taxpayers sooner and taken more effective action earlier to reduce expenditures. At this juncture, however, that issue is beside the point, at least with respect to California governments. What they are facing is the necessity of reducing expenditures. And the largest single item in their expenditures is personnel costs--the salaries and benefits of people who work for government. In some cases, personnel costs make up as much as 85 percent of the operating budgets of local governments, although the average is below that. There is no question that in any discussion of cost reductions, personnel costs deserve central consideration.

Layoffs and Freezes

Unfortunately in most of the debates about Proposition 13 before and immediately after its passage, the notion seemed rampant that there are only two basic ways of cutting or holding down personnel costs--general layoffs (cutting down the size of the workforce through direct separation of workers) and across-the-board freezes (on pay and benefits, on hirings). The California state legislature's plan for allocating the more than $5 billion state surplus to localities included several important conditions, one of which is that all local jurisdictions are required to freeze salaries for fiscal year 1978-79. That prospect is not very appealing to public employees nor to the unions that represent many of them.[15] Furthermore, many California jurisdictions reportedly have instituted hiring freezes and effected some layoffs. Such actions can be characterized most optimistically as stop-gap measures, and they hold the seeds of problems at least as severe as those they are directed towards, especially if they are maintained for any considerable length of time.

Government officials must not delude themselves that, for example, a hiring and promotion freeze is an efficient solution to any but the briefest revenue shortfall. It is almost axiomatic to point out that a hiring and promotion freeze, if prolonged, results in the employer's loss of the best employees and retention of the worst. Government salaries overall are relatively good, and the inferior worker is not likely to better his financial lot elsewhere. However, public sector salaries for top managers and many technical specialists frequently are only barely competitive with those of the private sector. Faced with the prospect of no promotion and no opportunity to obtain a better job in the government where they work, the best managers and specialists are likely to look elsewhere. And there usually are good jobs available for highly capable workers.

The same principle is operative in the case of salary freezes. The highest performers know their own wage-earning capability and, facing the prospect of long periods with no pay increases, will depart the government and find better pay in another job. There is also another problem with salary freezes that must not be overlooked. That is the potential for widescale worker unrest and dissatisfaction. When an entire class of workers (i.e., those in local government) are getting no pay increases, and their peers in the private sector and at other levels of government are receiving increases, the stage is set for exceedingly harsh relationships, perhaps including militant unionism and damaging labor actions such as strikes.[16]

Personnel Management Alternatives

We do not intend to argue that layoffs and freezes are not valid management tools to cut costs in the short run--they are. However, governments that are considering imposition of those measures need to assess them in relation to alternative, and perhaps more efficient, methods. In practice, that is not always easy.

Most local governments already have on their books a specific plan or procedure for effecting reductions in the workforce (sometimes as a layoff provision in union contracts). Since the procedure already exists, it is relatively easy to use it. Similarly, in the case of hiring, promotion, or salary freezes, usually one action by the chief administrative officer or elected council is sufficient to effect implementation. Other alternatives generally have not been laid out in advance, and coming up with them requires creativity, analytic capability, and receptivity to change.

Certainly one source of new ideas is the workforce itself. In any government, there are numerous people throughout the organization with a wealth of ideas on ways to cut costs. For example, when they have put the question to the employees, some jurisdictions have discovered that there are workers who would be willing to work fewer hours a week, with reduced total pay, to have more time to pursue other interests. For some kinds of jobs, alternatives to the traditional 40-hour work week are feasible, without substantially reducing services.

There frequently are lower-cost ways of doing traditional jobs. A good example can be found in Alexandria, Virginia. In the city's police department, there is a program to allow for the conversion of a number of non-law enforcement jobs to civilian status. In some divisions where uniformed police personnel used to sit, civilian employees now do many jobs at lower cost. For instance, dispatchers are non-uniformed, as are records clerks and some employees in planning and research. There are two basic, long-run results of this effort: (1) there are more uniformed police officers engaged only in law enforcement activities than would have been the case and (2) the essential records-keeping, dispatch, and planning tasks can be performed at lower cost because of the salary and pension differentials between uniformed and non-uniformed employees. In effect, the city's total personnel cost for a civilian worker in the police department is about one-half that for a uniformed police officer.

Some jurisdictions have used a technique called "broad-banding" (a job classification term) to achieve greater efficiency. In Worcester, Massachusetts, for example, the city had separate inspection units to handle construction inspections, building inspections for code violations, and residential inspections. A new Code Inspections Department was established to consolidate all inspectional activities and permit the assignment of inspectors to whatever inspectional jobs are required. There are no longer building inspectors, housing inspectors, and construction inspectors who do only those kinds of inspections. Such steps can also produce better services. In St. Paul, Minnesota, most of the various licensing bureaus were consolidated into one office, thereby eliminating duplication and unnecessary functions.

Many local governments have undertaken various kinds of work-scheduling programs to insure that the greatest numbers of needed workers are on the job at peak demand times without having to hire additional employees just to handle peak workload. Some such actions have been taken to assure that peak service demands are met following necessary cutbacks in the numbers of available workers. Other jurisdictions have analyzed service operations and discovered that in some departments staffing levels were set at the maximum number needed to meet peak workload demands, but that those staffing levels were much higher than necessary to carry the normal workload. They then have reduced the staffing levels to those required for average workloads (through attrition, reassignments and, occasionally, reductions-in-force) and made other arrangements, such as temporary reassignments from other departments, to handle heavy workload demands when they occur.

These are but a few of the countless ways that local jurisdictions have cut actual or expected personnel costs without resorting to general layoffs and across-the-board freezes. Some of the programs no doubt have entailed selective reductions-in-force and hiring freezes to lower the staffing levels through attrition. However, the key word is <u>selective</u>. Through analysis of their operations, local governments have zeroed in on the areas where efficient changes can be made..

One of the most promising activities in recent years with respect to government personnel management has been the establishment of joint labor-management committees. A number of jurisdictions have set up committees that comprise representatives of management and employee organizations or unions as a mechanism for them to work in a non-adversarial forum toward solving complex problems facing the governments. The National Center for Productivity and Quality of Working Life has been instrumental in fostering some of the labor-management committees and in setting up a network of such committees so that they may share some of their experiences, problems, and solutions.[17]

A New Look at Personnel Management

One of the things that the tax-cutting movement can do--with its obvious requirements to reduce costs and achieve greater efficiency for dollars expended--is provide a powerful incentive for government officials to take a comprehensive look at the way their workforces are managed. Managers and elected officials may well begin to ask straight-forward questions about whether their governments' personnel management programs in fact result in the highest levels of worker performance at the lowest cost.

A guidebook that we published in early 1977 argued that the fiscal squeeze and need for greater productivity in government should be forcing the assessment of personnel management policies, programs, and practices against clearly defined objectives.[18] We believe that public personnel management programs have been negatively affected by the misguided notion that their whole purpose is to ensure merit employment practices. The purpose of personnel management programs should be to encourage and enhance performance, both of employees individually and of the government as a whole. "Merit" is the means of achieving that purpose, and there is no quarrel with the principles of merit.

Local governments need to determine for themselves what it is that their personnel management practices are supposed to accomplish, i.e., define their objectives--establish realistic measures of performance, and determine whether the objectives are being achieved. For example, assuming that compensation programs are aimed at least partly at motivating employees to superior performance, one might ask whether employees receive "merit" increases only on the basis of their performance. The answer in many jurisdictions will be no--employees receive pay increases regardless of their performance, short of total incompetence. There are many similar questions that need to be posed and answered. Such an assessment can have a significant effect on government's ability to produce services at lower cost.

The guidebook mentioned earlier was one product of a broad study on personnel management and productivity in city government, which involved eight medium-sized cities across the United States. In the final report on that project, we concluded:

> Without doubt, many of the traditional systems, practices, and procedures that have grown up around the concept of merit pose significant barriers to improving government productivity. They especially do not provide adequate incentives to managers to manage well or to employees to perform well....That does not mean that the concepts or principles of merit employment in government should be challenged. Rather, it is meant to challenge the shrouding of incompetence, inflexibility, invalidity, inaccuracy, and unreasonableness in the cloak of merit. [19]

Conclusion

In this paper we have concentrated on two kinds of governmental changes that are potential components of effective government responses to the taxpayer revolt--moving toward greater use of charges and fees for public services and improving personnel management. We see a strong connection between these two kinds of positive changes--a connection based on performance.

Much of the attraction of user fees is that if governments do not perform well in providing the priced service, consumers have the option of not purchasing it. Similarly, performance should be the primary basis of all actions that a government takes with respect to its employees. Since employees have much to do with all aspects of any given service--its quantity, quality, cost, and timeliness of delivery--it makes good sense to argue that, if the service were priced, then consumers' decision to purchase or not can at least partly be an indicator of employee performance. That does not mean that public employees should become sales-persons, attempting to entice citizens to purchase the services. It does mean, however, that government workers should become well informed about their "market." They should strive to know more about what the citizens want and are willing to purchase, and how they, as service providers, can best meet those demands.

NOTES

1. Borcherding, Thomas E. and Deacon, Robert T. "The Demand for the Services of Non-Federal Governments." American Economic Review, December, 1972, 63 No. 5 891-901. p.894 and Hirsch, W.Z. The Economics of State and Local Government., New York, 1970.

2. Johanson, Leif. Production Functions. Amsterdam, 1972. and Salter, W.E.G. Productivity and Technical Change. Cambridge, 1960.

3. Dick Netzer, Economics and Urban Problems: Diagnoses and Prescriptions, New York:Basic Books, 1970, pp.185-190.

4. The principles of pricing municipal services has recently been discussed in Selma J. Mushkin, ed., Public Prices for Public Products, Washington, D.C.: The Urban Institute, 1972.

5. A detailed discussion on the efficiency characteristics of user charges is given in Werner Z. Hirsch, The Economics of State and Local Government New York: The McGraw-Hill Book Company, 1970; and a discussion of ways to maintain equity is given in Selma J. Mushkin and Charles L. Vehorn, "User Fees and Charges," Governmental Finance (November 1977): 42-48.

6. For a more complete discussion on the potential for benefits from charging property owners a price to finance the total firefighting operations of city fire departments see William Pollack, "Pricing Fire Protection Services," pp. 307-35, In Selma Mushkin (ed.), Public Prices for Public Products, op.cit., also Erling Mork, "A Fire Service Demand Charge Study," City of Tacoma, Washington, January 1976.

7. See the findings of a survey conducted by the NTA Committee on Local Nonproperty Taxation, "User Charges: Their Role in Local Government Finance," prepared by Frederick D. Stocker with the assistance of Marc Posner, Proceedings of the Sixty-Seventh Annual Conference, NTA-TIA, 1974 , pp 398-423.

8. Laurence, Dougharty, Charles Chew, et al., "Municipal Service Pricing: Impact on Urban Development and Finance Summary and Overview" Santa Monica, California: Rand, R-1878/1-NSF, November 1975.

9. Frederick D. Stocker, "Diversification of the Local Revenue System: Income and Sales Taxes, User Charges, Federal Grants," National Tax Journal, 20 (September 1976): 320.

10. Advisory Commission on Intergovernmental Relations, Local Revenue Diversification: Income Sales Taxes and User Charges (Report A-47), Washington, D.C., 1974.

11. Total charges equal public utility charges plus current charges plus liquor store revenues. Liquor store revenue is not shown separately in Figure 1 because it is a very small fraction of total charges, 1.3 percent in 1976.

12. For example, see Eugene P. McLoon, Gabrille C. Lupo, and Selma J. Mushkin, Long Range Revenue Estimation, State-Local Finances Project of the George Washington University, 1967; and Selma J. Mushkin and G.C. Lupon, "Project '70: Projecting the State and Local Government Sector," Review of Economics and Statistics, 49 (May 1967): 237-45.

13. John Blegler and Perry Shapiro, "The Responsiveness of State Tax Revenue to Economic Growth," National Tax Journal, 21 (March 1968): 46-56; Ann F. Friedlaender, Gerald J. Swanson, and John F. Due, "Estimating Sales Tax Revenue Changes in Response to Changes in Personal Income and Sales Tax Rates," National Tax Journal, 26 (March 1973); 103-10; Gerald E. Auten and Edward H. Robb, "A General Model for State Tax Revenue Analysis," National Tax Journal, 29 (December 1976): 422-35.

14. The regression was run in double-log form over the period 1955-76. The estimates have been adjusted for first-order autocorrelation, since the Durbin-Watson statistic was quite low when ordinary least squares was applied. The results are:

$$\ln GR = \underset{(-.45)}{-1.50} + \underset{(3.23)}{0.94} \ln Y + \underset{(6.53)}{1.12} \ln CPI_1 + \underset{(2.45)}{0.62} \ln A + \underset{(2.04)}{0.50} \ln FI - \underset{(-.88)}{0.14} \ln OT \qquad R^2 = .997$$

where the t-values of the coefficient estimates are shown in parentheses and

GR = general revenue
Y = real per capita income
CPI_1 = consumer price index lagged one year (a measure of last year's inflation experience on this year's budget)
A = percent of general revenue obtained from intergovernmental aid
FI = ratio of current charges to tax revenue
OT = tax revenue other than property and sales taxes as a share of own source revenue (municipal income taxes included in this variable). The coefficient for this variable has a sign contrary to expectations, but is not significantly different from zero. The share actually declined during the late 1950's and early 1960's.

15. See "A backlash to the tax revolt," *Business Week*, July 31, 1978: 69-70.

16. Joanne Omang, "Paying for the Tax Revolt," *The Washington Post*, July 2, 1978: B 1-2.

17. For reference, see *Directory of Labor-Management Committees*, Edition 2, National Center for Productivity and Quality of Working Life: Washington, D.C.: Spring 1978.

18. Selma J. Mushkin, Frank H. Sandifer, and Charles Warren, *Assessing Personnel Management: Objectives and Performance Indicators*. Washington, D.C.: Public Services Laboratory, 1977.

19. Selma J. Mushkin and Frank H. Sandifer, *Personnel Management and Productivity in City Government*. Washington, D.C.: Public Services Laboratory. (To be published by Lexington Books)

REPORT OF THE
PUBLIC SERVICE OPTIONS*
POLICY REVIEW COMMITTEE

JUNE 7, 1978

*Public Service Options is a joint venture of the Minneapolis-St. Paul Citizens League and the Upper Midwest Council to develop new options in the delivery of public services

PUBLIC SERVICE OPTIONS
Rm 507
84 South 6th Street
Minneapolis, MN 55402

(612) 339-9597

PREFACE

This report is the product of seven months effort by the Public Service Options Policy Review Committee. The Committee was established by the PSO Board of Directors in November of 1977 to review the evolution of the PSO concept and demonstrations; to draw conclusions about the applicability of the "options strategy;" and to develop recommendations for future action by the government, business and private non-profit sectors, and by Public Service Options.

The focus of the Review Committee has been the determination of the viability and transferability of the PSO concept. In performing this effort, the Committee made a detailed analysis of each of the PSO demonstration projects. The results of this analysis are found in the appendix to this report. The Committee has not attempted in this report to critique the success or failure of PSO management and staff operations. For those interested in this area of PSO, an outside evaluation study has been recently completed for the National Science Foundation by the Midwest Research Institute (Northstar Division).

Members of the Committee include: Lu Pearman (Chair), Judy Healey, Jim Hetland, Chuck Neerland and Wayne Popham. Ex Officio members include: Bob Bonine, Verne Johnson, Ted Kolderie and George Thiss. Ted Kolderie, John Carpenter and Carol Trusz-Masuda provided staff support to the Committee.

INTRODUCTION

Over the past four years, Public Service Options (PSO) has been conducting a unique and significant experiment in the Twin Cities area. The result of this test is the development of a substantially improved system by which public service demands are acted upon. It is a service delivery system incorating the concepts of effective "purchase-of-service contracting", "diversification" and "supported self-help".

The PSO designed system for organizing and delivering public services is a feasible system. It is a desirable system. It is a change in the "policy-executing" side of government comparable in magnitude to the changes introduced in the "policy-making" side in Minnesota and the Twin Cities area between 1963 and 1973. It is a change that may also require at least a decade to carry out.

The purpose of this report is to describe the development and evolution of the PSO proposal, to show the results of PSO's test demonstrations, and to present recommendations for adoption of this proposal.

33-595 O - 78 - 45

SUMMARY REPORT - MAJOR IDEAS

A. Traditionally, the responsibility for delivering the services that public policy determines should be provided has rested with the public bureau.

* Being a permanent organization in a non-competitive service area, with supporting revenues obtained largely from governmental appropriations, the public bureau has not had to respond in substance to community concerns over its effectiveness, economy, responsiveness, accountability and innovation.

* In addressing these concerns, the traditional remedy has been to focus on "better management." Over the years there have been repeated attempts to reform the Civil Service System, improve training techniques, and undertake departmental reorganizations. Recent attempts to introduce the concept of "zero-based budgeting" is further evidence of this conviction that government execution can be improved through internal, better management efforts.

  To date, none of these reforms have resulted in the kind of quality improvement predicted. The principal reason is that there have been developed no real incentives for the public manager to adopt the reforms. Public administrators have recognized that their positions are secure whether they choose to adopt the reforms or not.

B. By supporting development of alternative arrangements for carrying out a service that operate outside of the public bureau, Public Service Options has argued that competitive incentives would force an improvement in the way in which public needs are filled.

* It is not enough that these alternative arrangements exist. They must be continually available to public policymakers so that they can be immediately utilized if a change in supplier is needed.

* These competing services could be purchased by the public board for delivery to the public (purchase-of-service contracting) or purchased directly by the public (through a voucher system).

* Despite the competitive incentives offered through the purchase-of-service approach, the public board typically cannot operate in a way that would permit this system to be most objectively and effectively used.

  The problem is basically the conflict between the public board acting in response to the demands of its taxpayer and consumer constituents, and the public board as the director of a big service delivery corporation sensitive to the needs of its employees.

C. Two major trends offer the possibility that the concept of a diversified system of service delivery can be allowed to operate competitively.

* The first trend is a shift in the responsibility for revenue raising to higher levels of government. In Minnesota, this means that the State now provides almost 50 percent of the revenues received by local governmental unites. As a consequence of this revenue raising responsibility, the State is now in a position to determine what organizations or agencies will deliver services.

* The second trend is an increased interest in the non-governmental elements of the public service system. Public planning and policy making bodies are thinking increasingly in "system" terms. There is a growing recognition that most elements of any system are privately produced and owned. Examples can be found in such systems as: housing, police and fire protection, transportation, and health care.

  It is increasingly recognized that government will be called upon to step in when these "non-governmental" elements fail. As a result, greater attention is being given to keeping the private system working well.

* State government, therefore, need not be limited to the local public bureau. It can turn to alternative service suppliers - directly or indirectly - through purchase-of-service contracting or through a system of "supported self-help"

D. Over the pst four years, Public Service Options has tested and refined this proposition through a series of demonstration projects.

* PSO supported implementation of innovative and more diversified kinds of purchase-of-service contracting in both emerging and established public service areas. This included efforts to expand the cooperative purchase/delivery of public services involving more than one governmental unit. PSO undertook projects in such areas as: Dutch elm disease control, manpower training, education, Hennepin County Food Service, St. Paul solid waste collection, and the State Cooperative Purchasing Program.

* PSO also encouraged development of direct private systems for delivering public services (supported self-help models) in the following service areas: housing maintenance, shared ride transportation, and health care - Health Maintenance Organizations.

* In more process-related areas, PSO undertook projects aimed at improving the effectiveness and responsiveness of current county procedures for contracting and evaluating the delivery of human services. An effort was also made to link the strong management resources of the corporate community with the strong program resources of small non-profit agencies.

E. <u>On the basis of this experience, PSO is convinced that a major effort is needed, at this time, to restructure the system by which public services are delivered. This effort should build upon the strategy of "choices" to meet the community's demands for more responsiveness, efficiency, innovation and effectiveness in public service delivery</u>.

* The results of PSO's efforts, in a wide range of project areas, do demonstrate that ways can be found to expand the alternatives available for effective delivery of public services.

F. <u>At this point, State government and the Metropolitan Council are in strategic positions to provide policy support for an effort to restructure the public service delivery system</u>.

* The Legislature and the Governor are in the best position because they can exert considerable influence over how services will be delivered through their appropriations responsibilities. Both State government and the Metropolitan Council benefit by being principally policy making bodies with no direct public bureau or operating responsibilities.

G. <u>To succeed in an effort to expand alternatives available in the delivery of public services, there will need to be an emergence of new, willing and competent private vendors. The commitment of large, competent business firms is critical</u>.

* Organized efforts will be needed within the corporate sector for introducing alternative public service arrangements through the business community.

* Business firms, individually or in consortiums, should:
  . undertake new service ventures in public service areas.
  . provide administrative and management support to non-profit service providers.
  . provide administrative and management support to small private entrepreneurs in the public service field.
  . assist public policy bodies to effectively secure services through purchase-of-service contracting.

H. <u>There will need to be new attitudes in the community, with respect to the way public and community services should be, or can be, carried out</u>.

I. <u>It would be helpful to have an ongoing, parallel mechanism, working outside government and business, to continue advancing the alternatives strategy</u>.

* A PSO-type of service would be helpful in identifying and describing opportunities, designing and developing new service arrangements, making clear to prospective buyers and sellers the advantages of the proposed new service arrangements, and maintaining awareness and receptivity among all participants.

PART I - THE EMERGENCE OF THE PUBLIC SERVICE OPTIONS PROPOSAL

THE PUBLIC SERVICE OPTIONS PROPOSAL EMERGED IN 1972 AS AN ATTEMPT TO FIND A SOLUTION TO A GROWING PUBLIC CONCERN -- THE EFFECTIVENESS, ECONOMY, RESPONSIVENESS, ACCOUNTABILITY AND INNOVATION OF GOVERNMENT'S SYSTEM FOR MEETING PUBLIC SERVICE NEEDS.

A. The Twin Cities area became a clear focal point for this effort. The area was completing a major fifteen-year program to restructure its arrangements for the *making* of public policy. It became apparent that the emphasis during the next decade would relate to the restructuring of the arrangements for the *executing* of public policy.

There have always been institutions, in both public and private sectors, for executing policy. These are the systems for getting things done. To this point, most questions about public policy have been translated into legislative kinds of questions: "What do we want to do?". To this end, Minnesota has been deeply involved, recently, in the reconstruction of its mechanisms of social choice: the upgrading of the legislature, the introduction of the policy-making Metropolitan Council at the seven-county level, and the effort to make all its policy making structures more representative through reapportionment and through changes in the arrangements by which people are elected and appointed to policy making positions.

Beyond this effort lies another stage in which the principal question will be: "How are we going to carry out... deliver... the services which public policy has now determined shall be provided?"

B. The effort to seek new arrangements for carrying out public policies has been impelled by the continuing, and perhaps growing, concern about the effectiveness and cost of the traditional system.

The reach of public policy has been expanding. With this expansion, there has been a halting tendency to expand the scope of existing public service delivery organizations into areas previously occupied by the private sector. Public schools, for example, have considered expansion into "early childhood" education, traditionally served by nursery schools, day care centers, Montessori programs, and the like.

There is not a great deal of enthusiasm for this approach. It is not only the reluctance of the traditional non-governmental providers (church nursery schools, or whatever) to be displaced. It is also because elected officials are apprehensive about the longer term implications for the cost of government of substituting public organizations for the kinds of private organizations delivering those services today.

Much of this apprehension about expansion into new areas of public policy responsibility has resulted from what elected officials and others have seen in the established public service areas.

A principal concern is the rising cost of public service delivery. Increases from general inflation are often compounded by desires to avoid an interruption in community services, reflected in patterns of negotiation and the expanding use of arbitration.

At the same time, it is difficult to extract public resources from areas in which there is declining demand. Enrollments, for example, have been declining rapidly in elementary/secondary education and are now beginning to decline in the colleges. But with the difficulty in closing down the plant and in reducing staff, budgets actually continue to rise, rather than fall. The strong pressure from the profession is to find other needs: special education, early childhood education, mid-career education, college courses for the aged. The pattern is much the same in health care, where with the elimination of the historic diseases and the declining demand for hospital care, the programs expand, new services appear and expenditures continue to rise rather than fall.

This situation is particularly serious in Minnesota, where traditionally, service levels are high; where government is open and responsive to needs; yet where the full range of revenue sources is already in use, at relatively high rates.

C. There would be less apprehension if there was a more general perception of the distinction between government as "decider" and government as a "do-er"... a broader recognition that the public sector does not itself have to *produce* what ever it determines shall be *provided*.

The fact and the importance of this is apparent from the long-established and well-accepted practice in government of turning to other organizations to produce virtually all of the tangible goods it requires: desks and pencils and typewriters and trucks and buildings for public colleges, hospitals and offices. Almost everything, in truth, except for the army's ammunition and for the coinage of the realm.

Unhappily, "providing" and "producing" are still linked together in the conventional discussion about public services. So elected officials worry about the implications of their growing range of responsibilities, and about the process through which these are generated.

The great need, from the standpoint of the elected official especially, is for some way to respond as far as possible to the pressures for improved services, while at the same time being able to throw as small an additional load as possible on the community for the financing of those services.

D. It is important to note two large changes currently underway which are forcing a fundamental reshaping of the arrangements for service delivery, and are, in fact, changing our basic conceptions of what are "public services".

The first is the gradual separation of function between the levels of government. As public expenditures have risen, there has been a trend towards non-property based sources of revenue. With this change, the responsibilities for revenue raising have shifted up to the larger jurisdictions. The higher levels of government, in turn, have decided to decentralize and to pass onto the lower levels the responsibility for operating functions once held by the larger jurisdictions.

The State of Minnesota, for example, is moving toward a closing of its state hospitals, and even of some of its correctional facilities, and is planning to turn these over to community-based programs. Increasingly, the counties and municipalities (and school districts) are being made responsible for operating the programs within policies and with revenues set down by the State.

The second change is an increased understanding of the "systems" concept and the community's need to involve both publicly-owned programs and privately-owned programs in evaluating its problems and what ought to be done about them. Health care, in other words, involves both private doctors and public doctors, private hospitals and public hospitals. The private element is the largest. It is the largest, as well, in housing. Most of the vehicles in the "transit system" are not public vehicles. Public schools are a large part of education. Buth the "educational system" also includes television, magazines and parents. Policemen and firemen are a key part of the "public safety system", but so are fire extinguishers, smoke detectors, security services and deadbolt locks. All systems are mixed systems.

The private elements of these systems can be seen as basically systems of "supported self-help". Essentially, they involve the efforts of people in their individual capacity...making use of materials, designs, tools, know-how and occasionally motivation supplied by others, primarily though not entirely from the business sector. These systems have been expanding rapidly in recent years, as cost have increasingly made it impossible for people always to hire others to cook, clean, repair, drive, sew, and generally to care for them. To date, the improvement has been largely in terms of individual products. The private sector has not yet really begun to think about ways to package together all the elements of a system of supported self-help, including the know-how and motivation, and to deliver it to people as a system.

E. These changes and forces offer great potential for an effort, at this time, to restructure and to improve the arrangements for the handling of public services in the direction of increased effectiveness, responsiveness and economy.

Elected officials in the levels of government responsible for policy and finance are concerned about "having to rely on a sole supplier" for the service they increasingly finance. There is general discouragement with the efforts to remove this concern through additional reforms and improvements from within -- through better administration and management.

Beyond government, there is a growing constructive concern in the private community for the successful execution of public policies. There is much genuine sense of the public interest behind the talk about corporate social responsibility. Non-profit organizations remain eager to help, and anxious to maintain a role. And there are individuals who are coming up with better ideas about how the public business can be handled. This Twin Cities community has been, in fact, something of a center for R & D in public systems... in government organization, in public finance, in health care delivery, and in transportation.

Taken together, the commitment of the private sector, the interest of the governmental community in solving problems, and the innovative character of the non-profit institutions represent the opportunity for a major initiative on the problems of service delivery. It was this opportunity that brought about formation of the Public Service Options project.

PART II - <u>THE PUBLIC SERVICE OPTIONS PROJECT</u>

PUBLIC SERVICE OPTIONS WAS LAUNCHED IN JUNE, 1974, TO EXPLORE ALTERNATIVE SYSTEMS FOR THE DELIVERY OF PUBLIC SERVICES. IT WAS SET UP AS, AND REMAINS, A JOINT VENTURE OF TWO EXISTING PRIVATE NON-PROFIT RESEARCH AND EDUCATION ORGANIZATIONS IN THE TWIN CITIES AREA... THE CITIZENS LEAGUE AND THE UPPER MIDWEST COUNCIL. FULL FUNDING HAS BEEN PROVIDED THROUGH GRANTS FROM THE NATIONAL SCIENCE FOUNDATION, THE BUSH FOUNDATION, THE NORTHWEST AREA FOUNDATION, THE MCKNIGHT FOUNDATION, THE EDNA MCCONNELL CLARK FOUNDATION, THE LILLY ENDOWMENT, AND THE GENERAL MILLS FOUNDATION.

A. <u>The Public Service Options project was initially structured with an emphasis on moving government increasingly to a strategy of *purchasing* services</u>.

PSO functioned as an outside stimulus urging consideration of service delivery alternatives:

* PSO chose to work in major emerging purchase-of-service areas (e.g. *Dutch elm disease, manpower training, State Chemical Dependency Program, and education - long range planning*) and in established purchase-of-service areas where critical problems were forcing a reevaluation of alternatives (e.g. *food services and solid waste collection*).

* PSO initiated involvement in these service areas and developed credibility through extensive research and development activities.

* PSO helped identify service delivery alternatives and served in a liaison role offering neutral territory for discussion of these alternatives.

* PSO facilitated the appropriation of public and/or private resources to implement the delivery alternatives (e.g. *education and manpower*).

PSO offered assistance to individuals within the public bureau facilitating the transfer of contracting, evaluation and service delivery technology:

* Where there was administrative receptivity and policy support, PSO augmented its efforts outside the system by working within the system to effect technology transfer (e.g. *Hennepin County manpower, Hennepin County food service, and education - career mobility*).

PSO focused particularly on the needs in the Twin Cities Metropolitan Area arguing that an individualized approach was required when working towards overcoming obstacles unique to a particular organization or jurisdiction.

PSO approached corporations with specific proposals to which they could respond.

* Because corporations have a set of special problems that affect their willingness and capability to provide services either under contract to government or directly to the consumer, PSO found corporations most willing to respond to very specific proposals.

B. As the project evolved, PSO began testing the idea that non-governmental organizations were, even then, producing what would have to be termed "public services".

PSO explored the possibility of encouraging and strengthening this effort with the "shared ride" project. Later efforts in the area of housing maintenance were cast along the same model, as were efforts in the areas of health maintenance and, in part, refuse collection. In the end, a majority of PSO staff time and effort was devoted to service arrangements involving non-governmental, rather than governmental, buyers of service.

C. What has emerged from PSO's efforts is not only the concept of a much more diversified and much broader arrangement for the delivery of community services, but also some understanding of the kind of effort and mechanism necessary to bring it about.

PSO found it useful to work with a generalized four-part model, applicable both to changes in which government is the buyer, and to changes taking place in the market:

Redefining the service to be delivered:

* PSO found that in some cases, it is not so much the invention of a service as it is the "transplanting" into a new setting of a service invented and developed in another setting. (*e.g. the work of PSO in transplanting shared ride systems from the setting of a single large corporate location to a multi-employer setting. Or, the transplanting of the wood chipping system from the "forest products" setting to the "refuse disposal" setting in the central cities.*)

* In other cases, it is more of an invention. Much of this follows the "supported self-help" model, visible in the market for private goods and services. That is, the shift from selling labor to selling the tools/materials/know-how with which people can "do it themselves". (*Thus: shared ride and housing maintenance*) Because this involves non-professional

labor, it becomes a service more oriented to protection and prevention; while government-produced services emphasize professional services for recipients who need rehabilitation rather than prevention.

Redeveloping the buyer side:

* In many service areas, it may become necessary to redefine the buyer to permit development of a new service alternative. (*e.g. In the shared ride project, PSO developed a new buyer of commuter van services -- specifically, an entity comprised of business firms located within the confines of a multi-employer center.*)

* The government, as buyer, has the choice of buying not only from a private vendor but from another public jurisdiction or even from within the same agency.

  . PSO has urged putting all providers of service public or private, under a competitive contract.

  . PSO has provided assistance in setting up effective contracting and evaluation procedures. (*e.g. Hennepin County contracting procedures, and Hennepin County manpower*)

  . PSO has urged that competitive systems be established permitting ongoing comparisons of multiple providers including systems combining public and private providers.

* In several instances, PSO has helped strengthen the concept of direct consumer purchase of public services (*e.g. neighborhood group purchasing as a component of PSO's housing maintenance project and the collection of solid waste in St. Paul*).

Redeveloping the supplier side:

* Commercial suppliers are typically concerned about the red tape involved in doing business with government. They do not see public services as in their area of expertise. They are unable to see that these ventures present the kind of opportunity for return on investment they seek.

  . PSO found it necessary to approach corporations with specific proposals to which they could respond. (*e.g. Hennepin County alcohol and drug detoxification, Dutch elm disease control, State Chemical Dependency Program, and shared ride*).

  . The areas of greatest potential appear to be in services that offer a direct benefit to company employees. (*e.g. Hennepin County alcohol and drug detoxification, housing maintenance, shared ride, and health care*).

. A consortium approach to new service ventures, as demonstrated in the corporate sponsored Northside Child Development Center in North Minneapolis, may offer corporatioos an opportunity to reduce their risks of becoming overcommitted in an area where they may have little direct expertise.

. Another approach for corporations is to commit a portion of their philanthropic budget as "risk capital" in potential breakeven service ventures, as demonstrated by General Mills in their Stevens Court Housing Rehabilitation Program.

* Non-profit social service agencies are typically started and operated by conscientious social service professionals. Budget limitations, however, typically leave the smaller agencies without effective administrative and financial management.

  . PSO has urged agencies to contract for support services (such as financial management, accounting, law, facilities management, long-range planning, and fund raising) from a secondary organization - another non-profit, a business, or a consortium of businesses.

Focusing community support:

* There is a need to develop a broader context of support for the changes being proposed and a wider understanding of the problems being addressed -- to provide a stimulus to which government, or a private agency, will respond. There needs to be an expectation of performance... responsiveness, efficiency, accountability... in the community to counter the expectations of government that exist among the government's employees.

  . Generally, this seems to mean working with the following: (1) the "higher" levels of government that provide financial aids to the levels/units actually responsible for delivering the services, (2) the recipients of services, (3) the organizations interested in public-expenditure control, and (4) the media of communication that interest themselves in public affairs.

PART III - RESULTS OF THE PUBLIC SERVICE OPTIONS DEMONSTRATIONS

A detailed description of each of the PSO demonstrations is found in Appendix A. The purpose of this section is to describe the kinds of demonstrations in which PSO has been involved and to summarize some of the more significant results of these activities. Clearly, PSO played a more critical role in some demonstrations than in others; and not all of PSO's project efforts have been totally successful. In terms of PSO's broader objective to determine the viability of the "options concept," PSO believes it has learned a great deal from each of these demonstration efforts.

A. SERVICE-BASED PROJECTS: PUBLIC SECTOR

1. Public Purchase of services in Emerging Service Areas

   a. *Dutch Elm Disease - Utilization/Disposal Program*
   b. *Manpower - Minnesota Urban Comprehensive Employment and Training Consortium, and the Hennepin County Manpower Office*
   c. *State Chemical Dependency Program - Early Intervention/ Prevention Services*
   d. *Education - Long-Range Planning Services and Career Mobility Program*

   (Approximately 35 percent of PSO's total project staff time was spent developing these service-based projects.)

Public Service Options probably achieved its greatest public sector impact in developing and refining purchase-of-service contracting in emerging public service areas. Without the existence of an established service provider or delivery system, PSO found considerable flexibility, in many service areas, for bringing in private service providers with proven expertise, and establishing a more responsive service delivery system based on competitive bid contracting, performance contracting and program evaluation. The focus was on establishing diversified systems of public service delivery that offered public policymakers clear and reasonable alternatives for providing public services.

The following benefits resulted from PSO's efforts in these service projects: (a) Dutch Elm Disease - The City of St. Paul and the Minneapolis Park Board jointly contracted with a private vendor to operate and manage an innovative diseased wood recycling plant in St. Paul; (b) Manpower - Competitive bid and performance contracting procedures were incorporated successfully into the system for delivering manpower services; (c) State Chemical Dependency - a new law mandating competitive bid purchase-of-service contracting was passed by the legislature and successfully implemented by the State Area Mental Health Districts; (d) Education - a computer-based, long-range planning system was developed by a major locally-based corporation under a contract with the Senate Education Committee for use by public school district long-range planning task forces, and a three-school district pilot program was established to introduce the concept of career mobility - a proven corporate personnel management practice - to address the personnel problems facing public school districts in this state.

2. Public Purchase of Services in Established Public Service Areas

   a. *Hennepin County Food Service*
   b. *St. Paul School Food Service*
   c. *St. Paul Solid Waste Collection*

   (Approximately 8 percent of PSO's total project staff time was spent developing these service-based projects.)

Established public services, whether extensive use has been made of purchase-of-service contracting or not, have proven difficult areas for development by Public Service Options. Perhaps the major difficulty has been finding effective entrance points into these services. In most cases the existing service delivery systems have built up considerable momentum over time and the strong public bureaus and service providers have had little motivation for advancing the concept of diversified service delivery.

The three established service areas listed above are areas where PSO was successful in gaining at least an entrance point. In the case of Hennepin County Food Service and St. Paul School Food Service, there were strong economic pressures that were forcing abandonment of the existing service delivery system. In terms of St. Paul Solid Waste Collection, the emergence of a proposal for a refuse incinerator, intended to provide steam energy to the St. Paul central business district, established a need to organize the existing "open market" refuse collection system.

In each of these service projects, PSO was successful in forcing consideration of service delivery options. In the case of Hennepin County Food Service, decisions were made which resulted in a more diversified system of service delivery. Discussion on St. Paul School Food Service and St. Paul Solid Waste Collection is still underway at this time.

3. Cooperative Purchase/Delivery of Public Services

   a. *State Cooperative Purchasing Program*
   b. *Suburban Fire Protection Services*
   c. *Dutch Elm Disease - Metro Area Coordination*

   (Approximately 1 percent of PSO's total project staff time was spent developing these service-based projects.)

There are numerous examples at all levels of state and local government where public policymaking bodies have chosen to jointly purchase/deliver public services and in so doing have benefited by reduced costs of administration and operation.

The three projects in this section are illustrative of the range of approaches that can be adopted by public policymakers: (a) the State Cooperative Purchasing Program which enables local governmental unites with relatively small scale demands for supplies and "hard" services to tie into the State Department of Administration's high volume purchasing program, thereby benefiting from bulk discounts and reduced administrative paperwork; (b) Suburban Fire Protection Services which suggests the possibility of gaining sufficient scale through a joint powers agreement to permit the effective contracting out of a costly public service to a private vendor; and (c) Dutch Elm Disease - Metro Area Coordination which illustrates the concept of gaining both public and private sector input into public service planning to permit better orchestrated efforts to address an escalating public service need.

B. SERVICE-BASED PROJECTS: PRIVATE SECTOR

1. Direct Private Delivery of Public Services

a. *Housing Maintenance Services*
b. *Shared Ride Transportation Services*
c. *Health Care Services - Health Maintenance Organizations*

(Approximately 45 percent of PSO's total project staff time was spent developing these service-based projects)

As the Public Service Options project evolved, PSO came to see the importance of encouraging development of direct private service delivery systems, particularly in areas of expanding or emerging pub-ic services where community pressures might otherwise lease to large increases in government financed public services.

PSO efforts in the area of Housing Maintenance Services were designed to support development of privately provided maintenance services in stable, middle-income neighborhoods. By delaying the deterioration of housing in these neighborhoods, PSO argues that the need for future public funds for neighborhood rehabilitation and renewal in these areas would be effectively postponed.

In Shared Ride Transportation Services, PSO designed and developed a demonstration project which offers a wide range of both public and private transportation services to commuting employees in three Hennepin County multi-employer centers. The demonstration signals a significant departure from the traditional concept of public transit.

PSO's efforts in Health Care Services - Health Maintenance Organizations (HMOs) were directed towards gaining corporate sponsorship of one of the area's struggling private HMOs. The Twin Cities is acknowledged as the nations leader in development of the HMO service delivery model. PSO's objective in thes area was to strengthen the competitive market forces that are the basis for the development of cost effective HMO delivered services.

C. PROCESS-RELATED PROJECTS

1. Efforts Working with Public Sector Buyers of Services

a. *Hennepin County Contracting Procedures*
b. *Decision Making in Human Services*

(Approximately 9 percent of PSO's total project staff time was spent developing these process-related projects)

To improve the effectiveness and responsiveness of current public social service programming, Public Service Options has urged that governmental units put all service delivery -- both directly provided and purchased from private vendors -- in contract formats with specified terms and conditions. In addition, PSO has encouraged instituting direct competition among both public and private vendors with performance measured and compared through effective program evaluation.

To this end, PSO engaged in two projects to assist governmental units to institute the framework and procedures for deciding: (1) what services (or parts of services) should be purchased or directly delivered, (2) how the appropriate service providers should be selected, (3) what contract requirements should be placed on the services to be delivered by the selected public or private service providers, and (4) what consequences should result from a failure on the part of the service providers to live up to the terms of the service contracts?

PSO's efforts in the Hennepin County Contracting Procedures project focused on developing a manual, in cooperation with Hennepin County, outlining the procedures and criteria for effective contracting of social services. In terms of the Decision Making in Human Services project, PSO was seeking to educate and train public officials to recognize the kinds of decision making data that should result from effective program evaluation in human service areas.

2. Efforts Working with Vendors of Public Services

a. *Administration of Social Service Agencies*

(Approximately 2 percent of PSO's total project staff time was spent developing this process-related project).

Because of budget restrictions and limitations in staff resources, most non-profit social service agencies have traditionally been weak in such non-program areas as financial management, accounting, personnel management, facilities management, long-range planning, and fund raising. PSO saw the opportunity for increased variety and cost effectiveness of contracted services available to these private agencies.

PSO's Administration of Social Service Agencies project was designed to help agencies expand their capabilities to contract for administrative and facilities management services. PSO also saw the opportunity to involve major corporations in the provision of these support services.

PART IV - CONCLUSIONS AND RECOMMENDATIONS DRAWN FROM THE PSO DEMONSTRATIONS

A. There is a clear need, at this time, for a major effort to restructure the system by which public services are delivered. This effort should build upon the strategy of "choices" to meet the community's demands for more responsiveness, efficiency, innovation and effectiveness in public service delivery.

The results of PSO's efforts, in a wide range of project areas, do demonstrate that ways can be found to expand the alternatives available to public policy bodies in determining how public services will be delivered.

There is a growing understanding that public services contain elements that most appropriately belong in the public sector, while others clearly fall within the experience and capability of the private service sector; that the best system is one that supports the delivery of public services from both within and outside of the public bureau.

Within the concept of private service delivery, there is a recognition that tangible benefits can be obtained by supporting individual self-help efforts addressing public service issues of "prevention" and "maintenance." Private delivery is increasingly being seen as involving both direct services to consumers, and tools, know-how and motivation for self-help projects.

B. At this point, State government is in the most strategic position to provide policy support for an effort to restructure the system for public service delivery.

By being the primary revenue source financing public services, the State is in a position to exert considerable influence over how services will be delivered. In addition, the legislature and Governor, by not being caught up in daily operating considerations, can more easily address the changes in structure and supporting public policy that will be needed.

While not responsible for financial appropriations, the Metropolitan Council could also play an effective role in bringing about changes in the traditional public service delivery system. Like State government, the Council benefits by being principally a policy making body with no direct public bureau or 'operating' responsibilities.

Within government, and particularly at the local level, an effort is needed to overcome some of the obstacles which often inhibit efforts to fully develop the "options" concept.

The following is a list of some of the obstacles that PSO has observed, to a greater or lesser degree, in most local governmental units:

* Government too often tends to equate contracting with a loss of control. The traditional argument has been that you really do not have authority unless you own the delivery system (i.e. hire the employees, manage the system etc.). This is difficult for non-profit service providers to understand: they see themselves highly controlled by the terms of the contract, and highly responsive as a result of their need to satisfy the government in order to get their business continued.

* Government is hesitant to use for-profit vendors for the delivery of human services, despite the fact that society has traditionally relied on for-profit organizations for the delivery of food, shelter, clothing and medical care.

* Government too often tends to infer failure, or thinks others will, if it contracts for service. This is reinforced by the occasions in which contracting is, in fact, entered into as a result of a failure on the part of administrative management (e.g. the recent need by Hennepin County Medical Center to contract out its billing of hospital accounts).

* Government is excruciatingly sensitive to the impact of any change on the jobs of public employees, and highly responsive to the concerns of the employees and their representatives.

* Government typically sees change through R & D as something that is appropriate only during times of expanding resources.

C. It becomes clear that in order to bring about a new public service delivery system, based upon the concept of expanded alternatives, there will need to be an emergence of new, willing and competent private vendors. The involvement of larger business firms, possessing the needed commitment and competency, is critical.

How far, and how rapidly, businesses move to meet this need will depend in part on their ability to overcome some of the following obstacles observed by PSO:

* With only a few exceptions, business does not look in the public sector for new venture opportunities. This is despite the large growth being projected for the entire public service industry.

* Corporations are reluctant to become involved in "less than full profit" service ventures for fear of upsetting stockholders.

* Business is hesitant to invest in existing non-profit organizations for fear of being "left holding the bag" in an area in which they have no direct expertise.

* Business is concerned that visible activities in public service areas could be misinterpreted by consumer groups or company customers and result in damage to its business in general.

* Corporations are reluctant to enter service contracts with government for fear of being caught up in "red tape" and government bureaucracy. Often this reluctance is based on no previous personal experience.

* Corporations see the development of new service ventures as appropriate only during times of expanding resources.

* Corporations, when working with government, make little effort to understand the public sector's specific needs and perspectives.

D. Organized efforts will be needed within the corporate sector, in order to introduce alternative public service arrangements through the business community.

Business firms could operate individually or as a consortium. They should:

* Undertake new service ventures in public service areas.

  e.g., Control Data's Fair Break program training unemployable inner city minority persons for work, or its Rosebud Reservation Health Care Program serving the Rosebud Indian Reservation in South Dakota.

* Provide administrative and management support to non-profit service providers.

  e.g., Progress Valley, Inc., a program preparing chemically dependent persons for re-entry into the workforce and the community, solely owned and administered by the Rauenhorst Corporation; or H.B. Fuller Company's (and others) program of release time for employees to serve in community service organizations.

* Provide administrative and management support to small private Entrepreneurs in the public service field.

  e.g., General Mills' Stevens Court, Inc., set up to buy, renovate and lease small apartment buildings in a 50 block area around Stevens Square Park in South Minneapolis. General Mills joined with two local businessment who had developed strong neighborhood and community support for their smaller scale renovation efforts over the previous six years.

* Assist public policy bodies to effectively secure services through purchase-of-service contracting.

  e.g., an applied use of the existing "loaned executive concept" to improve the standards and procedures of government contracting, particularly in human service areas.

The concept of corporate philanthropy should be broadly and fairly rapidly expanded. The increase in the percentage of pre-tax profits devoted to community or social needs will continue to be important. But this by itself will not change the system... it will simply expand it. What is needed is the extension of the concept of a firm putting its own competent, production-oriented organization to work on public problems and, recognizing the low rate of return likely in such a venture, charging the margin of profit foregone against this expanded budget for philanthropy.

E. There will need to be new attitudes in the community, with respect to the way public and community services should be, or can be, carried out.

There should be a greater tendency to judge programs by results... and not by the amount of dollars put into them.

There will need to be an understanding that "duplication" is not a problem, but an element of safety in the system. It is the perception of a "back-up system." The public sector should be shaped on the basis that sound policy would structure an industry, not on the basis that it would structure an individual business.

There will need to be an underlining of the basic message that the existence of choices provide the leverage needed for responsiveness. This is important when managers try to make changes within a public bureau.

Organizations not heretofore involved in questions about service-delivery arrangements should be brought into the discussion:

* Consumer organizations.

* Organizations interested in public-expenditure control (e.g., The Minnesota Taxpayers Association and the Minnesota Council on Economic Education).

* Organizations of suppliers (e.g., the Minnesota Association of Voluntary Social Service Agencies, Inc.).

* Institutions in the media.

F. <u>The system could be helped by the presence of some party that could orchestrate the efforts of these various government buyers, service vendors, and service consumers</u>.

This is the function that Public Service Options has been performing. It is a function with the following key elements:

* The capability to help identify and describe opportunities of new kinds of service delivery.

* The capability to design and develop new service arrangements, responsive to these opportunities.

* The capability to help make clear to prospective buyers and prospective sellers the advantages of the proposed new service arrangements.

* The capability to help maintain awareness and receptivity among all the participants in the potential of this developing new service delivery system.

PUBLIC SERVICE OPTIONS

a joint venture of the Citizens League and the Upper Midwest Council to develop new options in the delivery of public services.

PERSPECTIVES

ISSUE #4
MARCH, 1977

FOOD SERVICE: A MATTER OF CHOICES

Unlike past Perspectives, this issue focuses in detail on one area—food service. The principal author is Peter Brown, whose involvement in this issue has spanned more than four years.

There are two reasons for this focused approach to the issue of food service.

The first is simply to inform the community about the food service issue. The experiences of Hennepin County and Minneapolis Public Schools point up a number of critical considerations and unresolved questions that bear directly upon decisions being deliberated in St. Paul and other public jurisdictions. We hope this newsletter will help focus those deliberations, and raise some options which otherwise may not be considered.

The second reason for this newsletter is to illustrate, in a more concrete way, the philosophy behind PSO, the logic, the barriers, and some of the strategies PSO uses to promote service delivery alternatives. The food service issue does not stand alone as a case where the "options" idea should be applied. Many similar opportunities exist for a wide range of other public services—transportation, housing, Dutch elm disease control, health care, social welfare services, and education, to name a few. We suggest that you read through this issue of Perspectives with an eye to applying the options concept in other public service areas. We welcome your comments.

PSO has been at work nearly three years now, to develop more choices—for recipients and for officials—in the provision of public services. Great diversity in the way government-financed services are delivered will permit the community to compare costs and effectiveness, to cast off unsuccessful programs, to change services or "suppliers" as needs change, and to demand more responsive service from the suppliers it chooses to finance.

One such service is the public feeding business. It is a large and growing industry, and some basic changes are occurring in the way food services are being delivered.

Food service looked like an easy issue for PSO.

The needs are relatively easy to quantify. There are many instances, public and private, where it is delivered under purchase arrangements. The Twin Cities area has a good variety of professional suppliers of "institutional" food services. Acquisition of food service is not terribly different from the purchase of hard goods, which government traditionally has opted to "buy" rather than "make". We even speculated that success by PSO in opening options on this issue might not generate much community response, since one would *expect* the purchase of food services at least to be considered as an alternative to direct delivery by local units of government.

But we were wrong—it was harder than we expected.

Our involvement started with Hennepin County's decision to include, in the new medical center, a sophisticated, multi-million-dollar manufacturing plant to produce meals for the whole complex of neighboring county institutions. . .as well as meals "for sale" to the private Metro-

(Choices *continued on page 2)*

NEW BOARD OFFICERS AND DIRECTOR NAMED

For those of you who are not in regular contact with PSO or its staff, we should take a moment to bring you up to date on the project's status.

- Verne Johnson and Jack Costello have been elected PSO Board Chairman and Vice Chairman, respectively. They replace Dick FitzGerald and Dave Durenberger who served more than two years as officers of PSO. Both will remain active on the PSO Board of Directors.
- Robert W. Bonine has been named Executive Director of Public Service Options effective March 1. Under a loaned executive arrangement, Mr. Bonine will be on half-time leave from the Northwest Area Foundation where he is Assistant Executive Director. Mr. Bonine is a past chairman of the West St. Paul School Board and is active on the boards of the Council of Minnesota Foundations, the Community Planning Organization, and the Higher Education Facilities Authority.
- On January 15, PSO moved to new quarters in Room 754 of the Midland Bank Building, 4th Street and 2nd Avenue South, Minneapolis, Minnesota 55401. The office telephone number remains the same—(612) 332-8757.

In Hennepin County, Options Were Adopted...

We first entered the food service issue in 1973. Hennepin County officials were faced with a recommendation to construct, in the new medical center, a highly technical plant to manufacture 3.5 million meals annually for the new center, the Metropolitan Medical Center, and several other county institutions.

We thought the burden of proof rested on the county to show why it should get into the food service business if it didn't have to. This seemed to us an excellent opportunity to explore alternatives. We were right, and the effort succeeded.

We tried to get important questions asked. We sought out and talked with private food service firms. They expressed strong interest.

We talked with county staff responsible for recommending how the county should meet its food service needs. They pointed out we were not very knowledgeable about the food service industry. And true enough, like many of the support services within government, it is a highly sophisticated business. We wondered, this being the case, why the county would want to take on such a complex task itself.

County staff also pointed to the fast pace of change in the industry—and the latest technology in their proposal (nitrogen freezing tunnel, integral-heating ovens, etc.). We wondered about obsolescence.

Staff explained the sensitivity of hospital feeding, the variety of special diets, the logistics of accurate meal distribution, and so on: the hospital needed to be in strong control. That made some sense to us. But we didn't see why a complicated manufacturing process owned and operated by the county would be easier to manage than one under contract, where alternative suppliers could be sought if the original supplier were not meeting contract specifications.

Obviously, the county's policy decision to *finance* publicly the provision of meals was not a mandate to *produce* those meals publicly. Likewise, a decision to *construct and own* a production plant publicly would not mean it had to be publicly *staffed and operated*. Some very important choices, and strategies for long term flexibility, were not being raised. Some important questions were not being asked.

At the request of then county board chairman Thomas Olson and county administrator Stanley Cowle, we identified the current status of the issue, the options already foreclosed, options still open, and strategies for evaluating those remaining options. We encouraged county staff to check their proposal against private delivery alternatives. Finally, we convened a meeting of county policy makers, the county staff and consultants who authored the proposal to construct and operate a new food plant, and seven private food service firms who were invited to critique the proposal. The dialogue was sometimes a little tense, and the self interests of the participants were fairly apparent. But equally apparent from the discussion was the firms' eagerness for a piece of the action. The county was in a "buyer's market" with diverse, willing suppliers.

The county first decided basically to "produce" rather than to "buy".
The discussion about the design of the service proved very helpful.

A reassessment was made of the county's food needs and delivery alternatives. Ultimately, the original staff proposal was rejected in favor of an approach focusing more on the purchase of commercially prepared foods and less on on-site manufacturing. Less equipment would be needed, and more options would exist over the long haul for acquisition of prepared foods in the open market. This new approach was approved by the county board, at a projected savings of 30¢ a meal—perhaps a million dollars annually—in operational costs. A decision was made to proceed with construction.

We then pressed the question of management.
The next issues were of control, accountability, incentives to perform, flexibility, and responsiveness to new efficiencies likely to emerge from the private marketplace.

Remember. . .the decision to construct a county facility was based on the staff's premise that the county could outperform suppliers in the private marketplace. The issue of management, therefore, was not so much a question of *who* should run the plant, but a question of *how* the management arrangement could be structured to ensure the public facility would continue to be cost-effective over time in comparison with market alternatives.

So we urged the county to put its management into a *contract* format which would clearly set forth performance specifications, costs, time deadlines, and consequences should the terms not be met. And to rebid the management contract regularly in the open market. The manager, then, whether a private firm or a food service director employed by the county board, would be held accountable for performance.

In the end, the county did contract for management.
The county built the facility, at a cost close to $3.5 million. But it contracted with a private firm, Service Direction, Inc., for management of the new plant. . . .And, in resolving the questions of how to provide food services to the public in a cafeteria in the county's new Government Center, the county entered a contract with another firm, Service Systems Corporation, for operation as well as for management. ■

(Choices *continued from page 1)*

politan Medical Center. We got involved when the Minneapolis schools proposed a $3.5 million central production plant for school lunches. . .and again when St. Paul schools started to move toward a new, central hot lunch production plant.

Food service is clearly removed from the main business of education, and from the business of the several county institutions involved (the hospital, jail, detox center, and so forth). So a decision to construct and operate these new facilities represented, in our view, a substantial policy decision.

We are not certain that private suppliers are necessarily better, or cheaper. But they need to be considered.

So we set out, in each of these three cases, to urge "the options concept". . . and, more than that, to help the institutions identify and compare the alternatives they faced.

Hennepin County did adopt an options strategy and pursued their alternatives. The Minneapolis schools did not. In St. Paul, the decisions are still open. ■

In Minneapolis Public Schools, The "Options" Strategy Was Rejected...

Time was when schools sent students home for lunch. Gradually, the schools provided lunch rooms where students who carried bag lunches could eat. Eventually, many schools began to produce and serve cafeteria lunches. The Minneapolis School District now produces 22,000 meals a day from a new 77,000-square-foot 'Nutrition Center' at 812 Plymouth Avenue North. The food manufacturing plant was opened at a cost of $3.5 million.

Results have been mixed.
A front page article in the Minneapolis Star (October 11, 1976) quoted students, teachers and administrators who were sharply critical of the meals being produced and the voluminous waste from students who were not eating their meals.

Well before the decision was finally made to construct and operate the factory, PSO urged school district officials to explore alternatives.

PSO raised some important questions we felt weren't being addressed and should be.
We learned early in 1974 of the district's plans to construct such a facility. So we suggested public alternatives, such as purchasing meals—from the new county facility, as well as from private alternatives.

Through a telephone survey, we made a cursory review of how districts in other cities are meeting their food service needs. We found a wide variety of direct and purchased delivery methods. Some important questions emerged about the efficacy of the Minneapolis proposal: a similar production plant built by the Cleveland schools was "moth-balled" because it was uneconomical at less than 100,000 meals per day; we found a private firm in Chicago was trucking 50,000 meals to the east coast every other day cheaper than it could manufacture them in a new eastern plant, so we wondered whether the Minneapolis schools could achieve true economies of scale; and it appeared that student acceptance of "preplated" airline type meals was low when tried elsewhere.

We raised these and other questions with Donald Bevis, associate director for business affairs, and to Gary Krimmel, district food service director.

We also raised the question of management. Again, it seemed only logical, if the district was to build the facility that it use a contract format for management. Whoever would manage the facility, we felt, should be faced with the *potential for failure*—knowing the district could turn elsewhere in the marketplace if management were unsatisfactory. We felt this to be an essential incentive for performance.

The district declined to ask for comparative proposals from outside vendors.
The Minneapolis school district built, equipped, staffed, and is operating the facility entirely itself. It now has little market flexibility for change, and all the responsibility for improving performance. ■

How Others Get Their Food

We have been interested, as we've been involved in the food service issue, in noting the wide variety of public and private institutions that obtain their food services under purchase arrangements with outside suppliers.

Northwest Airlines, for example, loads food onto planes at 32 points in its system. To provide these meals, NWA operates five of its own production plants, but contracts for food service in other locations where better prices can be had from independent suppliers.

Other examples we know of, without formally researching the question, include the following organizations who either contract out entirely or who contract for management of an on-site facility: Blake Schools, St. Catherine's, Breck, Carleton College, St. Thomas College, Macalester College, University of Minnesota Hospitals, Bishop Whipple School, the Kaiser Hospitals in California, "meals on wheels" for the Ramsey Action Program, Abbott and Northwestern Hospitals, Mt. Sinai, Lutheran Deaconess, Unity Hospital, Ford Motor Company, Cargill, General Mills, Blue Cross/Blue Shield in Minnesota, Univac, NSP, Lutheran Brotherhood, St. Paul Academy, the Minnesota state office buildings, Federal Reserve Bank of Minneapolis, Control Data, North Central Airlines, all of the Minnesota State University System, University of Hawaii, Philadelphia Children's Hospital, University of Alabama Hospital, Arizona State University,. . .and so on.

The public school systems, for appearance at least, look-out of step with comparable public and private institutions insofar as the schools do, generally, produce the meals served to students in their districts. This may or may not be the natural progression of a system which at first offered no meals, then provided some meals to students in some neighborhood schools using volunteers in the kitchen, to, ultimately, a costly public school feeding business which now is undergoing reorganization around the nation.

But there are districts that contract for outside production, or contract for management of in-house facilities. The Philadelphia public schools, for example, in reorganizing their food services, implemented a diversified system for delivery of more than 110,000 meals daily. Approximately half the district now gets its food from district sources, and the other half is contracted to a private supplier. The delivery system is flexible, and a variety of on-site and off-site production methods are used to meet the different needs of the district. The private supplier's share of the district's business is growing, as more of the delivery is turned over to the contract arrangement.

Other public school districts we know of who are contracting for food services include the Buffalo-Rochester (N.Y.) schools at 450,000 meals per day, the Chicago public schools, the Madison public schools, the Racine public schools, and the Golden Valley public schools. ■

In St. Paul Public Schools, Real Options Are Available

The St. Paul school district now is also facing the need to reduce the costs of its hot lunch program, while meeting federal nutrition requirements and maximizing student participation and satisfaction.

St. Paul's food service issue is still open.
The district appears to be headed in the same direction as Minneapolis: construction of a central, multi-million dollar manufacturing plant to gain economies of scale and take advantage of the latest food service technology.

Deputy superintendent Kenneth Berg and food service director Virginia Ball say the district is committed to construction of such a plant. Why? Because the previous school board approved such a strategy in concept and authorized acquisition of a building to house the new plant. Because the district has built or remodeled several school cafeterias to receive off-site prepared meals, charging the capital improvement budgets of these schools a pro rata share of the central facility construction costs. And because the balance of construction costs has been built into the district's long range capital improvements budget.

We question whether the district is irrevocably committed. It seems to us that the building which has been bought can be sold, off-site meal preparation could be purchased from a wide array of existing suppliers, and the capital improvements budget will be tight even without construction of a central kitchen.

And, as of this writing, the existing school board has not ratified a decision to construct and operate a central hot lunch production plant. The Board has authorized employment of an architect to proceed with design.

Some real options exist, and ought to be considered.
St. Paul is in a unique situation: it can learn from the experience of Minneapolis and Hennepin County, and it has even broader choices than they did for procuring school lunches.

The district is in an unusually tight fiscal situation. Any cost saving alternatives will be especially timely. It seems to us that the district administration owes it to the new school board to do some comparison shopping—find out from private suppliers the comparative costs of purchasing food services; or look carefully at the merits of buying food from the Minneapolis Nutrition Center, giving both districts more economies of scale; or break the district's schools into groupings which can procure food from alternative suppliers, public or private, throughout the marketplace.

Working with board chairman Eleanor Weber, we identified a range of alternatives, near and long term, for meeting the district's food service needs.

The schools now receive their meals from a number of satellite kitchens in schools throughout the district. It would be possible to convert a number of these recipient schools to contract arrangements with alternative suppliers. . .the Minneapolis Nutrition Center, existing satellite kitchens, private management of on-site preparation facilities, and any of a variety of off-site private suppliers.

The obvious benefits of such a diversified delivery system are the flexibilities, the control that comes with a contract relationship, and the built-in evaluation of costs and performance when multiple suppliers are used.

The question remains, will St. Paul take a hard look at its long term options.
A strategy of diversification would seem particularly logical in the near term, before the district commits itself to financing yet another food manufacturing plant in the Twin Cities. The upshot could be a decision, based on experience, to contract with one or more of the same suppliers over the long haul, or, indeed, to proceed with construction of a new facility.

We think that decision can best be made by fully exploring the merits of the choices facing the district. ■

Survey Of Private Food Service Suppliers

Below are some of the major national and local food service firms represented in the Twin Cities area. Other national and local firms not listed may offer viable contract alternatives for institutional feeding in the Twin Cities. All those identified below offer consulting services.

FIRM	CENTRAL MEAL PRODUCTION/ DISTRIBUTION TO CLIENTS	CONTRACTED OPERATION OF CUSTOMER'S ON-SITE KITCHEN
1. ARA Services, Inc. John Sagendorf Reg'l Manager 2830 N. Fairview St. Paul 55113 636-4450	• 3,500-4,000 meals/day locally, could be expanded to 10-15,000/ day. • serving in-flight airline meals and corporate dining rooms/cafeterias in Twin Cities (Braniff, Allegheny, United, 3M, Litton, Ramsey Action Program, U of M Hospital, and others).	• serving colleges, public schools and the "at-work" market in Twin Cities area (including Golden Valley schools, Lake Superior schools, Blake, St. Katherines, all 6 Minnesota state universities, etc.).

FIRM	CENTRAL MEAL PRODUCTION/ DISTRIBUTION TO CLIENTS	CONTRACTED OPERATION OF CUSTOMER'S ON-SITE KITCHEN
2. Canteen Corporation (subsidiary of TWA) Duane Hinkley Manager of Food Services 7515 Wayzata Boulevard Minneapolis 55426 544-8466	• these services provided elsewhere nationally for hospitals, restaurants, nat'l park service, etc.	• serving about 20,000 meals/day locally to private schools (e.g. St. Paul Academy, Breck, etc.) and to private corporations (e.g. Ford Motor Co., FMC, insurance firms, banks, etc.).
3. Daytons Don Hays 700 Nicollet Mall Minneapolis 55402 375-2930	• No	• Contract with Dayton Hudson Corporation. 7th floor IDS cafeteria serves up to 1,500 meals/day. Past contracts with the Minneapolis YMCA and the Towers Nursing Home in St. Paul.
4. Inter-State United Bob Gerhard 1091 Pierce Butler Rte. St. Paul 488-0515	• No	• Services provided in Minnesota to school districts (e.g. Faribault, Hibbing), private firms (e.g. 1st National Bank of St. Paul, Data 100) and industrial plants (e.g. Northstar Steel, Rosemount Engineering).
5. Marriott Corp., Inc. Ed Hurley Regional Marketing Dir. 221 W. 79 St. Bloomington 55420 474-9314	• Nationally: hospitals, colleges, firms. • Locally: 7,000 meals/day for airline companies and corporate jets (Western, Eastern, Cargill, Gen'l Mills, Honeywell, 3M, Burlington Northern, etc.); could be expanded to 40-50,000 meals/day.	• None locally, but nationally serving about 200 firms, 1,200 restaurants, 50-60 hotels, etc.
6. Northwest Airlines Bob Coiner Dir. of Food Service Mpls-St. Paul International Airport St. Paul 55111 726-5111	• Providing locally for NWA in-flight feeding, but no excess capacity. Providing outside catering from other facilities nationally.	
7. Saga Food Service John Nelson Reg'l Director 7500 Northliner Dr. Minneapolis 55450 726-9116	• Providing nationally, but not locally. • Customers include schools, hospitals, firms, others.	• Providing in Twin Cities to major firms, airlines, colleges, arts facilities; local volume approximately $5,000,000/year. • Blue Cross/Blue Shield, General Mills HQ, North Central Airlines, Madison schools, Philadelphia schools, Carleton, St. Thomas, Macalester, and others.
8. Service Direction, Inc. Karl Gerstenberger Ex. Vice President 7600 Parklawn Avenue Suite 368 Minneapolis 55435 835-5305	• No (except in case of Hennepin County facility which SDI manages).	• Mostly serving the hospital market (Hennepin County Medical Center, Abbott & Northwestern Hospitals, Unity, Lutheran Deaconess, Mt. Sinai, St. Mary's Nursing Home, Ebenezer Society and others).
9. Service Systems Corp. James Van Bortel Area V.P. Soo Line Bldg. Minneapolis 55402 336-3040	• Providing on limited basis here (about 2,000/day) but would consider gearing up a central kitchen for school food services.	• About 24,000 meals/day for the business market (Pillsbury, Lutheran Brotherhood, banks, insurance companies, etc.). • 450,000 meals/day to Buffalo-Rochester, N.Y. schools; Chicago public schools; others nationally.

From Our Perspective

The central theme of PSO is not public versus private delivery.

A sole private source of supply has all the same problems as does a public bureau. Our theme, rather, is *diversity*: choice, market flexibility, providers who are not indispensible. . .not putting all your eggs in one basket.

We like the *purchase* approach, because it offers *more control*.

A purchase relationship, in its essence, specifies what one is buying, from whom, the quality or size or results, when it will be delivered, and what will be the consequences of failure to deliver as agreed.

Purchase-of-service might better be termed purchase-of-*results*. The buyer (whether government or an individual) need not be as concerned about how the service is rendered as he is about the results achieved. And when multiple providers can be used at the same time, the delivery system holds itself in check: the buyer can readily compare costs and results, move about the marketplace as suits his needs, and deal firmly with a supplier, public or private, who is ineffective.

In St. Paul, an important decision is now before the School Board.

The question is whether they will look at their alternatives.

It seems astonishing to suggest that a public body might not examine choices. . . might not at least look at the long term interest of the district to see whether better quality and lower costs could be achieved through alternative arrangements. But we have serious concerns that the Board will not.

The school district staff say they have looked at options. We think they need to look closer. Consider separating the district into groups of schools utilizing a diversified system where comparison of results and costs will be readily apparent, . . .or groups which solicit competitive bids for off-site production for the entire district; or request management contract bids for a district facility; or let each school contract separately with a central supplier—public or private—with the option to go elsewhere at any time better results can be obtained from another supplier in the marketplace.

We think the School Board—and the students in school, and the taxpayers—are likely to regret a decision to commit totally to any single solution. The 'best' solution is a 'mixed' solution, with part of the service secured from one supplier (private or public) and part from another (again—private or public). . .and with a contract arrangement that makes it possible to switch, if the original service doesn't meet expectations. ■

Dun's Review

STRETCHING SCHOOL DOLLARS

State governments are introducing a new style in running schools. It uses management methods to get improved results from teaching and greater efficiency from the school dollar.

If proof were needed of the growing failure of the American public school system, it can be found in three sets of distressing statistics: Since 1972, the number of students in public elementary and high schools has *declined* by 2 million while the amount of money spent on public education has *jumped* 50%. But the results of this vast increase in per-capita spending—at least as measured by a test of reading and mathematical skills—has been just short of disastrous (*chart, page 55*).

The nation's corporations, as well as its parents, have a vital stake in this sorry situation. For one thing, $15 billion of the $37 billion corporations pay in state and local taxes is used for education (*chart, page 57*). For another, public schools turn out the vast bulk of workers industry needs, and more than a few employers have been dismayed in recent years at the inability of high-school graduates to perform even simple entry-level jobs.

For years, Americans did little more than complain about the quality and cost of education—and continued to pay the growing bill. But that era has ended. Prodded by business and the public, state governments have finally started to tackle the job of managing the whopping $75 billion that the nation spends on public education in an effort to get better results at an acceptable cost. For example, Florida now grades schools for their effectiveness in teaching students and their efficiency in spending money. Michigan grants extra funds to teachers and administrators who devise teaching techniques that are both innovative and effective. Georgia now tests teachers for competence. The programs differ, but the goal is the same: more bang for the educational buck.

These efforts have already produced some encouraging results. For example, schools in one Florida county ranked 34th or worse in various tests three years ago, but as a result of public pressure generated by the state's program, the county rose to sixth place last year. Michigan has raised the number of fourth- and seventh-graders reading at acceptable levels by more than 10% since 1974. And in Polk County, Georgia, a teacher-development program started in 1976 has increased the number of fourth-graders reading above grade level by ten percentage points and the number scoring above grade level in math by eight percentage points.

Bare Beginnings

These are only the barest beginnings in getting more out of school dollars. In fact, most of the programs to create more effective and efficient schools have been launched only in the past few years, and many are being implemented for the first time this year and next. In addition, the public education system is so large—with 43 million students taught by 2.1 million teachers in 43,600 schools—that it takes quite a bit of doing just to move the Establishment a few inches.

The sprawling, decentralized nature of public education also creates problems. Under most state constitutions, they have the right to regulate schools, but they have rarely exercised that right. Instead, schools are largely paid for and controlled locally, and this has resulted in a vast ignorance about what students learn and how much money is being spent. The country's 16,200 school districts vary widely in sophistication, management ability and financial resources, and there is no such thing as a uniform management-information or accounting system that is used by even a small fraction of those districts.

The states have finally been forced to try to bring some order to this administrative chaos. Pressure has come from a number of sources. Taxpayers finally rebelled against ever-increasing educational budgets. In numerous instances, they refused to approve budget requests and forced schools to close for lack of funds. In Ohio alone, sixteen school districts have closed for varying periods since 1971. Recently, the state had to advance $30 million in next year's funding to Cleveland to pay the system's 11,000 employees and keep the schools open to finish the year.

Civil rights groups and other activists have sued nineteen states to force them to assume responsibility for school financing and performance; the plaintiffs won major decisions in California and New Jersey that resulted in new funding methods and more active state involvement in shaping the education process. In New York State, a high-school graduate even filed a malpractice suit against his local school system claiming that he had been allowed to graduate without learning to read well enough to finish the simple written part of a driver's license

***A huge system:** It takes more than 2 million teachers in 43,600 schools to teach the nation's 43 million public school students*

The New Jersey Master Plan

One of the most comprehensive efforts to get a firmer management grip on the school dollar is taking place in New Jersey, which has instituted a thorough-going program patterned along the lines of a five-year corporate plan. The new system resulted from a court ruling that the state was not living up to the state constitution, which directs the legislature to "provide for the maintenance and support of a thorough and efficient system of free public schools."

To make the New Jersey system "thorough and efficient," abbreviated to T&E, the state legislature in 1975 mandated that the 600 school districts follow a six-step planning process: 1) develop goals, with the participation of the community; 2) decide on a level of achievement for students and how they will be evaluated on their achievement; 3) test students to determine their current level of proficiency; 4) write a plan to achieve the desired level of student performance; 5) evaluate the programs; 6) prepare an annual report of student progress and school spending. In writing the educational plan, the district must indicate what resources are being allocated to each program, identify who is responsible for implementing the programs and set a timetable for the education planning effort.

By law, the Number One priority was to develop basic verbal and computation skills. And by the end of the 1977 school year, 98% of the schools had formulated goals.

The state permits local districts to determine goals, choose their curriculum and their evaluation system, but it audits the school districts on a regular basis to see that they are complying with the law. All plans are submitted to the state to determine whether they meet the guidelines. And auditors visit the districts and schools personally to verify that the schools are fulfilling the plan. The state has hired 155 former superintendents, principals and teachers, one for each twenty schools, to act as auditors. They must monitor each school at least six times a year and report on compliance. It is not enough for the auditor to give an opinion that the district is complying; he or she must include evidence.

The annual report acts as another control. Each school district must report results of testing pupils in basic skills, on staff-development programs and on plans for improvement. The school must also submit a budget yearly and every two years, the state may require the districts to report on their use of plant and equipment and their capital spending plans. These annual assessments will be made public so that parents know how effectively the school is performing and at what cost.

All school districts must use a uniform reporting system for budgets. Currently, most of them use a traditional line format that reports the amount spent for books, salaries, and so forth. Beginning with the 1978 school year, the districts must identify instructional expenses with specific programs. This means that salaries for teachers in bilingual education are charged to that program and tools used in vocational education allocated to its budget. Thus, the program costs can be tracked from year to year and the payoff from increased spending or program improvements can be measured.

Along with the new planning process, the legislature put a cap on spending for public education; the amount of money spent per student is now indexed to increase with real-estate valuations. Since real estate has not been rising as fast as inflation in the state, the allowable budget increases have put a damper on school spending. The cap has increased confidence that school spending will be contained. As a result, according to one educator, since T&E was started the number of budgets turned down by the voters has declined.

---

exam. The case was dismissed on a legal technicality, but Joan Baratz of the Educational Policy Research Institute believes that lawyers are looking for similar cases in other states.

States have also been prodded into taking a more forceful role in managing schools because of their increased responsibility for funding. As the states' share of the school dollar grew, so did the responsibility of state legislators to supervise how the money was spent. In addition, states distribute federal grants; in all, on a national basis, the states now control more than 50% of the school dollar—although there is a wide variation among states, with Hawaii providing 100% of school funding and, at the lower end, New Hampshire providing only 6%.

As the states have become more active, Minnesota and New Jersey have gone so far as to establish not only educational goals but timetables, similar to corporate five-year plans. After they set goals, the states and local school districts plan programs to reach the targets, audit the effectiveness of the efforts by testing students, evaluate the cost-effectiveness of the programs and eventually may tie funding to results *(left)*.

Few states have embarked on such a comprehensive approach to the problem, but many have adopted major segments. In general, they cover four areas:

- Testing students to see what they're learning and to determine whether they're qualified to be graduated from high school. Amazingly enough, until two years ago, only three states had minimum standards for graduation from high school.
- Using money as part of an incentive program to establish more effective teaching methods.
- Testing teachers for competence.
- Trying to cut down on the educational overhead.

Evaluating Students

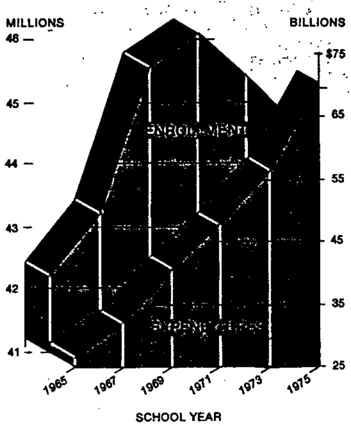
The first major step was the establishment of testing systems to evaluate pupil performance. Since 1965, forty states have enacted laws providing for the statewide assessment of educational programs. And largely since 1975, more than sixteen states have set up minimum standards of competency for graduation from high school. These testing systems are the foundation for improving education since, ideally, they serve a number of purposes. Among them: reporting on student progress; diagnosing problems; creating public pressure on schools to reform by publishing scores; and using the results to determine what schools and teaching methods should be financially rewarded for superior performance.

California, which started testing students in 1962, has one of the most sophisticated systems. It gives exams in reading, writing and math in grades 1, 2, 3, 6 and 12 and from the results develops a profile of each student, school and district; it is also able to see how the state is performing compared to the rest of the country. In addition, the state works out adjusted scores that factor in a student's economic level, parents' occupation, families on welfare and so on. The results not only chart progress, but also reveal weaknesses in programs. For example, one test pinpointed the existence of poor preparation in computation skills; this led to new emphasis on this area and a change in textbooks.

Florida takes the technique one step further and uses test results to grade the performance of each of its school districts. Results are published in raw form to show where each district ranks. Then the score is recomputed and the districts are ranked according to "effectiveness." First, the state measures five background factors in a district—the total number of minority students, the number of Spanish-speaking students by grade, number of students getting lunch free or

SCHOOL SPENDING CLIMBS . . .

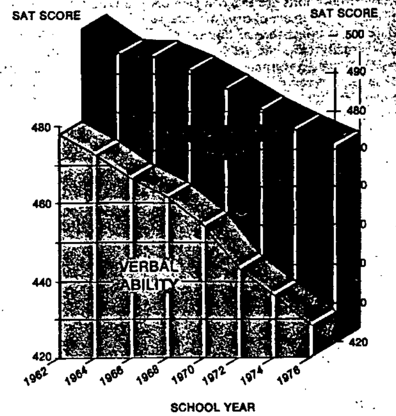
Since the 1971 school year, school spending has risen from $47.6 billion to $70 billion. In the same period, the number of students declined by almost two million.



Source: National Center for Education Statistics

. . . AS PERFORMANCE FALLS

The median scores of high school students taking the Scholastic Aptitude Test has been dropping steadily for fourteen years.



Source: College Entrance Examination Board

at reduced rates, pupils with college-educated parents and occupation of parents. Based on this information, officials determine what the district's test scores should be, and these are compared with actual scores to get the "effectiveness" grade. The districts are also ranked according to their "efficiency" in using educational funds. This grade is obtained by dividing the actual spending of each district by the average cost in the state adjusted for cost-of-living differentials.

The state counts on newspapers to publish the results and thus create public pressure for improvement in districts that lag. And the approach works. Manatee County in the central part of the state ranked a disappointing 34th out of 67 in its raw score in 1975, 56th in "effectiveness" and 57th in "efficiency." *The Bradenton Herald* played up the performance. "It gave us quite a club to wield," says managing editor Michael Finney. Stung and under voter pressure, district school officials revamped teaching methods. Each school received a checklist of new subjects to be covered in addition to the previous minimums. End result: In 1977, the county ranked sixth in all three ways of scoring.

The drive for minimum competency is a natural outgrowth of the testing programs. More than half the states will soon require students to take tests to demonstrate their proficiency in reading, writing and math. Those who fail may be denied a regular diploma, or they may be held back a grade. In Florida last fall, 37% of the eleventh-grade students tested for functional literacy in English and math flunked one or both parts of the exam. They got remedial help to prepare them to pass the test the next year.

> In Florida, 37% of the eleventh-grade students tested flunked either the English or math test.

Each district also gives tests in each grade that determine whether a student may be promoted. About 15% of the pupils fail and they must attend state-mandated remedial programs, such as summer school. Those that then pass are promoted; the others are left back. And in Chicago, almost 40% of the city's eighth-graders will be required to attend summer school this year to improve their reading if they want to go to high school.

When it comes to using the promise of extra funds as an incentive for schools and districts to improve, the hard fact is that most educational dollars are still allotted under traditional formulas based on school attendance. Large amounts of the budget are also earmarked for the poor or for poor performers. Nevertheless, there are modest amounts of money available to reward innovation and imagination, and several states are seeking ways to use the funds effectively.

In California, for example, the School Improvement Program enacted this year will provide from $65 to $110 per pupil each year to districts that join the effort. Participants must come up with a plan that includes an evaluation of program effectiveness based on student progress, teacher evaluation, the examination of parent-teacher relations and reporting on levels of violence and vandalism in schools. If the state approves the plan, the extra money is paid out during the next two years, after which the process starts anew.

In Michigan, the 530 school districts compete for $30 million in compensatory education money. The funds are granted after weighing two factors—need (determined by the number of students who score poorly on basic skills tests) and achievement (the past record in achieving better results, meeting state criteria on student-teacher ratios, involving parents in planning). This year, 115 districts received an extra $250 per student before the kitty was exhausted.

The federal government also has a

Three Cents Per Pupil

Most corporations are eager to support efforts to reduce school costs or increase educational effectiveness, but their efforts usually take the form of giving money to good-government groups, having executives serve on school boards or lending executives to government commissions to study education. Exxon Corp. has taken a different tack: It finances people with creative ideas for making education more cost-effective. One of its biggest successes came from a $150,000 grant of seed money in 1973 to a group that developed educational television for classroom use. The organization, Agency for Instructional Television, has earned many times its original grant, and it continues today as a successful, nonprofit operation producing new school programs at prices of 3 cents and 4 cents per child per year.

Television-assisted teaching was slow getting off the ground because it had to overcome the twin barriers of high initial programming costs and the antagonism of teachers. The organization that Exxon funded (along with a grant from the Ford Foundation) succeeded by adapting the format of network television; it produced programs and then syndicated them to school systems here and in Canada. Thus, the $60,000-an-hour it takes to produce a program like "Sesame Street" comes down to pennies per pupil. Using creative programming that helps teachers rather than substitutes for them overcame resistance. Nine programs have already been developed in areas such as metrics, health education, mental-health education and career development. Starting in the fall of 1979, there will be other programs in essential skills of reading, writing and math for fifth- and sixth-graders.

For states or communities, belonging to the syndicate pays off in additional instructural material at low cost. New Jersey, for example, paid less than $23,000 to participate in a series called "Inside/Out" that cost $1 million to produce. The series treats emotional health for eight- to ten-year olds in thirty programs of fifteen minutes each. It is popular with teachers because it discusses delicate matters of divorce and family problems that they are uncomfortable about introducing into the classroom. Roughly 160,000 students in the state will see the program for each of the next five years—the usual life-span before a program becomes outdated. Thus, the cost per student will run less than 3 cents a year.

program, administered by the states, that awards grants or extra compensation to teachers or administrators who develop ways to make teachers more effective. About $195 million was distributed under this program last year. And in at least one case, federal spending on educational improvement generated still more local spending in the same cause.

A group of teachers in the Canadian-border town of Sault Ste. Marie, Michigan, developed a program for beginning readers, and when they introduced the new curriculum, reading scores did indeed improve. The state used federal money to send the teachers to another community, Mancelona, in central Michigan, to instruct teachers there on the method. Again, reading results improved. According to the Mancelona elementary-school principal, the local school board was so impressed with the progress that it approved a budget for additional new programs—and this after turning down similar requests for years. Moreover, voter confidence in the school system increased, and residents approved a bond issue of more than $3 million to build two new schools.

No Way to Judge

One of the touchiest matters in the whole effort to make better use of the educational dollar is the issue of teacher competence and how to evaluate it. There is no systematic approach to the matter at present, and teachers' unions steadfastly oppose developing any. They fear that administrators would use such a standard unfairly when they had to cut staff. Unions hew to the straight labor line that any layoffs must be based on seniority—and as long as there is no agreed-on method of measuring teacher performance, then there is no defensible way to retain or fire teachers on merit.

In Washington, D.C., to cite a concrete and current example, public school enrollment is expected to decline sufficiently by 1980-81 to warrant the firing of almost 700 teachers. The teachers' union insists that the pink slips be based on seniority.

Almost 70% of the nation's teachers are unionized, and the unions are among the most powerful lobbies in state capitals across the country. Thus, most teacher-evaluation legislation is given little chance of passage right now. Nonetheless, parent pressure is producing some movement. The New Jersey state board of education proposes to write specific job descriptions for teachers and to use the standards—along with the personal observation of supervisers and student test scores—to measure teacher competence. True to form, the union is fighting the proposal hard. In Florida, both houses of the legislature have reported out teacher evaluation bills. And although the union is taking its usual tough stand against the measures, one state educator says: "The teachers' union has become resigned to the fact that there's going to be evaluation. It's an idea whose time has come."

Along with judging teachers once they are on the job is the effort to keep unqualified people out of the ranks to begin with. In Georgia, a mandatory program of teacher certification will begin this fall. Starting teachers will have to pass statewide tests and otherwise demonstrate their competance during their first three years or they will not be granted permanent status.

South Carolina, North Carolina and Mississippi are the only other states that use tests to screen teachers. The rest of the nation simply accepts a college degree as sufficient for certification. But now New York, Florida and Louisiana are considering testing or internship programs before a teacher is granted tenure. Says Russell Vlaanderen, director of research for the Education Commission of the States, a government statistics-gathering organization: "It's too early to call this a trend, but I expect it to gather momentum. It's definitely tied to the accountability movement."

Instruction accounts for the major share of the school dollar—but not so large an amount as most people might imagine. Although some districts reach as high as 80%, nationally the average share of the education budget spent on classroom activity is only 56%. That leaves a fat and eminently cuttable 44% in overhead—the so-called "delivery" system that includes not only administrative costs but also student transportation, capital costs and utility bills. States are moving in on this area, as well, to get more bang for the educational buck.

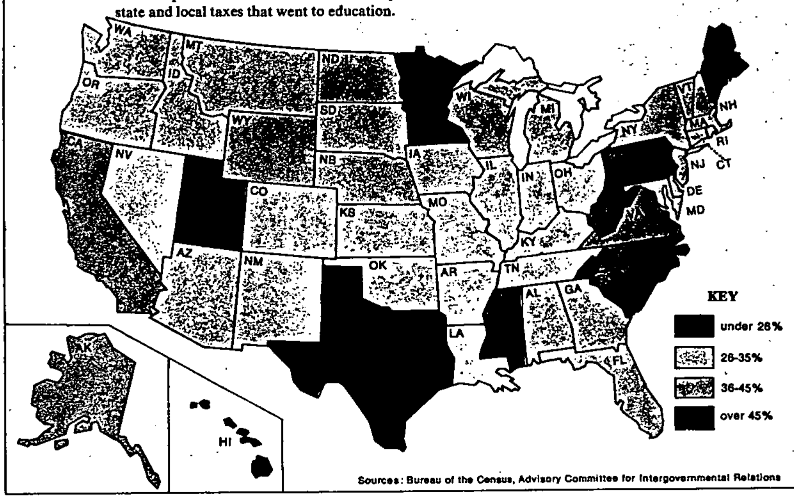
The problems here are as complex and stubborn as they are with instruction. To begin with, the states are still ignorant of exactly how educational funds are being spent because, with the tradition of local control, uniform accounting and management-information systems have never existed. These are just being installed for the first time. In addition, the states are reluctant to take control over certain functions out of local hands—and the districts are equally reluctant to give them up. But the pressing reality of declining enrollments means that the districts are receiving less money from states under the customary attendance formulas; they are seeking additional aid, and to get it, they must give up some control.

Minnesota moved decisively last year to get a grip on overhead when it passed a law to coordinate the use of school facilities around the state. School boards and superintendents must draw up budget projections for each district for

33-595 O - 78 - 47

THE BUSINESS SHARE OF THE PUBLIC SCHOOL BILL

Out of the $37 billion companies paid in state and local taxes in 1976, $15 billion went to public schools. Here is a state-by-state breakdown of the share of business' state and local taxes that went to education.



Sources: Bureau of the Census, Advisory Committee for Intergovernmental Relations

the years 1980-83. Each school board must estimate its enrollment, revenues and expenditures and analyze how it will use its facilities, even including the routes its school buses will take. These projections are combined into a district plan, which in turn is worked into a regional plan. And from all this, the state expects, by 1980, to develop a master plan for coordinating school operations and cutting overhead.

How to Save $30 Million

Minnesota is way ahead of most states in this regard. As many corporate executives know, the most popular state approach to cutting overhead is to call in businessmen as non-paid consultants to analyze problems and recommend solutions. Corporations from Citibank in New York City to Boeing Co. in Seattle lend executives to school systems to "discover" opportunities for efficiency. "It's a matter of squeezing all you can out of the business side so that there will be more money for education," says Boeing's director of educational relations Philip Swain.

A review conducted by the Association of Washington Business for the State of Washington in 1975 is typical. A task force of 22 management specialists worked full time for three months reviewing the operations of 55 local and five regional school districts. They came up with 128 proposals designed to save $30 million, and most of the suggestions could be implemented without new legislation. Three years later, another committee followed up on the recommendations and reported that a small but satisfying share had been implemented. These included putting in a standardized system for building new schools, revising the law for bidding on educational contracts, setting up a central plan for buying buses, reducing the number of employees used to serve lunch and coordinating computer processing so that a regional office did the financial accounting and check writing for local schools. Jack Frisk, a deputy state superintendent of education, estimates that there have been savings of 10%-to-40% in the functions involved.

> Washington businessmen reviewed the operations of the state's schools and came up with 128 ideas to save $30 million.

Chairman Alfred Barran of the General Telephone Co. of the Northwest, who headed the task force, is generally happy with the results. "We motivated the school superintendents to take more interest in management, and we got the number of intermediate school districts reduced from twelve to nine," he says. Most of the recommendations were ignored—including combining bus routes in various districts, setting up a self-insurance plan for the whole state school system and having the state, rather than the districts, sell bonds so that it could reduce financing costs. But Barran is realistic, and reconciled to having many proposals ignored. "Psychologically, you can go only so far in one step," he says. "Like a management consultant, you can only shove so much into a client's gullet at one time."

And perhaps that sums up the effort to improve public education and introduce sound management into the huge and sprawling educational establishment. The system is so big, so complex and so riven with conflicting interests that it is totally unrealistic to expect big change in a short period. But as the Chinese proverb goes, "A journey of a thousand miles starts with a single step." At long last, that important first step to more effective—and financially more efficient—public education has been taken.

—ARLENE HERSHMAN

TESTIMONY FOR THE
HOUSE SUBCOMMITTEE ON THE CITY
July 25-26, 1978
(SUBMITTED FOR THE RECORD)

PRODUCTIVITY AND PROPOSITION 13'S FOR
LOCAL AND STATE GOVERNMENTS

Harry P. Hatry, Director
State & Local Government Research Program
The Urban Institute
Washington, D.C.

It is ironic that the federal government has chosen this particular period to dismantle major federal productivity improvement efforts aimed at helping state and local governments. The National Center for Productivity and Quality of the Working Life is scheduled to go out of business on September 30 with its state and local programs apparently going nowhere, and both the National Science Foundation's and Department of Housing and Urban Development's state and local government productivity improvement efforts are being substantially reduced. And all of this at a time when Proposition 13 erupts and taxpayer organizations are springing up all over the country seeking to restrain government spending and demanding greater governmental efficiency.

Lack of Knowledge of Productivity Levels

The purpose of these protests are laudible. Most people in the country probably agree with the general principle that government spending should be cut to the lowest levels consistent with desired service levels and that government efficiency should be as high as possible. The trouble, however, is that no one really knows what the productivity levels are in any city, county, or state, or even in the federal government. Have any of your tried to obtain reliable information on the productivity of any agency in your local or state (or federal) government? Many suspect that there are gross inefficiencies; and with any large-scale organization, there are bound to be. But can they be found (especially when comparative productivity levels from agencies in other jurisdictions are lacking); and if so, can they be altered? Can major cost reductions be made without cutting back significantly on the quality and effectiveness of local services?

As would likely occur elsewhere, the cuts that are occurring in California will be based on little information as to the marginal efficiency or effectiveness of the services. Instead, the key factors in these choices will most likely be "gut" feelings as to relative worths of activities, and probably most influential, the level of protest and thus the level of pain to state and local legislators in making particular cuts. (For example, the mayor of Philadelphia was recently quoted as saying that, given that he had to cut a policeman or a solid waste collector, he would always cut the solid waste collector. Though one may sympathize with the importance of crime control, it is also clear that there are situations where individual police activities are of marginal value as compared to solid waste collection activities.) Those cuts are likely to be made that involve the least resistance and least political cost. And they will probably hit hardest those persons with the least political "clout." Results of polls of citizens asking them to identify their most and least preferred services will probably also be influential. But the citizens will have next to no information as to the potential cost savings and loss of services about which they are asked! Is this the way to run a government, or for that matter any business? Given the level of information currently available, this approach to cut-back choices is not surprising, nor is it even unreasonable, but it is certainly unfortunate.

If credible information can be made available to public officials on the costs and impacts on citizens of various options, this information could be used by those officials to help alleviate the pressure from affected interest groups. Unfortunately, seldom is such information available. Not only that, but the governmental offices most likely to be involved with evaluations and analyses of government services are also those offices that are likely to be first "axed." (In fact, one of the few such offices of any size in local government, the Office of Evaluation of Alameda County, California, has already been cut as part of the Proposition 13 backwash.) Thus, attempts by local governments to determine where cuts can best be made with the least loss of benefit to their citizens may well find themselves without the resources for making such assessments.

Unfortunately, citizens throughout the United States and many public officials have little understanding of how little is known about the performance of local services--either their efficiency or effectiveness. The presumption that by forcing governments to make substantial cuts, inefficient and less-productivie areas will be those cut, is ill-founded. Take personnel cuts, for example. Even if local agencies had accurate information as to the relative efficiencies of individual employees (which is usually not the case, though the small proportion of employees that are obviously substantially sub-par is likely to be well known at the first-line levels), it is unlikely that they could dismiss those performers. Existing civil-service regulations and strong employee organizations often mean that longevity is the key determinant of layoffs; and though lack of experience is one relevant factor, it is by no means the only determinant of good performance. "Merit" appears left out of "merit systems" in most governments.

Is "Privatization" an Answer?

An approach to reducing costs and increasing efficiency that will undoubtedly be receiving increasing attention is to shift to private contractors. A recent Columbia University study of solid waste collection costs reported that contract private firms (but not private firms dealing directly with the public) had lower unit costs.[1] However, major questions remain. Our own exploration of existing information on private as compared to public service delivery costs did not give a clear-cut picture.[2] Instead, change itself seemed to be associated

---

[1] "The Cost of Residential Refuse Collection and the Effect of Service Arrangement," Barbara J. Stevens and E. S. Savas, Columbia University, September 1976.

[2] "Private Provision of Public Services: An Overview," Donald Fisk, Herbert Kiesling, and Thomas Muller, The Urban Institute, May 1978.

with increased productivity in the few cases where meaningful data were available. Productivity appeared to increase whether the change was from public-to-private or private-to-public. One can hypothesize that the key factor was that conditions have to start off by being very bad in a city for such a major delivery system change to succeed in the face of the considerable opposition likely to be encountered. In such instances, any change is likely to be for the better. The available evidence also indicated that for local government services, it is not easy to obtain and maintain real competition (one of the key theoretical advantages of going private).[1] And there are serious problems and major costs involved in a local government switching to contracting out for service.

Where there is evidence that unit costs are high for a particular service in local government, we would suggest that this should be a trigger for the government to consider alternatives, including shifting to a private firm. However, it may be better to give the public agency, say, a year or two to "increase productivity or be contracted-out," i.e., "shape up or ship out."

In testimony I provided to the House Intergovernmental Relations and Human Resources Subcommittee almost exactly three years ago, I estimated that productivity improvements could at best reduce costs of a government by about 10 percent.[2] Three years later, I can see no reason to alter this. More drastic costs improvements will require either cutting service, cutting the quality of services, or reducing the need for a service, such as by a major breakthrough in technology. In fact, in the long run, the greatest role for the private sector in the area of public sector expenditures may be the development of new "breakthrough" technology--for example, an inexpensive, low-energy consumption, household "dispose-all" might reduce the amount of solid waste so as to permit major reductions in both solid waste collection and disposal costs. Similarly, breakthroughs in fire protective construction materials, pollution avoidance devices, and the like might lead to major opportunities for government cost reductions. On the social side, a breakthrough in employment and training programs--especially those for the disadvantaged--could lead to substantial reductions in the need for various types of public assistance and for special programs for the disadvantaged.

Vital Need for Information on the Impacts of New Approaches to Improve Efficiency

Such technological breakthroughs, however, are somewhat utopian, at least for the near future. For the time being, a major avenue for improvement would be to provide for careful testing and thorough evaluation of available technology and procedures to identify those innovations that have real promise for improving efficiency or effectiveness in a wide number of state and local governments. It is something of a disgrace that there has been only very sporadic systematic evaluation of local and state government innovations--both those that have and those that have not been initially developed through federal

---

[1] The Columbia University study cited earlier also qualified its funding to indicate that the lower unit costs could involve either public agency or private firm collectors as long as they were "freely competing for customers" (Op cit Page 22).

[2] "Fiscal Relations in the American Federal System," hearings before the House of Representatives Subcommittee on Intergovernmental Relations and Human Resources, Ninety-Fourth Congress, First Session, July 1975 (Pages 435-448).

funds. In my July 19, 1975, testimony, I pointed to the vital need for systematic experimentation and evaluation--activities that are clearly a role of the federal government. Few state and local governments can afford such activities. It is essential to assess both the costs of innovations and their impacts on service effectiveness and employees. Instead, today governments depend largely on promotional, public-relations type releases on new programs, information that is usually presented by the innovator (who is not likely to be unbiased) and is usually presented early in the life of an innovation so that the innovation's actual cost-effectiveness and long-term viability are yet to be determined. This leads to governments either trying "white elephants" or missing opportunities that have considerable potential because adequate information on these was not obtained from trials by other governments.

Individual local and state governments should (if they can obtain and retain financial support) undertake regular examinations of the efficiency and effectiveness of their major programs. And they should utilize information provided from trials in other governments that are adequately evaluated and reported--in order to identify inefficient activities that should be avoided and successful ones that should be introduced, continued, or expanded.

The federal government should provide evaluative data to local governments on major innovations, should develop productivity measurements on individual services that can be used by individual governments to compare their own levels of efficiency, and should sponsor research aimed at breakthroughs in service delivery.

Summary

The likelihood that Proposition 13's alone will lead to improved local or state productivity seems small indeed. What is needed is a substantial effort, with federal support, to identify important productivity improvement options. The recourse, otherwise, is to reduce the quality and level of government services and accept the risk that what will be sacrificed may be too great.

"Taxpayer protests" can have the benefit of putting strong pressure on state, local, and federal governments to maximize the efficiency of their operations. Let us hope that this pressure does not become counterproductive leading to misinformed cutbacks that are a <u>disservice</u> rather than an <u>advantage</u> to the public.

PUBLIC ADMINISTRATION REVIEW

STATE AND LOCAL GOVERNMENT PRODUCTIVITY AND THE PRIVATE SECTOR

R. Scott Fosler, *Committee for Economic Development*

The potential for improving state and local government productivity through more effective relationships with the private sector is limited by inadequate understanding of the nature of the "private sector." Rather than suggest a single theory or set of definitions, this analysis works from three different perceptions of economic activity in a state or local jurisdiction: that of a market economy; a pluralistic economy; and a holistic economy. None of these three perceptions is necessarily the correct one; each probably describes some aspects of economic behavior in various jurisdictions more usefully—for the purpose of improving public productivity—than a single model that attempts to synthesize all three. Each perception also suggests a somewhat different definition of public productivity.

The Market Economy

The perception of a market economy, generally based upon the notions of Adam Smith, distinguishes clearly between the roles of business and government. The private sector is viewed as a composite of homogeneous businesses motivated by the desire for profits to produce the goods and services demanded by consumers, in accordance with freely fluctuating prices that efficiently allocate resources. The role of the public sector is to protect life and property, assure justice, and provide the infrastructure or overhead necessities (e.g., police and fire protection, street construction and maintenance) required to support the activities of the private sector.

Government productivity by this perception is largely synonymous with efficiency. The goals of government are assumed to be reasonably straightforward: dispose of refuse, facilitate transportation, put out fires, etc. The greatest concern is that they be achieved at the least cost. The private sector can influence this goal indirectly in two ways: first, businesses comprise a political force that can pressure governments to increase their efficiency; and second, the business model of organization tends to be copied by public agencies in certain respects. More direct action by the private sector to raise public productivity can take the forms described below.

Business Assistance

Businesses commonly provide expertise to local governments to increase efficiency, a practice begun in the Progressive Era to bring "rational," "non-political," "business-like" management to government.

Efforts by business groups to study and improve government efficiency have been most successful where advisors have modestly confined themselves to government operations that are most akin to the business operations with which they are familiar—in particular those that have specific, clearly identifiable, and usually quantifiable objectives.[1] These include certain line operations (e.g., refuse collection, institutional food services, and motor pools), administrative systems (e.g., financial management, scheduling, and inventory control), and analytic capability (e.g., industrial engineering and quantitative analysis). In dealing with more politically sensitive or policy-related problems, the business advisor's success seems to depend not so much on the direct application of business systems or expertise as on his ability to analyze complex problems and to understand and cope with the political forces affecting government management.

Criticism of such efforts includes a lack of concern by business advisors for effectiveness or quality as a trade-off with efficiency; the tendency of business people to be patronizing or scornful of government officials (compounded by defensiveness on the part of government managers); the inclination of corporations to assign less than top-quality people as advisors; and the failure of business advisors to understand or to acquaint themselves with the special political and administrative problems that characterize government operations.[2]

Contracting Public Services to Business

Contracting public services is also most successful for those government activities most akin to business operations. Governments traditionally have purchased such goods as vehicles, office equipment, and other materials, and contracted for such services as street lighting, solid-waste collection, consulting, communications, equipment repair, cleaning and laundering, and the health care of individuals. These—and less frequently contracted services such as water supply, street maintenance, snow removal, and building maintenance—tend to have reasonbaly precise and quantifiable objectives and are characterized by a high degree of routine in their operation.[3]

Deciding whether to provide a service with in-house staff or to contract with a private business is similar to the "make or buy" decision faced by a business firm. Simply put, the question is whether it is cheaper or more effective for an organization to make a given product component in-house, or to purchase it from an outside firm (or to do both as a means of deliberately fostering competition for the in-house operation). Governments, however, need also

Scott Fosler is Director of Government Studies for the Committee for Economic Development. He has held management and staff positions in the public and private sectors including an assignment to the National Commission on Productivity. The author of a number of publications in the field of productivity, Mr. Fosler has extensive international experience.

consider the political implications of contracting, including resistance from public unions that fear loss of jobs and members; corruption—especially bribes and kickbacks—tempted by contract; and the sensitivity and responsiveness of private contractors in meeting public objectives.[4]

Experience and study have demonstrated that contracting can be beneficial for some government operations, but the potential is not boundless nor can the risks be ignored.[5] Success is highly dependent upon specific conditions relating to the nature of the service, the government's skill in contract management (which for most jurisdictions is limited), the availability of competent businesses to do the work, and the size of the jurisdiction to be served.[6] The principal advantage in contracting may be to foster competition among organizations providing services whether they happen to be in the public or private sectors.

Private vs. Public Responsibility

Suggestions that government simply "turn over" responsibilities to the private sector are generally more rhetorical than serious, since there is obviously no guarantee that a service terminated by government will be automatically picked up by an enterprising business. The reason many government services were undertaken in the first place is, of course, precisely because businesses found them unprofitable, or, for whatever reason, did not rise to meet the demand. It is a matter of debate, nonetheless, whether governments over the years have expanded beyond the provision of basic public needs into services that otherwise might be provided by the private sector. Recreation and adult education are typically cited as examples. Businesses, it is argued, do not enter certain service areas that might otherwise interest them because they cannot compete with government services provided free or below cost due to public subsidy.

A variation between direct contracting and simply terminating a government service (in the expectation it will be assumed by business) is the provision of government vouchers which supply the consumer with purchasing power, thus assuring him the provision of a specific service considered basic to everyone's needs. Food stamps and rent supplements are examples. Experiments with vouchers for education have been mixed. In San Jose, California, parents were given vouchers that permitted them to choose among public schools only. Rather than increase competition as the program had intended, however, the voucher system prompted collusion among the schools to standardize curricula in order to prevent any one of them from losing students.[7]

The Pluralistic Economy

The perception of a pluralistic economy views government not as a limited overhead operation, as in the market perception, but as a large, intrinsically important, and integral part of the economy.[8] The state/local government sector alone produces 15 per cent of the gross national product, and employs nearly 12 million people, or one-seventh of the American workforce.[9] Many public sector organizations, do not conform to classical characteristics of government. Similarly, the private sector is comprised of a variety of heterogeneous organizations, including not-for-profit as well as for-profit operations, many of which do not conform to classical principles of market behavior.[10]

Public productivity under the pluralistic perception continues to stress government efficiency, the more so given the substantial resources devoted to the public sector. But greater emphasis is placed on the effectiveness and quality dimension of productivity than is true in the market perception. Public goals are recognized as more complex, and consequently the selection of appropriate goals and cost-effective approaches to meeting them will impact productivity as much, or more, than the efficiency of public-agency operations. As in business, achieving higher output-input ratios depends heavily upon equating marginal costs with marginal returns (or results) rather than simply meeting pre-established objectives at any cost, even if efficiency is high.

Coordination of Delivery Systems

Many of the public goals pursued by government require a contribution by private-sector organizations. The interdependence of business and government in the pursuit of common or integrally related objectives results in the behavior of one affecting the productivity of the other. In the case of fire protection, for example, suppression of fires is typically a government responsibility, while fire insurance is provided by the private sector. For some jurisdictions, insurance companies set premium rates according to the level of firefighting capacity of the local government. Consequently, rigid or obsolete insurance standards requiring conventional equipment could inhibit a fire department from introducing new and more cost-effective technology which could improve firefighting productivity.[11]

Coordination of Capital Investment

The rate of state and local government capital investment (about $43 billion in 1975[12]) has declined in constant dollars during the past five years, partly due to a decrease in the rate of population growth and urbanization and partly because some public capital spending has been shifted to the private sector. Sidewalks, storm drainage sewers, access roads, street lighting and other such facilities once provided by government are now included by many jurisdictions in subdivision standards and hence are the responsibility of the private developer. When the costs of these facilities are included in the price of new homes, the marginal costs of added infrastructure are borne by the homeowner who presumably enjoys the marginal value they provide. At the same time, privately constructed capital facilities must be operated, maintained, and replaced by government, and hence their design and the quality of construction will affect the productivity with which they are subsequently serviced by public agencies.

Governments also depend almost exclusively on the private sector for the design and construction of publicly funded capital projects. Local governments typically contract the design of new facilities independently of one another, with resulting high costs in design preparation and failure to incorporate available cost-saving construction techniques. Skillful design of school buildings, fire houses, and other facilities can minimize future operating costs in such increasingly expensive areas as physical maintenance and protection against vandalism, and increase future options for multiple or alternative uses (for example, facilitating conversion of schools with declining pupil enrollment to other uses).

The design of private residential, commercial, and industrial construction can also affect the productivity of public-service operations. For example, use of fire-resistant materials in residential and office construction would reduce the need for expanded fire services. Plumbing facilities in private homes that used less water, or new industrial plants designed to conserve water, would relieve the pressure for expanded public water supply and sewage-treatment facilities.

Public-Private Hybrid Organizations

A growing volume of economic activity does not conform to traditional notions of either government or business organization. In the public sector, for example, there are numerous single-purpose agencies, public-service corporations that support themselves principally through service fees, and public land and housing corporations. Most such organizations were established on the assumption they could perform more aggressively, escape administrative or civil service restrictions, pay higher salaries to attract more qualified employees, assemble larger amounts of capital, or encourage innovation—all of which could increase productivity. Their record, however, has been mixed. Some are regarded as models of efficiency while others have been scandalized by corruption and mismanagement.[11]

In the private sector, highly regulated utilities differ from public corporations only slightly, principally in that their boards of directors are selected by stockholders (although in practice, boards are likely to be well represented by local financial, commercial, and political interests), and they raise capital through taxable bonds and stocks. Their records, however, are also mixed, causing Lyle Fitch to conclude that "good management and efficient performance depend upon factors apart from the question of whether the corporation is public or regulated private."[14]

Private Research and Development

Only 1 per cent of total industrial research and development (estimated at $18 billion in 1970) is directed to the state/local government market.[15] The low level of effort is generally attributed both to lack of incentive for government agencies to innovate and hence to create a demand for new products, and to the fragmentation of the state/local market, which discourages companies that fear they will not be able to sell a standardized product once it is developed.

Part of the problem, however, lies in the fact that those corporations that account for more than 80 per cent of industrial R&D (including aircraft, electrical equipment, motor vehicles, machinery, and chemicals) sell only a small fraction of their products to state/local governments. Consequently, they neither see the state/local sector as a promising market for their customary products, nor are they familiar with or inclined to learn about public-service needs to which they might contribute.

Economic Development and Public Productivity

Economic decline affects government generally by undermining the tax base, but it can also hamper the productivity of public services specifically in at least two ways. First, lack of jobs and low income produces higher welfare loads, family disruption, youth problems (people between the ages of 16 and 24 represent one-quarter of the workforce but one-half of the unemployed), and crime. The goals of government social service and criminal justice agencies might be met far more effectively and efficiently by providing jobs and raising incomes than by heroic efforts to increase the productivity of their internal operations.

Second, decline in economic activity and population can result in the underutilization of municipally owned and operated infrastructure, including water and sewer systems, transportation networks, and other utilities, so that unit costs rise.

While most city governments sponsor public relations campaigns to attract industry, and offer business limited technical assistance and financial incentives such as industrial bonds and tax abatement, few conceive of themselves as having a major role in the economic vitality of their communities.[16] Only recently have some city governments, faced with severe fiscal pressures clearly related to economic decline, recognized that they have a profound impact on private-sector behavior through their decisions on tax policy; the construction and operation of infrastructure required for economic development; regulation (such as housing codes, zoning and subdivision requirements, consumer regulation, utility rate setting, and rent controls); educating and training the labor force through primary and secondary schools, colleges, and vocational training programs; adequacy of transportation, education, crime control, and other key services; and the attitude of political leaders and administrators in dealing with business.

An added complication is posed by the role of government as "employer of last resort." Creation of jobs in the traditional public agencies (for instance, by adding new positions to the fire and police departments) seemingly runs counter to efforts to increase the productivity of those services. The creation of make-work jobs, on the other hand, is distasteful to the public, to regular public employees, and not least of all to the unemployed who have little choice but to accept them. Many public officials have been baffled by the paradox of federal policy that, on the one hand, exhorts them to trim their staffs and increase their productivity and, on the other hand, gives them Comprehensive Employment and Training Act money to hire the unemployed.

Part of the confusion lies in the failure to recognize that the nature of the local "economy" has changed. Government is no longer a peripheral overhead operation but a principal component of the economy. The local economy is characterized by a complex set of relationships between the public and private sectors; the spending, staffing, and production policies of each impacts the productivity of the other.

The Holistic Economy

Both the market and pluralistic perceptions of the economy concern themselves with organizations that produce goods and services that are measurable in monetary terms, and consequently contribute to the gross national product. The holistic perception is concerned, in addition, with the large number of organizations and volume of productive activity whose product is not necessarily measured in monetary terms, and hence whose value is not calculated as part of GNP. The latter include such purposeful pursuits as household operations (cleaning, cooking, shopping, child-rearing, and manufacturing[17]), volunteer organizations (shopping co-ops, health associations, hospital aides, care for the elderly, government advisory groups, political and civic associations, labor unions and professional associations), education, recreation, transportation, socializing, and searching for employment.

For those organizations whose product is measured in GNP, the holistic perception is not concerned simply with whether they are public or private, but also with such distinguishing characteristics as their goals, nature and essentiality of output, source of revenue, nature and structure of workforce, type of technology employed, and size of operation.[18] For example, a large insurance company may have more in common with a large state welfare agency than with a neighborhood shoe store, even though both the insurance company and shoe store are businesses. A public hospital is more similar to a private hospital than to a public landfill operation, even though both the public hospital and landfill are government-operated.

It is noteworthy that the GNP activities consume about 10 per cent, and the non-GNP activities about 90 per cent, of Americans' waking hours.

Public productivity, by the holistic perception, is broadly concerned with the ration of the satisfaction of human needs and wants compared to the resources invested to achieve that satisfaction.[19] Goods and services, which in conventional definitions of productivity are conceived as "final outputs," thus become intermediate outputs, and simultaneously are inputs into the process by which human needs and wants are satisfied. Maximizing output-input ratios in the production of goods and services by GNP organizations (both public and private) is no less important than in the market or pluralistic economies. But in the broader perspective of the holistic economy, it is not sufficient. A further consideration is the extent to which, and the manner in which, those goods and services combine with non-GNP activities to satisfy human needs and wants.[20]

The Productivity of Consumption

Economics traditionally has been concerned with the efficient use of resources in the *production* of goods and services demanded by consumers. Less attention has been paid to the efficient *consumption* of those goods and services to satisfy human needs and wants.[21] In the abstract, the process of consumption is similar to the process of production—in both, resources are manipulated to achieve specific goals.[22] In the production of bicycles, for example, the manufacturer consumes the product of rubber, steel, and paint producers. The bicycle, in turn, is "consumed" by the bike rider in the production of entertainment, exercise, or transportation. Part of the current energy debate centers on the issue of whether public policy should emphasize higher levels of energy production or greater efficiency in the consumption of energy at the level currently produced.

Consumption—the organization and use of goods and services to satisfy human needs and wants—is increasingly complex. Ironically, as many of the traditional functions once performed by the individual have been assumed by specialist-producers (public as well as private), the "consumer" has been left relatively underskilled in integrating the array of highly technical goods and services required to serve his own purposes. For example, "the advertising industry, the school, and the mental health and welfare services have taken over many of the socializing functions of the home . . . (and) have propagated the view that the family cannot provide for its own needs without outside assistance."[23]

The case of public mental health programs is illustrative. Conventional approaches to dealing with mental health problems have relied heavily on the medical model and consequently have focused on therapy of the individual as a means of relieving stress. Unsatisfactory progress has led some mental health clinics to take a broader approach:

> If a woman with five children is suicidally depressed because of the inadequacy of her welfare payments, the dreariness of her home, and the rats that threaten her family, the center's crisis team would work first of all on those realities, help her deal with the welfare department, assist her with child care, and bring in an exterminator.[24]

Such a woman presumably does not possess the skills required to successfully "consume" or otherwise use the services of (1) income maintenance provided by a government agency, (2) rodent extermination provied by a business, and (3) child care provided by friends, relatives, or formal day-care centers (which in turn may be operated by government, business, or community organizations). If the clinic is to be successful in meeting its goal of relieving the woman's stress in order that she can function independently in caring for herself and her children, it feels it cannot confine itself solely to a therapeutic relationship with the woman, but must take steps to improve her access to and ability to use other services basic to her needs. The public clinic's "productivity" therefore may depend partly upon its success in helping the woman utilize other services, both public and private, and upon the effectiveness with which those services are provided and coordinated to meet the woman's needs.

In the market economy it is assumed that businesses pursuing their own interest will simultaneously contribute to social well-being, since producers will only supply what consumers demand through their purchases. In the pluralistic economy, the price mechanism is not so reliable an allocator of resources, since important economic functions are performed by government and by private not-for-profit organizations which are not as sensitive to the "market" as business. In the holistic economy, where a substantial proportion of important economic activity (both production and consumption) operates largely outside the monetary economy, the price system, as traditionally structured, may be unsatisfactory in assuring that the objectives of individual production units are compatible with the needs of consumers or with public goals in general.

Former HEW Secretary David Matthews observed that public programs too often fail to understand "that government, which can move with great force, is quite dependent on the local, informal, community institutions and community leadership which supports and sustains people." The "essential question right now in the country," he concludes, "is not what government can do *for* but rather what government can do *with*."[23] He cites several examples of apparently successful programs that harmoniously organized the abilities and energies of government, business, community organizations, and individuals, such as Community Health of South Dade, a "shopping center" of health services accessible to 40,000 low-income people at a cost of $42 per day as compared with the $215 charged at the nearest hospital.

For some types of services it may be possible to charge service fees or otherwise use prices as a means of encouraging a more efficient mix of contributions from various "producers." For example, householders who desire backyard as opposed to curbside collection might be charged the 30 per cent or more higher cost of backyard service, or otherwise choose to supply their own labor to take the refuse cans to the curb and pocket the savings to spend as they please.

The Productive Role of Politics

Politics, while not generally perceived in our culture as a productive force, is nonetheless concerned with the allocation of values among competing social demands, just as economics is concerned with the allocation of resources among more narrowly conceived economic demands.[24] Whereas economics deals in measurable values for which prices may be a suitable mechanism of allocation, politics also deals in less measurable values (such as influence and prestige) for which the less precise play of political power is the principal allocation mechanism. A market economy is not so much free from politics as it is wholly supported by a political consensus which permits prices to fluctuate according to shifts in consumer demands and the availability of supplies.

In the holistic economy, politics is likely to play a more active or overt role for several reasons. As affluence increases, human priorities shift from material needs, which businesses can provide efficiently, to such desires as improved health and education, for which business has not proved to be as suitable a supplier as government.[25] Negative externalities of production, such as environmental pollution, become more onerous. Specialization and interdependence of economic activity reaches a degree of complexity that does not automatically regulate itself through a free play of the market. And perhaps most important, the existence of material wealth gives rise to a demand for it; no matter who produces wealth, those with political power will seek it. Total government spending in the United States is equivalent to approximately 33 per cent of GNP. Thus, the political decisions of government determine the use of about $525 billion per year. Who pays that bill through taxes is also politically determined.

In such a world, the traditional tasks of politics take on a new importance in promoting the productive use of resources. Unnecessarily conflicting goals can be creatively synthesized to avoid needless expenditure and counterproductive effort. Inherent and inescapable differences in interest among competing groups can be resolved with minimum conflict that would otherwise consume time, dollars, and goodwill. New and more productive approaches to achieving goals can be developed and political consensus built to support them.

Local government officials today find themselves in the thick of affairs that involve all segments of the community in the expenditure of huge sums of public and private funds. For example, the construction of a major sewage treatment plant, costing as much as half a billion dollars, may require complex and prolonged negotiations among elected officials, public managers and analysts, private consultants, local businesses, land developers, environmental and neighborhood groups, and state and federal funding and regulatory agencies. The skill with which these various interests are balanced to provide a cost-effective, economically supportive and environmentally sound system will affect the productivity of a community's waste-water management—and all the public and private activity it impacts—far more than the operating efficiency of a sewage treatment plant.

Conclusion

The market perception suggests a relatively simple set of relationships by which business capability can be used to help increase government efficiency. It is here that the most familiar and practical possibilities are to be found for improving public productivity.

The pluralistic perception recognizes that government is a substantial component of the economy, and that it interacts with business in complex ways in the pursuit of public goals. Public productivity depends not just on the efficiency of its internal operations, but also on its effectiveness and its harmony of interaction with the private-sector, although it still defines the "economy" as those activities (public and private) measured in gross national product.

The holistic perception departs significantly from the first two by recognizing the important contribution of productive activity that is not calculated in GNP, and the importance and intricacy of consumption as a determinant of economic efficiency. Public productivity in such a system requires attention not only to government agencies' internal efficiency and effectiveness, and not only to government's interaction with business, but also to the scondary and tertiary consequences of public policies as they affect business, nonprofit, civic, family and personal activities.

Notes

1. R. Scott Fosler, "The Application of Business Methods to Improve Government Management," presentation to the Conference Board, New York City, April 1977.
2. David Rogers, "Business and the Urban Crisis: The Case of the Economic Development Council of New York City" in Willis D. Hawley and David Rogers, *Improving the Quality of Urban Management* (Sage Publications: Beverly Hills, California, 1974), p. 457.
3. *Purchase of Service Contracting by Local Governments: An Initial Examination* (Washington, D.C.: The Urban Institute, 1974), pp. 131-132.
4. R. Scott Fosler, "Cautions in Contracting Public Services," presentation to the National League of Cities Conference, Denver, Colorado, 1976.
5. See Lyle C. Fitch, "Increasing the Role of the Private Sector in Providing Public Services," in Hawley and Rogers, *op. cit.*, pp. 501-560.
6. E.S. Savas, *Evaluating the Organization of Service Delivery: Solid Waste Collection and Disposal*, preliminary report (New York: Center for Government Studies, Graduate School of Business, Columbia University, 1975), p. iv-v.
7. Allen E. Pritchard, "Private Delivery of Public Services," *Urban Options I*, National Urban Policy Roundtable (Columbus, Ohio: Academy for Contemporary Problems, 1976), p. 63.
8. John Kenneth Galbraith *(The Affluent Society)* has dwelt upon the tendency of modern economics and public attitudes to assign goods and services produced in the public sector to a category far inferior to those produced in the private sector: "Alcohol, comic books, and mouthwash all bask under the superior reputation of the market. Schools, judges, and municipal swimming pools lie under the evil reputation of bad kings." (New York: New American Library, 1970) p. 126.
9. *Improving Productivity in State and Local Government* (New York: Committee for Economic Development, March 1976)
10. Eli Ginzberg calculates that the "not-for-profit" sector, including government, accounts for 31.9 per cent of total employment (1973), or one in every three American workers. His definition of "not-for-profit" and composition of employment is as follows: Government, 15.8 per cent; activity resulting from government purchases which are consumed by government, 8.4 per cent (e.g., defense purchases from Lockheed); and nonprofit institutions, 7.7 per cent (e.g., churches, colleges, volunteer hospitals, labor unions, social organizations, and special-interest associations). ("The Pluralistic Economy of the U.S.," *Scientific American*, December 1976).

    Galbraith describes the modern private economy as a combination of large, planning-oriented corporations on the one hand, and "something resembling the neo-classical admixture of entrepreneurial monopoly, oligopoly, and competition" on the other. (John Kenneth Galbraith, *Economics and the Public Purpose*, New American Library, New York, 1975, p. vii.)
11. "First Alarm Attack Vehicle Design and Development Program," Public Technology Incorporated, Washington, D.C. (Project description), and discussion with Joseph Carlson, assistant to the senior vice president, Public Technology Incorporated.
12. George E. Peterson, "An Examination of State and Local Governments' Capital Demand" (Washington, D.C.: The Urban Institute, 1977), p. 9.
13. Fitch, *op. cit.*, p. 519.
14. *Ibid.*, p. 522.
15. "Industrial R&D and New Product Development Investment on a National Scale," Public Technology Incorporated, Washington, D.C.
16. *Business/Government Partnership in Local Economic Planning* (New York: The Conference Board, 1976), p. 6.
17. Such activities as these are, of course, calculated as part of the gross national product if they are performed by a paid domestic. Galbraith has observed that "the conversion of women into a crypto-servant class was an economic accomplishment of the first importance." (John Kenneth Galbraith, *Economics and the Public Purpose*, New American Library, New York, 1973, p. 32.)
18. Peter Drucker, *The Age of Discontinuity* (New York: Harper and Row, 1969), p. 175.
19. E.F. Schumacher, *Small is Beautiful: Economics as If People Mattered* (New York: Harper and Row, 1975), p. 58.
20. Since an important determinant of human satisfaction is the pleasure, dignity, or diversion of activity, the *process* of productive work, as well as its output, is important in determining over-all human welfare or satisfaction.
21. See Kenneth Boulding, *A Reconstruction of Economics* (New York: Science Editions, Inc., 1952), chapter 8.
22. Harvey A. Garn, *et. al., Models for Indicator Development: A Framework for Policy Analysis* (The Urban Institute, 1976), pp. 8-9.
23. Christopher Lasch, "The Undermining of the Family's Capacity to Provide for Itself: How Mass Education and Madison Avenue Have Replaced Main Street and Mommy and Daddy" *(The Washington Post*, February 10, 1977).
24. James S. Gordon, "New Roads to Mental Health" *(The Washington Post*, February 17, 1977).
25. David Matthews, "A Secretary's Parting Reflections" (*The Washington Post*, January 11, 1977, p. A-17).
26. See Bernard Crick, *In Defense of Politics* (Baltimore: Pelican Books, 1964), p. 23.
27. See Ruth P. Mack, "Values, Social Indicators and Priorities," paper for the TIMS XX Conference, Institute for Public Administration, New York, 1973, which suggests a taxonomy of human needs and wants.

FEDERAL POLICY AND THE APPLICATION OF TECHNOLOGY TO STATE AND LOCAL GOVERNMENT PROBLEMS

J. DAVID ROESSNER*

September 1977

(Revised version to appear in a forthcoming issue of Policy Analysis.)

*Policy Analyst, Division of Policy Research and Analysis, National Science Foundation, Washington, D.C. 20550. The views and recommendations presented are those of the author and do not necessarily reflect the official position of the National Science Foundation. The author wishes to thank Irwin Feller, Robert Yin, and W. Henry Lambright for their comments on an earlier version of this paper.

Introduction

The severity and apparent intractibility of urban problems no longer come as a surprise to anyone. The dimensions of these problems are all too visible to the majority of Americans who live in cities, and the voluminous analyses of, and disappointing experiences with, federal programs to ameliorate these problems have left us better informed as to their complex, deep-seated nature. The mid-sixties saw the symbolic apex of man's technological achievement, the moon landing, and the symbolic apex of the Federal Government's response to social ills, the Great Society programs. Emerging from this fortuitous convergence of events was the belief that science and technology might have a role in helping to ameliorate social problems, particularly those faced by state and local governments.

In a 1970 report, the House Science and Astronautics Committee recommended that "the scientific method and technological research should be increasingly utilized by regional, state, and local organizations in seeking solutions to societal problems."[1] In his 1972 science and technology message, President Nixon referred to the challenge of applying R&D resources to public problems and declared that effective use of these resources would require that state and local governments play a central role.[2] Many of the basic policy concerns were set forth in a series of 1972 reports published by the Federal Council for Science and Technology, the Council of State Governments, the Urban Institute, and the National Science Foundation.[3] These reports introduced the term "public technology"[3a] and brought a relatively new set of issues to the attention of federal policy makers.

This flurry of interest in public technology helped stimulate individual agency activities such as the Department of Transportation's "technology sharing," an effort to provide state and local governments (and private industry) with information about DOT programs and mechanisms for obtaining information about R&D activities or results; and the Law Enforcement Assistance Administration's "prescriptive packages," syntheses of research findings in specific problem areas, written in practitioner language and distributed to local law enforcement agencies. It also brought together at the interagency level such strange bedfellows as NASA's Technology Utilization program and the National Institute of Mental Health's Services Development Branch, which sat with several dozen other agencies on the Committee on Domestic Technology Transfer of the former Federal Council for Science and Technology. A recent directory issued by the Committee included descriptions of 43 different federal technology transfer programs, resources, and contact points.[4] The most recent manifestation of federal-level concern with public technology is the provision of the National Science and Technology Policy, Organization, and Priorities Act of 1976 that requires the Director of the new White House Office of Science and Technology Policy to establish an inter-governmental advisory panel that would identify and define problems at the state, regional, and local levels which science and technology could assist in resolving.

These public technology activities are part of a larger set of federal activities that might be labelled "technology policy" activities, but assuredly are not the product of a strategically planned and coordinated federal effort. As Lambright points out, U. S. technology policy and U. S. science policy are those allocations of resources and sets of programs that result from a large number of day-to-day decisions made in a variety of locations within the federal establishment.[5] Federal technology policy may be regarded as the sum of federal efforts to change the rate and direction of technological innovation in the U. S. economy, particularly efforts to stimulate or control the development and use of new technology.[5a] Public technology policy, from the federal perspective, is that subset of activities directed toward influencing the development and use of new technology by regional, state, and local governments.

The intergovernmental flavor of public technology has implications for the context in which public technology programs are operated and policy issues framed. Federal mechanisms employed to influence the development and use of new products and techniques by state and local governments largely are different varieties of intergovernmental resource transfers: categorical grants, block grants, revenue sharing, and research and demonstration grants. The fragmentation of intergovernmental programs and the complexities of intergovernmental politics--what Allen Schick has called the "intergovernmental thicket"--[5b] are thus mirrored in the structure of public technology policy making.

The relatively low priority of intergovernmental relations among domestic problems, the lack of an effective federal coordinating body for either intergovernmental affairs or technology policy, and the weakness in Congress of city and state lobby groups relegate public technology programs to second-class or lower status in most federal agencies.

Coincident with the flurry of interest in public technology in the early 70's was the Nixon administration's New Federalism; a call for administrative decentralization of federal programs and the devolution of decision-making authority and responsibility from federal agencies to those of state and local government. As suggested in a recent report to the Office of Management and Budget,[6] the trend toward devolution and decentralization is fueled by factors that reach beyond the ideology of the administration in office. They include a shift in the nature of public problems from equality of opportunity and economic growth to mass transit, crime, housing, pollution, and other problems that have their focus at the subnational level; the increasing administrative burdens of federal assistance programs; and the rising demands being made on state and local services coupled with their increasing financial instability.[7] Public technology policy issues, then, rest at the nexus of two broad streams of public concern: the perceived need to stimulate the use of research and new technology by regional, state, and local governments, and the need to assist these same governments as they assume greater responsibilities for the solution of increasingly complex public problems. The problem for federal policymakers is how to develop and implement programs that will at once increase the availability and use of new technologies by state and local government <u>and ensure that doing so actually helps solve the complex problems they face</u>.

The purposes of this paper are to discuss how public technology policy issues can be conceptualized and analyzed, present the results of empirical research that bears on the resolution of these issues, and discuss the implications of research findings for federal public technology policy.

<u>Conceptual Approaches to the Analysis of Public Technology Issues</u>

It is frequently said among policy analysts that to identify the problem brings one half way to the solution. This maxim clearly applies in the case of public technology. Thus, one approach to the analysis of public technology issues is to look more closely at the statement of the problem made immediately above. That statement glibly connects two programmatic goals--increase the use of new technology (innovation), and help solve problems--that upon closer examination may not be compatible in many circumstances.

There is no <u>a priori</u> reason to assume that federal programs intended to stimulate the development and use of new products and techniques by state and local governments will, in fact, contribute significantly to those governments' efforts to solve their problems <u>as they see them</u>; conversely, federal programs intended to help state and local governments solve their problems need not involve the introduction of new products or techniques. While this would appear to be an obvious distinction, a number of federal programs have failed to clarify their goals along these lines. Moreover, rarely if ever are public technology programs assessed according to problem-solving criteria; more typical criteria include a few success stories, the number of persons requesting information, the number attending seminars, or the number of agencies purchasing or using a new technology.[7a] As we shall see below, innovation and problem solving at the local level have sometimes been found to be more contradictory than complementary.

An alternative approach breaks the "What's the problem?" question into three more specific questions: Is it a demand problem? (state and local government agencies are inherently unreceptive to new ideas and techniques.) Is it a supply problem? (Private industry, federal agencies, and other suppliers of innovations are unresponsive to the needs of state and local governments.) Is it an infrastructure problem? (The system of communication among state and local governments, and between them and the suppliers of innovations, is inadequate or ineffective.) When stated this way, these questions suggest research as a way to obtain answers, and at least one federal research office has structured its public technology research problem this way.[8]

A third approach begins with a list of specific types of federal involvement or intervention mechanisms, followed by an assessment of the likely effectiveness of each mechanism. In an early effort of this type, the present author developed a set of criteria intended to reflect the standard concerns of policy makers (e.g., cost, effectiveness, risk) and some of the more immediate concerns of the then-current administration.[9] These criteria were applied to a list of recommendations for federal action, grouped according to type of action proposed:

1. Increase the technical capacity of state and local government manpower.
2. Disseminate technical information to state and local jurisdictions.
3. Increase the influence of state and local interests in federal science and technology policy making.
4. Encourage technical support to state and local jurisdictions by institutions having scientific and technical resources.
5. Support or conduct research and/or demonstration programs.

The results showed this to be a useful scheme, though clearly others of this type could prove equally useful.

The conceptual issues do not end here, because attempts to implement any of the above approaches confront a host of problems associated with the applicability of existing research to the analysis of public technology policy. Several recent reviews of the literature potentially applicable to better understanding of technological innovation in state and local government agencies--organizational behavior, economics, the diffusion studies, public administration, management science, technology transfer, organizational change—reveal the inability of existing theory to adequately explain or predict patterns of adoption, use, and rejection of innovations by state and local governments.[10]

What's the Problem: Innovation vs. Problem-Solving

The "innovativeness" of organizations or individuals can refer to several different phenomena. From the perspective of diffusion research, innovativeness usually refers to early or frequent adoption of products, processes, or services that are perceived as new by members of the adoption unit.[11] Alternatively, much of the literature on research and development activities in private firms focuses on innovation as the successful development and marketing of new products and industrial processes. Sociologists frequently encompass innovation within the broader framework of organizational change. Rowe and Boise[12] outline major unresolved definitional issues:

1. whether to include the generation of new ideas as well as their acceptance and implementation;
2. whether to restrict the definitions to organizations which are the first to adopt among a set of similar organizations;
3. whether to require that the introduction of new ideas, etc., be followed by successful implementation;
4. whether to require that the decision to innovate be made within an organization.

Additional problems arise because of the lack of a theoretically meaningful typology of innovations. In the absence of such a typology, one cannot say whether early adoption of a "trivial" innovation is more innovative than later adoption of a "significant" one; nor can one say whether the adoption of fifteen innovations of one kind is more innovative than the adoption of five innovations of another.[13] An additional complication occurs if one asks whether an organization that adopts an innovation inappropriate to its goals is more or less innovative than a similar organization that adopts the same innovation for "appropriate" reasons.

These problems spotlight the sterility--from both a theoretical and practical point of view--of the concept of "innovativeness." What matters is not that an individual or organization adopts an innovation, but whether the innovation is used, how it is used, and how its adoption and use are linked to the satisfaction of a need or solution of a problem. Existing conceptualizations in the innovation literature, then, lead us to the conclusion that useful research must address the link between the adoption of innovations and the consequences of adoption for organizational or individual problem-solving.

A similar conclusion is reached if the documented experiences of federal programs related to public technology are considered. Through the decade of the 60's numerous programs attempted to increase the utilization of the results of federally supported R&D.[14] These programs ranged from "spinoff" efforts such as NASA's Technology Utilization to the research utilization activities of social service agencies such as the Office of Education, Manpower Administration, and Social and Rehabilitation Service.[15] As experience with these programs accumulated, emphasis shifted from passive information dissemination to active efforts such as field offices, research utilization specialists, demonstrations, adaptive engineering, and other forms of technical assistance.

The Law Enforcement Assistance Administration's Pilot Cities Program was one of these active efforts to provide technical assistance to local governments. As originally conceived, the program called for the establishment in eight cities of a team of researchers and professional analysts who would facilitate the introduction and use of law enforcement innovations in the local setting. An evaluation of the program, conducted after more than five years had passed since the first site was funded, came to the following conclusions:

1. Innovation is often unnecessary to improve local law enforcement systems. This is because what is known about law enforcement and criminal justice far outstrips what is generally practiced.

2. Innovations tend to deal with issues in the periphery of law enforcement/criminal justice needs. Teams characteristically had to choose between dealing with a central law enforcement/criminal justice issue or producing a genuine innovation.[16]

The National Science Foundation has supported a number of projects intended to demonstrate ways of introducing new technology into cities and states. The California Four Cities Program, jointly sponsored by NSF and NASA, placed aerospace professionals in four California cities for several years to find out if aerospace technology could be used to help solve municipal problems. A GAO study of the program concluded that technically trained persons in city managers' offices could contribute significantly to the solution of city problems, but that aerospace hardware technology applications were practically nonexistent in the four cities. In fact, the technology advisers' primary contributions involved management skills and problem analysis.[17]

These two examples illustrate from a programmatic perspective the potential conflict between efforts to stimulate innovation in state and local governments and efforts to help solve their problems. This is not to say that innovation and problem solving are invariably at odds; there are too many examples of how innovations in cities have produced cost savings and other evidence of increased productivity for this to be the case.[18] The problems arise when either innovation theorybuilders and researchers or public technology policy makers forget that what matters about innovation is its consequences, not innovation *per se*.

What's the Problem: Demand, Supply, or Infrastructure

To the extent that the public technology "problem" can be associated with an unwillingness or inability of users--state and local government officials--to adopt and use new products and techniques, it is a demand problem and federal policies should be directed toward the system of incentives that affect local officials' decisions. To the extent that manufacturers and federal agencies produce ideas and techniques and products that are too complex, too expensive, or unrelated to state and local needs and priorities, then one can say there is a supply problem, and federal policies should be directed toward increasing the responsiveness of innovation suppliers to state and local needs. If users are willing to innovate and suppliers are eager to respond, but the flow of information to suppliers about needs and the flow of new ideas, techniques and products to users do not occur, one can say there is a communications (infrastructure) problem, and federal policies should be directed toward building or strengthening the communications networks that link suppliers with users. This section discusses the evidence that exists to support each of these explanations of the public technology problem.

What evidence exists to confirm or disconfirm the argument that state and local governments are inherently resistant to innovation (i.e., it is a demand problem)? William Baumol[19] argues that the gap between wage levels and service levels in the public sector (and in cities in particular) will continue to widen inexorably because of conditions endemic to what he calls the "nonprogressive" sector of the economy. He argues that this sector, because it is intrinsically labor-intensive, is largely denied the usual routes to productivity increase--capital accumulation, economies of scale, and technological innovation--and therefore the possibility is reduced that wage increases will be offset by increases in productivity. Baumol is not alone in his belief that public sector organizations are relatively immune to significant productivity increases, especially increases that result from innovative behavior. In making theoretical links between innovativeness and economic sector, economists begin with theories of market efficiency, organization theorists begin with analyses of bureaucratic behavior, and political scientists begin with the ways citizen demands for democratic accountability are translated into the institutional arrangements and legal constraints which form the context of public organizations. Each approach leads from different origins to a common expectation: public organizations are probably less innovative than private organizations.[20] Literature based on the experiences of public officials has tended to support this theoretically based conclusion.[20a] The findings described below are those of recent, systematic research efforts to improve understanding of innovation in state and local governments. For the most part they tend to question the conclusions of earlier work.

There is evidence that public sector organizations operate under a different set of incentives than their private sector counterparts, and that these differences may lead to misleading conclusions concerning the innovativeness of public organizations. For example, studies of the diffusion of technologies among industrial firms assume implicitly that potential adopting firms have common technical problems, an assumption that often is unwarranted in the case of city and state agencies.[21] The efficiency with which public agencies provide services (production efficiency) can be viewed as the analog of private sector profits, but the major incentives that affect public officials may be more numerous and complex than in private firms.[22] The "performance" of public agencies frequently is judged by criteria such as responsiveness, representativeness, openness, equitable treatment of clients, and accountability; production efficiency is only one of a large number of frequently conflicting organizational goals. Robert Yin has postulated the existence of two innovation processes operating in government organizations: one driven by incentives related to improvements in organizational efficiency or the quality of service output, the other driven by bureaucratic self-interest.[23] Yin argues that bureaucratic interests play a far larger role in public organizations than in private ones. Clearly, it is exceedingly difficult to disentangle the relative influence of efficiency, performance, and bureaucratic self-interest factors in explaining decisions to innovate in public agencies. The point here is that observers of public sector organizations may be prone to mistakenly label nonperformance-related decisions as noninnovative decisions.

In a major study of the diffusion of innovations among cities, Irwin Feller and Donald Menzel present diffusion curves for 43 technologies in four different local government service areas (traffic, fire, air pollution, solid waste), based on survey data collected from agencies in 810 cities with population 25,000 and above.[24] Comparing qualitatively these city diffusion curves with those obtained from diffusion studies of private firms, the authors observe that both the shape and slope of the curves obtained are similar. They conclude that the lack of responsiveness of city agencies to new technologies has been overstated.[25]

The same authors reached a similar conclusion in an earlier, more limited study of the diffusion of technologies among state agencies.[26] Other studies by Bingham[27] and by Russell and Burke[28] also suggest that state and local government agencies are not as slow to adopt innovations as has frequently been suggested.

While these findings add some badly needed correction to the common wisdom concerning the innovativeness of state and local governments, they do not diminish the fact that major, institutional factors constrain the ability of public officials to innovate. Many of these constraints were documented in detail by Frohman, et al., in the case of one type of local government service, the fire services.[29] At a more general level, several institutional features of public organizations are generally agreed to act as disincentives for public officials to innovate.[30]

1. The democratic accountability of government agencies to clients, legislative bodies, and higher levels of government means that, relative to private firms, public agencies are less capable of independent action than their private counterparts. There exist multiple, extra-agency appeal routes for displeased subordinates.
2. Top leadership changes are both more frequent and more farreaching in public agencies than in private firms. The short tenure of most elected public officials means that political survival is dependent upon production of short-run, highly visible results. Programs to produce these kinds of results must be low-risk and quick payoff, characteristically not the attributes of innovative activities.
3. The client or constituent groups of public agencies tend to be more heterogeneous than those of private firms, particularly in the sense that demographic characteristics such as age, race, education, and health all have political implications. Because the values, interests, and reward structures of public agency constituents vary so much, and because public decisions are so visible, significant changes are difficult to effect.

4. Since public agency outputs are not evaluated in external markets, it is difficult to develop objective performance measures and to specify goals and functions operationally. The consequent lack of clarity of goals and objectives makes it difficult to develop incentives to perform and favors highly visible but superficial change over change that might significantly affect service effectiveness or efficiency in the longer term.

Regardless of how receptive state and local governments are to new technology, the rate of technological change in government--the rate at which old or obsolete products and techniques are replaced by newer, improved versions--could be low if the rate of supply of innovations for the state and local government market is low, or if the innovations offered to this market do not match the pattern of demand. There is a some evidence that both these conditions exist, at least in a few specific areas of state and local government services.

In their study of innovation in the fire services, Frohman, et al., analyzed data on 99 manufacturers and 398 distributors of fire equipment. They found that firms selling primarily to the fire service market are small, financially weak, and unable to obtain outside financing for product development activities.[31] Though large firms capable of conducting R&D do market products to the fire services, for these firms this market is not a major one and product development investment tends to be oriented toward markets more profitable than the fragmented fire service market.[32] Similar results were obtained by Radnor in his study of the law enforcement R&D system,[33] who concluded that "law enforcement cannot, by itself, be a large enough market to make anything other than very small companies profitable unless they deal in other markets as well."[34]

A careful analysis of data from a sample of nearly 200 heads of firms in the Delaware Valley (Philadelphia, Pennsylvania area) revealed a number of features of industrial participation in and attitudes toward the municipal market.[35] The impact of the local/municipal government market in the Delaware Valley appears to be small relative to other markets: municipalities represent an insignificant or minor share of business for firms in the Valley. Responding firms also indicated that their major marketing efforts are not directed toward municipal markets; the author suggests that this limits the exposure of municipalities to innovative technologies.[36] Additional interviews with sixteen of the most active local venture capitalists revealed that "few of the venture capitalists recognize municipalities and local governments as a promising market for ventures based upon technological innovation."[37]

This gloomy picture is mitigated somewhat by the fact that it does not hold uniformly across all government service areas. Feller's study of the diffusion of highway and transportation innovations among states showed, at least with respect to impact absorption devices, a high level of innovative behavior among the relevant firms and vigorous marketing to the state highway departments.[38] Feller and Menzel's more recent study of diffusion at the municipal level showed that firms do exercise independent influences on the rate and patterns of diffusion of new technologies among cities, and that these influences include the location of firms in different regions, firm resources, and marketing networks.[39]

The Federal Government is another potential source of innovations intended for use by state and local governments. Some domestic agency R&D programs were created to provide results useful to state and local government practitioners (e.g., teachers, vocational rehabilitation workers, water pollution control agents), and the growing number of technology transfer and research utilization programs and activities reflects increased efforts to get the products of this federal R&D used.[40] Unfortunately, few systematic studies of these efforts have been done that would enable conclusions to be drawn about how responsive they are to the needs of their state and local government clients. Scattered case analyses and a recent Rand Corporation study of federal demonstration projects do not offer grounds for optimism, however.[41] Possible reasons for the lack of evaluations of these kinds of programs include the difficulty in developing program effectiveness criteria, the cost of conducting surveys of state and local government users, and agency concern that the results might be embarrassing.

It does appear, then, that there is a "supply" problem, but it is due more to the fragmented state and local market than to the unresponsiveness of the private firms to state and local needs. In other words, if the market were more attractive, it appears that private manufacturers would respond with more aggressive marketing efforts, larger investments in R&D, and a portfolio of projects more responsive to the state and local market. Impressionistic evidence suggests that federal agency suppliers, for whom market profitability is not an immediate concern, have difficulty accurately identifying state and local government needs, using those needs to plan R&D programs, and stimulating the widespread use of federal R&D products.

Suppliers and users are necessary but not sufficient ingredients in any system which provides innovations responsive to state and local government needs. Needs must be communicated to suppliers; products must be advertised; regulations and standards must be set, communicated, and enforced; and evaluative information about new products and techniques needs to be shared among users. Where "users" are state and local government agencies, key components of the infrastructures which perform these functions include public interest groups (e.g., the International City Management Association), professional associations (e.g., the American Public Works Association), trade associations (e.g., National Association of Wholesaler-Distributors), standard-setters and product evaluators (e.g., National Bureau of Standards, the National Fire Protection Association) and the myriad distributors of industrial products. Except in scattered cases, little is known about how these kinds of organizations act to facilitate or inhibit the adoption and use of new technologies by state and local agencies.

Professional associations appear to be a key component of the communication networks that operate horizontally among similarly-placed state and local officials in different cities and states, and vertically among functional area counterparts at the local, state, regional, and federal levels. Feller, Menzel, and Engel[42] observed that state highway and transportation departments are part of a strong, tightly integrated network that includes organizations such as the American Association of State Highway and Transportation officials and the Transportation Research Board of the National Academy of Sciences, but that analogous organizations in the air pollution field either do not exist or do not perform intermediary roles as effectively.

Similar contrasts appear to exist at the local government level. Limited evidence suggests that an effective "grapevine" operates among fire chiefs and other fire officials, who rapidly pass around information about the existence of new products and techniques in the fire services.[43] This informal network also functions, but not as effectively, to transmit information about how well these new products or techniques actually work. The perceived importance of rules, regulations, and laws enacted at different levels within the federal system varies widely across the fire services, traffic, air pollution, and solid waste.[44] Differences also exist among the four functional areas with respect to their perceptions of the importance of information from different sources and its adequacy for assessing new technical innovations.[45]

Assessments of Federal Intervention Strategies

Federal agencies have launched dozens of programs, demonstrations, and "quasi-experiments" as parts of efforts to develop workable arrangements that will facilitate the application of new technology to state and local government problems. The range of strategies employed is wide; a small sampling includes: placing technically-trained persons in city managers' offices and providing them with institutional backup from industries, research organizations, and universities; developing and demonstrating computerized information systems in several cities; forming a consortium of federal laboratories; forming a consortium of large cities and urban counties in order to aggregate public sector markets; introducing new procurement procedures such as life cycle costing and performance specifications into state and local practice; and establishing "user needs" committees to communicate state and local agency needs and concerns to federal policy makers. The sheer amount and variation of these activities is overwhelming, reflecting in part variations in agency mandates and clientele and in part uncertainty about which strategies work under which conditions. Though the level of activity is high and there is great interest among policy makers in learning about what works and why, there has been virtually no systematic effort to read across these various programs and activities, assess their effectiveness, and analyze the factors associated with success and failure. Moreover, only the most rudimentary data base for such an assessment exists. Much has been written about these programs and activities, but this literature contains very little that could be described as hard, objective evaluation.[46]

Until such cross-cutting analyses are performed, public technology policy analysts must draw upon the kinds of studies of local government behavior that have been cited above. Few of these studies were intended to shed light on the efficacy of one or another federal intervention strategy or program; rather, they were intended to provide public policy makers and analysts with better understanding of the incentives and influences that act upon state and local government officials as they decide whether to consider, adopt, or reject innovations. The improved understanding that these studies have provided forms a basis for drawing tentative conclusions about federal strategies for facilitating the development and use of new technology state and local governments.

While it is clear that the financial resources provided by federal programs enable state and local governments to purchase innovations they otherwise would not, at best a tenuous link exists between federal support for a specific innovation and the "appropriate" adoption and implementation of that innovation.[47] This is not to say that federal programs are unimportant for providing a larger pool of resources that can be drawn upon in specific cases, or that they do not help create a more innovative local climate. When the decision processes of local government officials are scrutinized carefully, it is apparent that decisions to adopt or reject specific innovations are the result of a process in which problems and potential solutions become increasingly concrete and specific over time, and that when a new product is identified as an appropriate solution, resources are obtained from any one of a number of sources and budget categories, fuzzying up any direct link between individual federal programs and the innovative solutions chosen.[48]

Both agency performance improvement (e.g., lower crime rates, improved productivity) and bureaucratic self-interest (e.g., growth, prestige, visibility) are important incentives acting on state and local government officials, and their relative strengths as explanators of innovation decisions depends heavily on large number of localized conditions such as the level of slack (relatively unprogrammed) resources, the service area involved, and the nature of the innovation itself.[49] Moreover, the "objective" needs or requirements of state and local government jurisdictions for a specific innovation differ widely. A city or state may not have the problem the innovation is designed to address, has solved the problem by another technique, or chooses to use its resources on the solution of other problems.[50] Even when different cities decide to adopt the same technology, they frequently do so for quite different reasons or use the technology differently.[51] Within the same city agency the relative significance of performance-related and self-interest reasons for innovation decisions can vary widely across different innovations.[52]

Summary and Implications for Public Technology Policy

A demand, supply, infrastructure approach to the analysis of public technology policy issues suggested that there are problems, and hence opportunities for improvement, in all three areas. State and local government agencies evidently will respond favorably, and rapidly, when exposed to a new technology or technique that addresses a priority problem as they define it and is accompanied by credible information about implementation problems, performance, and consequences. The unique institutional context of public organizations means that problems and priorities will vary widely across cities and states that on the surface appear similar; the social and political demography of their citizens differ, their laws and regulations differ, and traditions concerning the appropriate role of government and citizen-government interaction differ. The highly localized nature of problem definition and priority-setting also means that there is a long incubation period for innovations before they become widely accepted; in some cases this is due to the lack of an effective or credible source of evaluative information, in others because of the lack of an effective communications network among practitioners, in others because the innovation requires a large amount of adaptation to local conditions.

The institutional context of public organizations also has implications for the rate of supply of innovations to the public market. Public accountability requirements in purchasing decisions, coupled with the large diversity of local needs, creates a fragmented market in many state and local government service areas. Private firms do not regard this market as profitable relative to other markets, and the low profit margins that result from limited markets and competitive bidding requirements do not encourage investment in new product development. The situation summarized here and detailed in the chapter suggests that federal public technology policy should emphasize certain strategies.

Whenever a federal agency's mandate and political climate permit, it should avoid attempting to develop and foster the utilization of particular "solutions"--technologies, techniques, or systems--and work toward building the analytic and evaluative capabilities of its state or local government clientele. Given the difficulty of specifying common needs of state and local governments, communicating these to federal agencies, incorporating them in R&D and technical assistance programs, and disseminating the results of R&D projects, it would appear to be far more efficient and effective to bolster the ability of local decision makers to define their problems in technical terms, identify alternatives that may or may not include innovative solutions, and evaluate alternatives themselves or have the expertise to buy useful evaluative information from the outside. This type of strategy will have the additional benefit of sharpening the nature of state and local government demand for new products, possibly resulting in some aggregation of local markets.

Recent research and experience concerning the innovative behavior of state and local officials suggests that the most effective way to improve these officials' technical capability is to utilize what Robert Yin calls "natural" points of entry into the incentive system in which

<u>they live.</u>[53] Natural points of entry are those groups and activities toward which state and local officials look for rewards and cues for action. They include professional communications networks, particularly public interest and clientele groups such as the International City Management Association and the National Association of State Purchasing Officials, and colleagial networks made up of acquaintances in neighboring jurisdictions or in jurisdictions looked to for leadership in the technological or problem area involved. Other natural points of entry are the tests used in government personnel systems as bases for promotion, and the curricula used in education and training programs for public management positions. Ensuring that the latest accepted analytic methods and management techniques are part of the curricula of the schools that produce public managers, and introducing the latest accepted ideas, practices and techniques into civil service examinations for higher positions in fire departments, policy departments, etc., should have salutary effects on local officials' awareness and use of the best available techniques and information. Similarly, some professional associations could be stimulated through federal action to upgrade their efforts to evaluate innovations and communicate the results to their clients, or develop and disseminate training and educational materials that utilize current, best practice techniques. Finally, federal grants could be used more extensively than at present to help upgrade the scientific and technical capabilities of state legislatures through the support of in-house analytic staffs.[54] It is worth pointing out, however, that heavy

federal involvement with professional associations and public interest groups can lead to loss of these groups' independence, and hence their credibility with their clients.

If a federal agency is faced with the problem of disseminating specific technologies or techniques to state and local governments, some strategies may be more effective than others. First, to the extent possible, agencies should focus on the process by which they select research and development projects. Analyses of federal demonstration and civilian R&D programs[55] revealed that project failures were frequently associated with the absence of any prior assessment of the demand for the product or technique at an early state in R&D planning. Market analysis evidently needs to become a far more common practice in federal civilian R&D agencies than is now the case. Second, and relatedly, agencies need to be aware of the strengths, weaknesses, and operation of the innovation system or systems in which their primary client groups exist. For example, decisions by the Law Enforcement Assistance Administration to support the development and demonstration of new, lightweight body armor requires information about the roles and behavior of the International Association of Chiefs of Police, police unions, standards agencies, body armor manufacturers, and distributors. Any reasonably complete market analysis of the likely demand for lightweight armor would require information about the behavior and interaction of each of these involved parties with respect to new products.

These suggested strategies may not be looked upon with favor by federal agencies. They tend to be long term in their effects (e.g., changing curricula in schools of public management, changing questions on civil service examinations), and most of the benefits of building state and local capacities are intangible relative to measures such as the number of pieces of information requested or technologies in use. Perhaps most problematic from the federal agency perspective is that increased analytic capability at the state and local levels may mean increased rejection of the technologies offered by federal agencies.

Current trends suggest that the locus of control for federal agency decisions on what R&D projects will be done, for whom, how they shall be packaged, and how they shall be disseminated will shift from the agency closer to the intended client: greater influence will be manifested by professional associations, advisory groups, and public interest groups. The Cooperative Extension Service of the Department of Agriculture and the Federal Highway Administration in the Department of Transportation represent agencies whose locus of control has shifted considerably from the federal official to the state or local client. The benefits, costs, and peculiarities of such arrangements need to be explored carefully as U. S. public technology policy follows the direction of the New Federalism's successor.

Footnotes

1. U. S. Congress, House Committee on Science and Astronautics, Toward a Science Policy for the United States, Committee Print, 91st Congress, 2nd Session, October 15, 1970.
2. President's Message to the Congress, March 16, 1972.
3. Federal Council for Science and Technology, Public Technology: A Tool for Solving National Problems (Washington: USGPO, 1972); Council of State Governments, Power to the States--Mobilizing Public Technology (Lexington, Kentucky: Council of State Governments, 1972); The Urban Institute, The Struggle to Bring Technology to Cities (Washington: The Urban Institute 1971); Action Now, Partnerships--Putting Technology to Work, Report of the National Action Conference on Intergovernmental Science and Technology Policy, Harrisburg, Pennsylvania, June 21, 22, 23, 1972, (Pennsylvania Office of Science and Technology, August 1972).

3a. As used here, public technology refers to federal government efforts to stimulate the development, dissemination, adoption, and implementation of new products, systems, or managerial and analytic techniques by regional state, and local governments.

4. National Science Foundation, Directory of Federal Technology Transfer (Washington: National Science Foundation, 1975), NSF 75-402.
5. W. H. Lambright, Governing Science and Technology (New York: Oxford University Press, 1976), p. 187.

5a. It is worth noting that Federal antitrust, tax, patent, and economic policy may have as much or more impact on the rate and direction of technological innovation as programs intended to apply direct

influences. See Technological Innovation and Federal Government Policy, Research and Analyses of the Office of National R&D Assessment, National Science Foundation, January 1976, NSF 76-9.

5b. A. Schick, "The Intergovernmental Thicket: The Questions Still are Better Than the Answers," Public Administration Review, Special issue, December 1975, pp. 717-722.

6. Executive Office of the President, Strengthening Public Management in the Intergovernmental System, Report prepared for the Office of Management and Budget by the Study Committee on Policy Management Assistance, (Washington: National Science Foundation, 1975), NSF 75-600.

7. Ibid., pp. 1-5.

7a. National Science Foundation, Federal Technology Transfer: An Analysis of Current Program Characteristics and Practices, Report to the Committee on Domestic Technology Transfer, Federal Council for Science and Technology, (Washington: National Science Foundation, 1976), NSF 76-400.

8. National Science Foundation, Office of National R&D Assessment, Official Program Plan for Support of Extramural Research, FY 1974, FY 1975, FY 1976.

9. J. D. Roessner, "Policy Options for Public Technology," in Serving Social Objectives Via Technological Innovation: Possible Near-Term Federal Policy Options, National Science Foundation, Office of National R&D Assessment, May 1973.

10. J. D. Roessner, "Innovation in Public Organizations," presented at the National Conference on Public Administration, Syracuse, New York, May 1974; E. M. Rogers, "Innovation in Organizations: New Research Approaches," Presented at the Annual Meeting of the American Political Science Association, San Francisco, September 2-5, 1975; P. Berman and M. McLaughlin, Federal Programs Supporting Educational Change, Volume I: A Model of Educational Change, the Rand Corporation, R-1589/1-HEW, September 1974; E. R. House, The Politics of Educational Innovation (Berkeley: McCutchan, 1974); K. E. Warner, "The Need for Some Innovative Concepts of Innovation: An Examination of Research on the Diffusion of Innovation," Policy Sciences 5 (1974), pp. 433-451; G. W. Downs, Jr., and L. B. Mohr, "Conceptual Issues in the Study of Innovation, Administrative Science Quarterly, December 1976, pp. 700-714.

11. E. M. Rogers and F. F. Shoemaker, Communication of Innovations (Free Press, 1971).

12. L. A. Rowe and W. B. Boise, "Organizational Innovation: Current Research and Evolving Concepts," Public Administration Review, vol 34, no. 3, (May/June 1974).

13. See Downs and Mohr, op. cit., and R. Eyestone, "Confusion, Diffusion, and Innovation," American Political Science Review (forthcoming).

14. S. I. Doctors, The Role of Federal Agencies in Technology Transfer, (Cambridge: MIT Press, 1969).

15. R. G. Havelock and D. S. Lingwood, R&D Utilization Strategies and Functions: An Analytical Comparison of Four Systems, Institute for Social Research, University of Michigan, 1973.

16. C. A. Murray and R. E. Krug, The National Evaluation of the Pilot Cities Program, American Institutes for Research, November 1975, National Institute of Law Enforcement and Criminal Justice, Contract No. J-LEAA-016-74, pp. 178-179. It should be noted that the "failure" of the Pilot Cities Program was due largely to implementation problems rather than to flaws in the basic design of the program. The finding that innovation and problem solving were frequently incompatible was an important finding but does not account for the failure of the program.

17. Comptroller General of the United States, Technology Transfer and Innovation Can Help Cities Identify Problems and Solutions, PSAD-75-110, August 6, 1975.

18. National Commission on Productivity, Third Annual Report (Washington: National Commission on Productivity, 1974); E. K. Hamilton, "Productivity: The New York City Approach," Public Administration Review, vol 32, no. 6 (November/December 1972), pp. 784-795.

19. W. J. Baumol, "Macroeconomics of Unbalanced Growth: The Anatomy of Urban Crisis," American Economic Review, vol 57, no. 3, (June 1967), pp. 415-426.

20. For an elaboration of these arguments, see J. D. Roessner, "Incentives to Innovate in Public and Private Organizations," Administration and Society, May 1977 (forthcoming).

20a. For examples of this literature, see T. W. Costello, "Change in Municipal Government: A View from the Inside," in L. W. Rowe and W. B. Boise, eds., Organizational and Managerial Innovation:

A Reader, (Goodyear, 1973); F. O'R. Hayes, "Innovation in State and Local Government," in F. O'R. Hayes and J. E. Rasmussen, eds., Centers for Innovation in the Cities and States, (San Francisco Press, 1972); Urban Institute, The Struggle to Bring Technology to Cities, op. cit.

21. K. E. Warner, op. cit.; H. P. Utech and I. Utech, The Communication of Innovations Between Local Government Departments, Pilot Study for the National Science Foundation Office of National R&D Assessment, August 1974; Feller, Menzel, and Engel, op. cit.; Feller and Menzel, op. cit.

22. For a full discussion, see J. D. Roessner, "Designing Public Organizations for Innovative Behavior," presented at the Thirty-Fourth Annual Meeting of the Academy of Management, Seattle, Washington, August 20, 1974; and Roessner, "Incentives to Innovate in Public and Private Organizations," op. cit.

23. R. K. Yin, et al., A Review of Case Studies of Technological Innovations in State and Local Services, The Rand Corporation, R-1870-NSF, February 1976, Final Report on National Science Foundation grant RDA 75-04134.

24. I. Feller, and D. C. Menzel, Diffusion of Innovations in Municipal Governments, Center for the Study of Science Policy, Pennsylvania State University, June 1976, Final Report on National Science Foundation grant DA-44350.

25. Ibid., p. 256.

26. I. Feller, D. C. Menzel, and A. Engel, Diffusion of Technology Among State Mission-Oriented Agencies, Center for the Study of Science

Policy, Pennsylvania State University, October 1974, Final Report on National Science Foundation grant DA-39596.

27. R. D. Bingham, The Adoption of Innovation by Local Government (Lexington, Massachusetts: D. C. Heath, 1976).

28. L. B. Russell and C. S. Burke, Technological Diffusion in the Hospital Sector, National Planning Association, October 1975, Final Report to the National Science Foundation, grant RDA 75-14274.

29. A. L. Frohman, Jr., M. Schulman, and E. B. Roberts, Factors Affecting Innovation in the Fire Services, Report to the National Bureau of Standards, Contract 1-35905, March 1972.

30. Taken from Roessner, "Designing Public Organizations for Innovative Behavior," op. cit.

31. Frohman, Schulman, and Roberts, op. cit., pp. 18-24 and 121.

32. Ibid., p. 121.

33. M. Radnor, Studies and Action Programs on the Law Enforcement Equipment R&D System: Evaluative Study of the Equipment Systems Improvement Program, Northwestern University, January 31, 1975, Report to National Institute for Law Enforcement and Criminal Justice, Grant No. 74-NI-99-0004-G.

34. Ibid., vol II, p. 298.

35. J. F. Blair, Jr., Industry, Innovation and the Municipal Market, The Franklin Institute Research Laboratories, October 15, 1973, Final report on U. S. Department of Commerce grant F-C3431.

36. Ibid., p. 11-25.

37. Ibid., p. 11-86.

38. Feller, Menzel, and Engel, op. cit.

39. Feller and Menzel, op. cit., p. 277.

40. Directory of Federal Technology Transfer, op. cit.

41. W. S. Baer, et al., Analysis of Federally Funded Demonstration Projects: Final Report, Rand Corporation, R-1926-DOC, April 1976, Final report to the Experimental Technology Incentives Program, Department of Commerce contract no. 4-35959; and D. S. Green, et al., Management of Federal Civilian R&D Programs. Phase I Review and Approach for Phase II, Stanford Research Institute, May 6, 1976.

42. Feller, Menzel, and Engel, op. cit.

43. Utech and Utech, op. cit.

44. Feller and Menzel, op. cit., p. 185.

45. Ibid., p. 177.

46. For example, see F. R. Hayes and J. R. Rasmussen, (eds.), Centers for Innovation in the Cities and States (San Francisco: San Francisco Press, 1972); and National Science Foundation, 1974), NSF 74-50.

47. Yin, et al., op. cit., p. 143.

48. See, generally, Feller and Menzel, op. cit.; the case studies in Bingham, op. cit.; W. H. Lambright, Adoption and Utilization of Urban Technology: A Decision Making Study, Syracuse Research Corporation, Interim report to the National Science Foundaton

on NSF grant RDA 75-19704, January 1977. and J. D. Eveland, E. M. Rogers, and C. Klepper, The Innovation Process in Public Organizations. Department of Journalism, University of Michigan. Final report to the National Science Foundation on NSF grant RDA 75-17952, March 1977.

49. Yin et al., op. cit.; Feller and Menzel, op. cit.

50. Feller, Menzel, and Engel, op. cit.; Bingham, op. cit.; Utech and Utech, op. cit.

51. Feller and Menzel, op. cit.

52. Lambright, op. cit.

53. R. K. Yin, "R&D Utilization by Local Services: Problems and Proposals for Further Research," The Rand Corporation, R-2020-DOJ, December 1976.

54. See D. C. Menzel, R. S. Friedman, and I. Feller, Development of a Science and Technology Capability in State Legislatures: Analysis and Recommendations, Center for the Study of Science Policy, Pennsylvania State University, June 1973, Final report on National Science Foundation grant GT-34868. The National Conference of State Legislatures has an active Office of Science and Technology that provides scientific and technical support to state legislatures.

55. Baer, et al., op. cit.; Green, et al., op. cit.

PREPARED STATEMENT OF STEPHEN B. FARBER, DIRECTOR, NATIONAL GOVERNORS' ASSOCIATION

Chairman Reuss, Chairman Moorhead, and members of the House Subcommittee on the City and the Joint Economic Committee, I appreciate the opportunity to appear before you today on behalf of the National Governors' Association, the policy instrument of the nation's Governors.

Your hearings on efforts to limit taxes and expenditures, and their implications for fiscal federalism, are timely and important. Since the passage of Proposition 13 on June 6 by the voters of California, taxpayers and public officials in every state have been grappling hard with the problems and the opportunities created by efforts to limit taxes and expenditures. The issues involved are in great need of less heat and more light. These hearings can help develop the sound and reliable base of information required for a better informed consideration of the issues.

In my statement today I would like to address four fundamental questions:

1. What is the actual fiscal condition of the states?

2. What constructive steps have states taken in the past, and are they now taking, to provide greater financial assistance to their local governments?

3. What constructive steps have states taken in the past, and are they now taking, to limit taxes and expenditures?

4. What effects will tax limitation efforts have on the state and national economies and on the delivery of services?

The first question -- what is the actual fiscal condition of the states? -- is of crucial importance. I regret to say that there is widespread error and confusion on this point -- despite the best efforts of the National Governors' Association, the National Conference of State Legislatures, the National Association of State Budget Officers, and others -- and it is high time to set the record straight.

Notwithstanding the data contained in the NGA-NASBO Fiscal Survey of the States, the prevailing myth in some quarters is that there is a massive "surplus" in the states in the range of $30 billion. This figure has been taken out of context from the President's Economic Report of last January and from the national income and product accounts of the Commerce Department's Survey of Current Business which have preceded and followed it.

The reality, as opposed to the myth, of the state "surplus" -- or more accurately, the states' general fund operating balance -- is quite different.

First, the general fund operating balance of state and local governments is not $30 billion. The $30 billion figure is actually a combination of what the Commerce Department calls "social insurance funds" and "other funds." The President's Economic Report notes that "a large part of the aggregate surplus represents accumlations of pension funds for the 13 million employees of state and local governments." The social insurance funds are not available to state and local governments to pay operating costs.

The most recent figures from the Commerce Department -- for the first quarter of 1978 -- show $19.9 billion in "social insurance funds" and $11.5 billion in "other funds". These figures are significant for at least two reasons. First, they reflect the increasing efforts by state and local governments during the past three years to put their pension funds in order. Second, they show that of the total state-local "surplus", nearly two-thirds is unrelated to the current state-local fiscal condition as measured by operating balances.

Second, even the "other funds" category is misleading because it includes a significant amount of restricted revenues -- for highways, parks, and other purposes -- not available for general fund expenditures. The aggregate state government general fund operating balance, as of the first quarter of 1978, was projected at six billion dollars, and reflects sound budgeting practices. Commerce Department figures released in May indicate that the local share of "other funds" has generally been larger than the state share since 1970. In 1976, for example, "other funds" for local governments were $2.6 billion and for state governments, $1.2 billion. During the first quarter of 1978 local governments appeared to have an operating balance of approximately the same size as state governments -- that is, in the range of $6 billion.

The aggregate state operating balance represents less than 6% of the aggregate operating budgets of all states. Sound budgeting experience suggests that such a contingency is necessary to offset unexpected emergencies or financial difficulties. The 6% aggregate figure represents a slimmer margin for emergencies than many states normally seek to budget. Moreover, since nearly every state is requried by its constitution or statutues to have a balanced budget, such operating balances are imperative.

Third, the bulk of the aggregate state operating balance is found in just a few states, and in those states -- such as California, where Governor Brown and the legislature have acted decisively to deal with the impact of Proposition 13 -- the balances have already been largely committed. Most states have very modest or marginal balances. The balances reflect strong economies in energy- and food-producing states, the effects of more progressive revenue systems in an improving national economy, and inflation-induced revenue growth.

Fourth, the states' fiscal 1979 budgets will further reduce current balances. A substantial percentage of the balances which are reported by the states in our surveys will be spent in the fiscal year which began in most states on July 1. A preliminary survey of 29 states indicates that by the end of FY 1979, next June 30, operating balances will decline to four to five percent of general fund expenditures. The revenues will be used to support property tax relief programs, recession-delayed projects, inflation-caused cost increases for labor and materials, and hard-pressed local governments. Also requiring increased state financial support will be such needs as underfunded pension liabilities, equalization of school support, services for the handicapped, and maintenance and upgrading of the public infrastructure.

These demands will put existing balances quickly and efficiently back into the state economies. Moreover, far from acting as a "drain" on the economy -- as the President's Economic Reports suggests -- these resources will enable states to supplement federal efforts to further expand economic growth.

In short, the reality of state finances is significantly different from the myth. The surplus, as Barron's Magazine concluded in its May issue, is "vanishing" and "phantom." The aggregate operating balance for state governments is about $6 billion, or one-fifth of the commonly cited $30 billion figure, and is projected to be proportionately smaller -- perhaps by 30% -- by the end of FY 1979. The balances in most states are small and represent sound financial management. And far from acting as a drain on the economy, these balances will be either returned to citizens to reduce property taxes or re-invested in economic growth and development.

It is imperative that the current misunderstanding of state fiscal data be clarified. We have urged Chairman Schultze of the Council of Economic Advisers to work with us to improve reporting and data collection techniques for state government finances and to incorporate these data into the federal budget reports and the annual Economic Report of the President. And because many federal policy makers have seemed to interpert the state-local "surplus" figure in the national income and product accounts as the definitive measure of the fiscal condition of state and local governments, we have urged Secretary Kreps to include in the Survey of Current Business a short explanation of the "surplus" figure and its limitations as an indicator of fiscal condition. A copy of our letter to Secretary Kreps is attached for the record.

The impact of this information on the tax limitation debate, and on fiscal federalism, cannot be overstated. Misinformation on the fiscal condition of the states could well confuse, and perhaps even inflame, the tax limitation debate. And as the night follows the day, inaccurate data will lead to unsound public policy. It is frankly high time to consign the myth of the massive state surplus to the oblivion it deserves. As Governor William G. Milliken, Chairman of the National Governors' Association, has said, "Any one who claims that there are massive state surpluses is not familiar with the facts."

As the Administration and Congress consider the FY 1980 federal budget and examine longer-term issues, such as continued state participation in general revenue sharing, it is extremely important for options to be considered and decisions made on the basis of the reality -- not the myth -- of the states' fiscal condition.

Let me turn briefly to the three other fundamental questions before these hearings.

The first question is what constructive steps have states taken in the past, and are they now taking, to provide greater financial assistance to their local governments? Precise information about this increased state assistance, which has helped to restrict the growth of property taxes, is essential to informed debate over tax limitation strategies.

A report just completed by the NGA Center for Policy Research entitled <u>Allocation of State Funds to Local Jurisdictions</u> indicates that state support of local governments now totals $73 billion and has virtually doubled in the last 12 years, even after the impact of inflation is discounted. The report also shows that two-thirds of all state revenues go to support local governments and that state discretionary grants to local governments have increased twice as fast as overall state aid. As a resut local property taxes have steadily declined both as a percentage of total state-local revenues and as a percentage of personal income.

During the past twelve years, the report shows, state assistance to local governments in welfare has grown by 450%; in revenue sharing, by 409%; in education, where many states have acted dramatically to overhaul their school finance systems, by 240%; in highways, by 103%; and in health and hospitals, by 259%.

A related and equally important question is what constructive steps have states taken in the past, and are they now taking, to limit taxes and expenditures? On the tax side, almost every state has acted in the past three years to limit state and/or local taxpayer liability through increased credits, deductions, or exemptions. State circuit breaker programs, for example, now operate in 30 states and in 1977 returned $932 million -- an increase of 108% over 1974 -- to just over five million households -- an increase of 68% over 1974 -- for an average rebate of $184. On the expenditure side, tax expenditure limits of difference kinds have been set in Tennessee, New Jersey, Colorado, and Michigan and are pending in other states.

In short, the past several years have seen extensive state action to limit taxes and expenditures. The need now, as states consider new approaches in the wake of the passage of Proposition 13, is for proposals that are well considered and precisely targeted. To assist in this effort the NGA Center of Policy Research, in response to a suggestion made by Governor Ella Grasso and at the request of Governor Milliken, will serve as a clearinghouse to advise Governors on different approaches to tax and expenditure limitation and their impact on services.

A final question of basic importance is what effects will tax limitation efforts have on the state and national economies and on the delivery of services. The Congressional Budget Office has just completed a report on the impact of Proposition 13 on the national economy, federal revenues, and federal expenditures. That report is sobering and instructive. It argues that Proposition 13 will cause an employment loss of about 60,000 jobs by the end of 1978; a reduction in the national Consumer

Price Index of 0.2% by the end of 1978 and 0.4% by mid-1980; an increase in federal revenues of $600 million in FY 1979 and $900 million in FY 1980; and a potential reduction in California's participation in federal grant programs that have matching requirements, particularly in welfare, employment and training, education, and transit. The report further argues that "if such actions spread to a signficiant number of states, the impact on the nation's economy and the federal budget could become significant. Unless the reductions in taxes are at least twice as large as the accompanying slowdown or cut in expenditures, the net effect is likely to be a slowdown in economic activity and employment growth."

Whether or not one fully agrees with the report's data and conclusions, the message here is clear. We must insist on knowing the full impact of proposals to limit taxes and expenditures on the economy of the statesand the nation, and on the delivery of services, before, not after, they are adopted.

On this question, as on the others I have discussed, the stakes -- for responsible government and for fiscal federalism -- are extremely high. The National Governors' Association will continue to address these questions as fully and forthrightly as we can. We look forward to a continued close working relationship with the Administration and Congress in this effort.

National Governors' Association

William G. Milliken
Governor of Michigan
Chairman

Stephen B. Farber
Director

July 24, 1978

Honorable Juanita M. Kreps
Secretary of Commerce
Department of Commerce
Washington, D.C. 20230

Dear Madam Secretary:

As you may know, the National Governors' Association and National Conference of State Legislatures have expressed concern on several occasions about what appears to be a widespread misunderstanding of the meaning of the state-local "surplus" figure reflected in the national income and product accounts prepared by the Commerce Department's Bureau of Economic Analysis. Enclosed are some of the materials in which we have conveyed our concerns to members of the Administration, Congress, and the press.

Regrettably, the misunderstanding has persisted despite our efforts, and it appears to have the potential to influence public policy. This letter is to ask your assistance in a small matter that could go a long way toward clearing up this misunderstanding.

The heart of the problem is that many federal decision-makers have interpreted the state-local "surplus" figure in the national income and product accounts as the definitive measure of the fiscal condition of state and local governments. We are sure that your economists would agree that the national income and product accounts were not intended to measure the absolute fiscal condition of state and local governments and that they should not be used for this purpose.

We believe that it would be helpful if the Commerce Department would publish in the Survey of Current Business a short explanation of the precise meaning of the surplus figure and of its limitations as an indicator of fiscal condition. By way of example, the following language addresses the main points with regard to the figure's limitations:

> The size of state and local government surpluses, as reflected in the national income and product accounts, has attracted significant public attention in recent months. The following technical points should be kept in mind in interpreting this statistic:
>
> 1. The national income and product accounts are not a definitive measure of the fiscal condition of state and local governments. The accounts measure flows among sectors of the economy that generate income or product. The accounts thus provide income and expense information

but do not show state and local government balance sheets, which would be necessary to make informed judgments about fiscal condition. The accounts do not show, for example; the debt position of state and local governments nor do they reflect the condition of assets with regard to maintenance and replacement.

2. The accounts cover more than 80,000 governments, and aggregate trends can mask contrary conditions for even a majority of these governments.

3. The accounts show the net flow of social insurance funds as part of the state-local surplus although these funds are not available to state and local governments to pay operating costs.

4. The vast majority of state and local governments are required by constitutional provision or statute to operate on a balanced budget and are prohibited from borrowing to meet operating costs. In these governments, the ability to deal with contingencies may dictate the deliberate budgeting of a surplus.

5. A significant portion of state and local revenues is restricted by constitutional provision or statute to specific and narrow uses and is therefore not relevant to the fiscal condition of state and local government general operating funds.

6. The size of the state-local surplus as reflected in the national income and product accounts may be influenced by changes in the rate at which state and local governments spend for capital construction. These changes may be caused by external factors not significantly related to the fiscal condition of the governments.

An explanation along these lines in the highly respected Survey of Current Business would help ensure that the state-local surplus figure is not misunderstood and would therefore contribute to better-informed public policy.

Sincerely,

William G. Milliken

William G. Milliken
Governor of Michigan
Chairman, National Governors' Association

Jason Boe

Jason Boe
President, Oregon Senate
President, National Conference of State Legislatures