BUDGETING FOR BASICS:
THE CHANGING LANDSCAPE OF CITY FINANCES

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EXECUTIVE SUMMARY

Charged with providing myriad basic services, local governments are challenged by budget hurdles both cyclical and structural. Beyond the booms and busts of the economy, city finances are also often straitjacketed by wage and benefits agreements and taxpayer or legislative limits on the property tax, the largest source of municipal revenue.

Additionally, city financial structures vary widely across the nation. Some cities have responsibility for education, some can levy income taxes, and some charge a sales tax.

This study examines the finances of 162 cities from 1977—the year before California's momentous Proposition 13 tax cut sparked a national property tax revolt—to 2000. Further, survey data from 54 cities collected in 2004 gauges cities' responses to the recession of 2001.

Overall the paper finds that:

- **While direct federal aid to cities has declined since 1978, it has largely been supplanted with state aid**. Federal aid dropped from 17.5 percent of city general revenue in 1977 to 5.4 percent in 2000. Moreover, most state aid to cities has been for education needs. Cities also rely less on the property tax now than 30 years ago. Most city revenue growth has been through local income taxes, where permitted, local sales taxes, and user fees, the fastest growing category of revenues.

- **Spending in cities grew more slowly than at any other level of government.** For the cities in the study, per capita spending grew 35.1 percent from 1977 to 2000, compared to 73.4 percent for states. Education and police were spending priorities for cities, and debt service increased substantially. However, contrary to popular perception, salaries and wages shrank as a percentage of city expenditures since 1977.

- **Behind these broad trends lie different scenarios for each city, depending on their taxation tools and municipal responsibilities.** Cities with only the property tax received the largest increases in state aid and increased user fees faster than average. Cities with local sales taxes relied more upon that tool over time while receiving less state aid than average. Cities with an income tax have increased their reliance on that revenue over time as well. Because of their unique circumstances, cities in California are broken out into a separate category. Over time the importance of the property tax declined, while those cities increasingly used utility taxes and current charges to generate revenue.

- **The cities surveyed responded to the 2001 recession incrementally, hoping to avoid political pain.** Though cities increased spending in the 1990s, they also built reserves. In 2001, caught between declining revenues and increasing costs—especially for health care, education, and public safety—most respondents characterized their fiscal shortfalls as both

structural and cyclical in origin. Reductions in state aid were the leading source of fiscal pressure, followed by reduced fee revenue. To cope, cities most frequently cut general government expenses followed by education. Reserves were also often tapped to fill budget gaps, and a number of cities adopted creative measures to boost revenue and spend more efficiently.

Despite recent news of improving city budgets, municipal governments will forever be vulnerable to the vicissitudes of the economy unless structural change occurs in their revenue options. Though, like a good portfolio, city revenue sources are more diverse than ever, most of the budget fixes enacted in recent years were short term and one-time only. Most surveyed cities said they would like to expand services, but legislative tax limitations and an anti-tax electorate make such prospects remote.

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I. INTRODUCTION

Local governments in the United States deliver the most basic and among the most important services to the taxpaying public. They are the governments of first contact and last resort. Yet with balanced budget requirements, personnel-heavy expenditure commitments, dependence on often-unpredictable state aid, and revenue options limited by their respective states, city officials face the most difficult budgeting task of any level of government.

The challenges to city finance are both structural and cyclical. Structural factors have long-term ramifications that often limit cities' fiscal flexibility. Wages and benefits, for example, place continuous upward pressure on city budgets nationwide. Further, cities' demographic makeup and economic conditions can demand increasing expenditures on such things as education tailored to a large immigrant (and non-native speaking) population, or costly crime prevention efforts in high poverty neighborhoods. At the same time, cities in many states face taxpayer and/or state-imposed limits on the productivity of the property tax—the predominant source of municipal tax revenue. Overlaid on these structural challenges are cyclical forces that cause the availability of resources to ebb and flow. The most obvious of these forces is the fluctuating economy, which has a particularly significant revenue effect on cities heavily reliant on income and sales taxes.

This report examines how local governments have responded to these challenges over the last several decades, and more recently, while maintaining their ability to effectively serve their citizenry.

In order to place the current state of city finances within a broader perspective, the report begins by analyzing trends in public finance for 162 cities from 1977 to 2000. These years are significant for two primary reasons. First, 1978 marked the passage of California's Proposition 13, which spawned a modern day tax revolt primarily aimed at the property tax—local government's tax staple. Further, 1978 was the peak year for federal aid to cities, after which the majority of federal aid began flowing to people (through entitlements) rather than places (state and local governments).

As the trends for this period reveal, these changes had a significant impact on the public finance landscape, and cities entered the new millennium with dramatically different revenue structures than had been in place in 1977. They also faced a new series of fiscal challenges. Relying on survey data collected in 2004, the second half of this study examines how fifty-four of the sample cities have responded to the fiscal pressures generated by the recession of 2001, a slowdown in state aid, and continuing expenditure demands, including the escalating cost of health care and other benefits for city employees, and in many cities, pressure to spend more on K-12 education.[1]

[1] The survey analysis complements the "City Fiscal Conditions" reports put out annually by the National League of Cities. See, for example, Michael A. Pagano, "City Fiscal Conditions in 2004," (Washington: NLC, 2005).

Importantly, this study seeks to refine some of the previous analyses of city fiscal behavior. Reports of city finances often state that "the average city raises X percent of its budget from local income taxes," or "spends Y percent of its budget on K-12 education." But cities have differing revenue options and expenditure responsibilities which influence how they collect and spend their resources. To say that the average increase in local income taxes for cities was Z percent last year understates the increase for those cities with that revenue option, and is of no significance to all of those cities without it. The "average city" does not exist. This study analyzes city fiscal trends, conditions, and responses for relevant subgroups.

Ultimately, this paper seeks to inform several groups. Federal and state legislators responsible for designing urban policy can use the analysis to refine programs and policies to meet the distinct needs of specific city types. City officials can benefit from a consideration of what their colleagues in other cities have done. Finally, citizen/taxpayers may come to a better understanding of the fiscal issues faced by their own local governments, and thus be better able to participate in their governance.

II. METHODOLOGY

To understand *long-term* trends in city finances, and set the stage for an analysis of current fiscal conditions and response, the study uses Census of Governments data to analyze a sample of 162 cities with a population over 100,000 in 1977.[2] The year 1977 was chosen as it was the year *before* California's Proposition 13 ignited a nationwide tax revolt that had disproportionate impacts on states and cities. The year 2000 was selected due to the fact that in 2001 the Census reduced its sample size for city finances, eliminating many of the cities in the study.[3] Adding 1990 allowed for a demarcation of the fiscal changes during the relatively "boom" times of the 1990s. All years refer to fiscal years. All dollar figures are in 1977 dollars, using the NIPA state and local deflator.

In order to gauge the *current* fiscal state of cities, a survey was sent in February of 2004 to chief financial officers in the 162 cities that had populations over 100,000 in 1977.[4] The purpose was to obtain their impressions of the fiscal year that had ended—2003—and how their cities were faring approximately half-way through the then-current fiscal year 2004. The survey also captured how cities were responding to several recent downward trends, chief among them reductions in state aid. Valid surveys were returned by 54 cities, for a response rate of 33 percent.[5] Responding cities ranged in population from 85,000 to 2.9 million, with the greatest number, twenty-one, in the 100,000 to 200,000 range. Eight had populations over 500,000. All regions of the country were represented. Interviews were conducted with mayors and chief financial officers in several cities. Correlation analysis was applied to selected items within the survey responses.

[2] This includes all cities that were over 100,000 in population in 1977, excluding Washington, DC, which was omitted due to its unique relationship with the federal government. Initially the sample was to include all cities over 100,000 in 1997, but that sample would be biased by cities with the most population growth. For example, California's percentage of all US cities over 100,000 jumped from 12% of all such cities in 1977 to 23% in 1997.
[3] Conducting research of this sort has been made increasingly difficult by budget cutbacks to the Census of Governments division of the Census Bureau, and resultant reductions in the amount of data collected.
[4] The focus of this study is the larger, older city. The 1977 cutoff was chosen to avoid overpopulating the sample with cities that had grown the most in the past 25 years.
[5] This response rate compares favorably with rates typical of National League of Cities surveys; NLC obtained a 31 percent response rate from its members in 2003, with a higher response from larger cities.

III. CHANGING CITY FINANCES, 1977 TO 2000

There were several significant trends in the finances of large U.S. cities between 1977 and 2000. Sources of intergovernmental aid shifted dramatically from the federal to state governments, reliance on the property tax fell, and user charges soared. Spending on police and K-12 education took an increasing share of resources. Fiscal patterns differed, however, between cities with responsibility for providing K-12 education and those without it, as well as for cities that relied exclusively on the property tax versus those with local income and sales tax options.

A. Revenue Trends

City revenue structure was very different at the start of the new millennium versus 1977.[6] Anti-property tax sentiment fueled by California's Proposition 13 and its offspring, and in some cases, by state court-ordered school finance reform, produced a steady decline in the share of city revenue derived from that tax instrument, and an even more dramatic rise in the percentage of revenue coming from charges and fees. The latter are more dispersed throughout the taxpaying public, and therefore to a certain extent are less visible—at least in terms of their aggregate impact on citizens. They also meet the benefits-received criterion that tends to reduce taxpayer opposition. Cities were fortunate that over this period the diminishing share of resources from the federal government was in the aggregate replaced by aid from their own state governments, with by far the largest increases in state aid going to education.

1. The Decline in Federal Aid to Cities Has Been Dramatic, but State Aid Has Filled the Gap

Federal government aid to cities expanded dramatically in the 1960s and early 1970s. During this period, the federal government initiated or increased funding in many areas, including, for example, public housing, public works, urban renewal, and K-12 education. It even provided unrestricted aid in the form of the General Revenue Sharing program.

In response to persistent budget deficits and a resurgent belief in devolution, federal aid to cities dropped by 67.3 percent in real terms per capita between 1977 and 1990, before rebounding slightly in the 1990s (Table 1).[7] Nonetheless, federal aid dropped from 17.5 percent of city general revenue in 1977 to 5.4 percent in fiscal year 2000.

[6] All of the analysis that follows relies only on the Census categories "General Revenue" and "General Expenditure." General revenues of cities include taxes, fees, and revenues from the federal and state government, but not those from trusts or business-like activities like public utilities or state-run liquor stores. General expenditures include spending from federal and state funds, and include operating and capital expenditures for all areas except pension funds, and utility and liquor store activities.

[7] See Bruce A. Wallin, *From Revenue Sharing to Deficit Sharing: General Revenue Sharing and Cities* (Washington: Georgetown University Press, 1998).

Table 1. Federal Aid to Cities Per Capita				
	1977	1990	2000	1977–2000
Average	$86.24	$28.17	$35.04	
Percent Change		-67.3%	24.4%	-59.4%
Percent of Revenue	17.5%	5.0%	5.4%	

Equally noteworthy was the increase in state aid over this time period, which in the aggregate substituted for the decline in federal aid, allowing the overall level of city intergovernmental aid to return in 2000 to 1977 levels in real dollars per capita (Table 2). Still, federal and state aid combined have fallen from 40 percent of city revenue to 30.3 percent. Nonetheless, state aid has on average grown to account for the largest percentage of city general fund revenue.

Table 2. State Aid to Cities Per Capita				
	1977	1990	2000	1977–2000
Average	$110.95	$122.54	$161.87	
Percent Change		10.5%	32.1%	45.9%
Percent of Revenue	22.5%	21.8%	24.9%	

2. Most of the Growth in State Aid Has Been for K-12 Support

While state aid may have replaced federal aid in the aggregate, there most certainly has been an important shift in the activities funded by intergovernmental aid to cities. K-12 education has become the leading beneficiary under the current scheme, with a loss of a wide range of programs once funded by the federal government. Most of the reduction in federal aid was in areas such as housing, community development, urban economic development, and the elimination of revenue sharing.

In response to challenges to improve education performance, funding for K-12 education drove much of the overall growth in state aid, and in turn drove the growth in overall intergovernmental aid in this period (Table 3). State aid for K-12 rose 121.8 percent in real terms over the 1977 to 2000 period—compared to the overall increase in state aid of 45.9 percent—and grew from 29.0 percent of all state aid to 44.2 percent.

Table 3. Education Aid Per Capita				
	1977	1990	2000	1977–2000
Average	$32.22	$48.19	$71.46	
Percent Change		49.6%	48.3%	121.8%
Percent of all State Aid	29.0%	39.3%	44.2%	

3. City Reliance on the Property Tax Has Steadily Declined

There has been a steady decline in the relative position of the property tax in city finances, the only tax used by all cities. Dissatisfaction with the property tax was one of the leading causes of the tax revolt that began in 1978. While there was very mild increase in real property taxes per capita over the period (3.7 percent), total local tax revenue went up 26.7 percent. The great majority of growth in tax revenue came from local income taxes, with 77.8 percent real growth per capita, and local general sales taxes, with 57.6 percent growth. The share of all municipal general revenue generated from property taxes fell from 27.1 percent in 1977 to 21.4 percent in 2000 (Table 4).

Table 4. Property Tax Revenue Per Capita

	1977	1990	2000	1977–2000
Average	$133.72	$134.94	$138.72	
Percent Change		0.9%	2.8%	3.7%
Percent of Revenue	27.1%	24.0%	21.4%	

4. Cities Are Relying Much More on Current Charges to Finance Services

The U.S. Constitution grants taxing authority to the national government and to states. Thus local government tax options are limited by their respective state governments. Some states allow cities to impose sales taxes, and some allow them to impose a local income tax. A few allow both.

But unlike local income and sales taxes, all cities have the discretion to impose charges and user fees for services. This has been by far the fastest growing significant category of city revenues. On average, revenues from charges increased 110.4 percent in real terms per capita over the 1977 to 2000 period, versus the 26.7 percent increase in tax revenues overall. Charges grew from 11.2 percent of city general revenue in 1977 to 17.9 percent by fiscal year 2000. The largest revenue producers include water and sewer fees, and charges for trash collection, but cities also have imposed or increased recreation and library fees.

Table 5. Revenue From Current Charges Per Capita

	1977	1990	2000	1977–2000
Average	$55.22	$94.50	$116.17	
Percent Change		71.1%	22.9%	110.4%
Percent of Revenue	11.2%	16.8%	17.9%	

The increase in user fees more than replaced the loss in the percentage of city general revenues from property taxes over this period. The percentage of general revenues from current charges increased its contribution to all general revenue from 11.2 percent to 17.9 percent, a 6.7 percent increase, compared to a 5.7 percent drop in the percentage from property taxes.

In sum, over the 1977 to 2000 period federal aid declined dramatically in real dollar terms and as a percentage of city general revenues, while state aid increased substantially in real dollar

terms but held rather steady as a percentage of city revenues, with the bulk of the growth in aid for K-12 education. City property taxes remained rather constant in real dollar terms throughout the period, but fell significantly as a percentage of general fund revenues as budgets grew, with their contribution replaced by real increases in current charges. Cities with local income and sales taxes increased their reliance upon them over the period.

B. Expenditure Trends

With a few exceptions, changes on the expenditure side of city budgets were less dramatic than those affecting revenue. Several of the relatively large areas of spending—including police and K-12 education—saw above average expenditure growth, as did housing and community development and health, both of which still generally make up a small portion of city budgets. Highways and libraries experienced below average increases.

1. Spending Grew More Slowly For Cities Than Other Levels of Government

Growth in general expenditures per capita for the cities in this study substantially lagged that of state governments and all local governments over the 1977 to 2000 period, and trailed the federal government's increase for the period in which comparable data were available (Table 6).[8]

Table 6. Percentage Growth in Per Capita General Expenditures

	1977-1990	1990-2000	1977-2000
Cities in Study	18.2%	14.3%	35.1%
All Local Governments	25.9%	19.0%	49.8%
State Governments	33.4%	30.0%	73.4%
Federal Government	35.9%	NA	NA

2. Interest Payments on Debt Have Grown

Unfortunately for cities, interest on debt—a relatively unproductive use of resources—grew the most over the period (Table 7). Spending in this category did decline in real terms during the 1990s, most likely due to refinancing at lower interest rates, as well as the reduction in federal aid programs that subsidized (and therefore promoted) capital projects, which require borrowing.

3. Spending on Housing and Community Development and Health Outpaced Other Substantive Categories, Though Their Respective Shares of Total Spending Remained Relatively Small

Spending on housing and community development and health also greatly outpaced average city budget growth, although spending on each accelerated in different periods. Housing and

[8] In this table, expenditure growth for the cities in this study was computed at the aggregate level to allow comparison to available data for the federal, state, and local sectors. Therefore the percentage growth presented here will differ from that presented below, which present an average of cities, not an aggregate of all cities.

community development spending grew rapidly from 1977 to 1990, while health expenditures expanded significantly in the 1990s. The growth in housing and community development spending, especially from 1977 to 1990, was most likely tied to federal programs such as the Community Development Block Grant Program, Urban Development Action Grants, and Section 8 funding, along with other programs.

Table 7. Growth in Expenditure Areas, Per Capita Average, Fiscal Years 1977–2000				
	1977	1990	2000	1977–2000
Total Gen Exp	$466.89	$562.99	$644.43	
Percent Change		20.6%	14.5%	38.0%
Spending Areas with Above Average Growth 1977-2000				
Interest on Debt	$20.24	$45.35	$38.58	
Percent Change		124.1%	-14.9%	90.7%
Housing & Community Development	$17.77	$25.75	$32.77	
Percent Change		44.9%	27.3%	84.4%
Health	$7.86	$9.85	$14.08	
Percent Change		25.4%	42.9%	79.3%
Police	$50.11	$63.43	$78.93	
Percent Change		26.6%	24.5%	57.5%
K-12 Education	$72.70	$85.87	$110.14	
Percent Change		18.1%	28.3%	51.5%
Areas with Below Average Growth 1977–2000				
Parks & Recreation	$24.91	$32.06	$34.35	
Percent Change		28.7%	7.2%	37.9%
Fire	$34.33	$41.32	$46.33	
Percent Change		20.4%	12.1%	35.0%
Highways	$33.95	$35.41	$42.96	
Percent Change		4.3%	21.3%	26.5%
Libraries	$6.15	$7.01	$7.37	
Percent Change		14.2%	5.1%	19.9%
Other Items				
Construction	$71.70	$69.26	$82.79	
Percent Change		-3.4%	19.5%	15.5%
Salaries/Wages	$228.48	$255.10	$274.44	
Percent Change		11.7%	7.6%	20.1%
Surplus/Deficit	$27.03	-$.50	$4.90	

The rise in health spending can be tied to strong inflation in the medical sector; this increase must be qualified, however, by the fact that the average of all cities is distorted by extraordinary growth in a few cities with greater responsibilities for health care, including, for example, cities with their own hospitals.[9] Both housing and community development and health care remain a relatively small share of the average budget (Table 8).

Table 8. Expenditures as Percent of Total General Expenditure, 1977–2000			
	1977	1990	2000
K-12 Education	15.6%	15.3%	17.1%
Police	10.7%	11.3%	12.3%
Fire	7.4%	7.3%	7.2%
Interest on Debt	4.3%	8.1%	6.0%
Highways	7.3%	6.3%	6.7%
Parks and Recreation	5.3%	5.7%	5.3%
Housing and Community Dev	3.8%	4.6%	5.1%
Health	1.7%	1.8%	2.2%
Libraries	1.3%	1.3%	1.1%
Other Items			
Construction	15.4%	12.3%	12.9%
Salaries/Wages	48.9%	45.3%	42.6%

4. K-12 Education and Police Remain Top Priorities of Cities

The two areas of local government spending that traditionally attract the most attention, K-12 education and police, were the top two categories of spending on average for these cities in each of the fiscal years under review, and also experienced greater than average growth. Spending on police benefited from the increased attention given to anti-crime efforts in cities, and was particularly stimulated in the 1990s by the Community Oriented Policing Services (COPS) program, a program of federal aid that helps fund additional police officers. Spending growth in elementary and secondary education, particularly in the 1990s, was due to several factors. An upturn in the school age population required the addition of classrooms and teachers, and in some cases the reopening of mothballed schools and the construction of new schools. In many states, state supreme court decisions mandated increased state aid to less wealthy communities, many of them cities. Finally, whether in response to a call for better schools or as a precondition of increased state aid, many schools were given new mandates for testing and remediation.

5. Some Areas of Spending Lagged Average Growth

Among areas that lagged average growth were parks and recreation, fire, highways, and libraries. Spending growth on parks and recreation and libraries particularly slowed during the 1990s, increasing less than half of total growth in general expenditures. These areas are, for better

[9] For fiscal year 2000, for example, thirty-three of the cities had no expenditures for health, while another eighteen had expenditures less than $5 per capita. Meanwhile, San Francisco's per capita expenditure was $525 and Philadelphia's was $518.

or for worse, often seen as less essential services compared to spending in other, high-priority areas. It is also significant to note that spending on construction lagged in the earlier 1977 to 1990 time period, but then outpaced average budget growth in the 1990s as falling interest rates made deferred projects more affordable and a growing school age population increased the demand for new buildings.

6. Salaries and Wages Have Become a Smaller Portion of City Budgets

Notably, salaries and wages grew significantly less than the overall budget in both time periods. As a result, as shown in Table 8, salaries and wages shrank from 48.9 percent of cities' average general fund budgets in 1977 to 42.6 percent in fiscal year 2000. This trend may have continued in recent years. A recent report by the Boston Municipal Research Bureau noted, for example, that the city of Boston's 2004 workforce was the lowest it had been since 1997.[10] This is contrary to public perceptions of waste in government—and may surprise those who hold to the stereotype of continuous growth in city bureaucracies.

C. Trends by City Type

The trends described above provide insight into average revenue collection and expenditure patterns for the cities included in this study. Cities have differing expenditure responsibilities and revenue options, however, and trends vary substantially by city type. For purposes of refining the analysis of fiscal trends, the 162 cities were divided into eight categories (Table 9). Cities may be included in several categories—e.g. many cities with utility taxes also have local sales taxes, some cities with responsibility for education ("education cities") impose local income taxes, etc. To be included in *any* category, a city had to qualify in all three years. For example, a city that did not have responsibility for K-12 education in 1977 but was responsible for schools in 2000 would *not* be included in the education category. This allows analysis of trends by city type over time (See the appendix for a full list of cities and their categories.).

[10] Boston Municipal Research Bureau, "Boston's Workforce at Lowest Level in Seven Years," Special Report 04-3, May 2004.

Table 9. City Types			
City Type	Number of Cities	Definition	City Examples
Education Cities	31	K-12 expenditures over $10 per capita in *each* of the years.[11]	Boston, Hartford, Providence, New York, Richmond
Non-education Cities	120	No K-12 expenditures over $10 per capita in *any* of the years.[12]	Los Angeles, Denver, Chicago Kansas City
Property Tax-Only Cities	50	Cities without a local income or sales tax in *any* of the years.	Portland, Milwaukee, Miami, Trenton, Gary
Income Tax Cities	22	Income tax imposed in *each* of the years.	Birmingham, Detroit, New York, Philadelphia
Sales Tax Cities	76	Sales tax imposed in *each* of the years.	Mobile, San Diego, New Orleans
Utility Tax Cities	97	Utility tax imposed in *each* of the years.	Phoenix, Oakland, Orlando, Houston
California Cities	21	Cities in California	San Jose, Anaheim

1. Education Cities

Responsibility for providing K-12 education varies by state. In some states, general purpose governments like cities and towns carry that responsibility. In other states, independent school districts are responsible, with their own taxing powers. Some states use both methods.

Educational expenditures are a large budget item for those cities with responsibility for K-12 education. Thus any "average" for all cities, which would include those without responsibility for K-12, seriously understates its fiscal impact on the cities that provide education (Table 10). For example, while the average fiscal year 2000 spending on K-12 education for the 162 sample cities was $110.14 per capita (17.1 percent of general funds), $528.33 per capita (43.6 percent of general funds) was spent for that purpose in cities with responsibility for education. Growth in real education spending per capita in those cities that provide it is also understated when using an average. Spending grew 64.9 percent in education cities over the 1977 to 2000 period compared to 51.5 percent across all cities.

[11] Some cities list minor expenditures for education.
[12] Eleven cities either lost or gained responsibility for education over the period, and therefore, by our methodology, couldn't be included in either education category.

Table 10. K-12 Spending Per Capita in Education Cities			
K-12 Education Spending Per Capita			
	1977	1990	2000
Average	$72.70	$85.87	$110.14
Education City	$320.32	$409.19	$528.33
K-12 Education Spending as Percentage of Total General Expenditures			
	1977	1990	2000
Average	15.6%	15.3%	17.1%
Education City	36.9%	39.3%	43.6%
Growth in K-12 Education Spending Per Capita			
	1977-90	1990-2000	1977-2000
Average	18.1%	28.3%	51.5%
Education City	27.7%	29.1%	64.9%

a. State Aid is Much More Important to Education Cities

Over the period of this study cities with responsibility for providing K-12 education have always relied more heavily than the average on state aid than non-education cities, and this reliance has increased over time (Table 11). State aid to cities with responsibility for education grew 50.3 percent in real terms per capita over the 1977 to 2000 period, compared to an increase of 30.2 percent for cities without that function. More dramatically, state aid grew from 34.8 percent of an education city's budget in 1977 to 42.8 percent in 2000, while declining as a percent of revenue for the non-education city.

Table 11. State Aid Per Capita to Education Cities and Non-Education Cities				
	1977	1990	2000	1977–2000
Education City	$339.06	$372.92	$509.68	
Percent Change		10.0%	36.7%	50.3%
Percent of Revenue	34.8%	36.4%	42.8%	
Non-Education City	$46.19	$48.76	$60.12	
Percent Change		5.6%	23.3%	30.2%
Percent of Revenue	13.0%	11.3%	12.3%	

b. Education Cities Rely Less on User Charges

A common impression is that after the advent of Proposition 13, city school systems had to obtain an increasing share of their revenues by placing fees on students and their parents. This may have happened in the 1977 to 1990 period, when the percentage of overall city revenue coming from current charges did increase for education cities (Table 12). But it then fell during the 1990s. Further, the reliance of education cities on charges grew at about half the rate of those cities without responsibility for education over the period. The greater amount of state aid received by education cities would appear to have reduced the need for increased fees.

Table 12. Current User Charges Per Capita in Education Cities				
	1977	1990	2000	1977–2000
Education City	$62.53	$106.13	$101.80	
Percent Change		69.6%	-4.1%	62.8%
Percent of Revenue	6.4%	10.4%	8.6%	
Non-Education City	$52.99	$89.87	$119.30	
Percent Change		69.7%	32.7%	125.1%
Percent of Revenue	14.9%	20.8%	24.4%	

c. Total Expenditure Growth is About the Same in Education Cities as Others

The higher rate of growth in spending on K-12 education in education cities did not produce significantly greater growth in overall city expenditures in those cities; over the entire period the increase was slightly above average and just a few percentage points above that of non-education cities.

Table 13. Growth in Total General Expenditures Per Capita			
	1977–90	1990–2000	1977–2000
Average	20.6%	14.5%	38.0%
Education City	19.9%	16.2%	39.3%
Non-Ed City	23.4%	10.5%	36.4%

Nor did the disproportionate growth in K-12 spending in education cities come at the expense of spending on police. In fact, from 1977 to 2000 spending on police grew faster in education cities than it did in other cities, although that rate of growth was slightly less in the 1990s when the rate of growth in K-12 spending accelerated for the reasons cited above (Table 14). The two prime areas where spending growth lagged for education cities were libraries (9.4 percent growth from 1977 to 2000 compared to 19.3 percent for non-education cities), and housing and community development (39.8 percent for education cities compared to 94.2 percent for non-education cities).

Table 14. Growth in Per Capita Spending on Police			
	1977–90	1990–2000	1977–2000
Average	26.6%	24.5%	57.5%
Education City	34.1%	22.6%	64.4%
Non-Ed City	26.4%	23.7%	56.3%

d. Interest Payments in Education Cities Are a Smaller Percentage of Their Budget

Finally, interest payments as a percentage of the general fund in education cities were lower than both the average share of interest payments and the share in non-education cities (Table 15). While potentially a sign of positive fiscal health for education cities, it's difficult to draw conclusions based on only three years of data.

Table 15. Interest Payments on Debt as a Percentage of General Expenditures			
	1977	1990	2000
Average	4.3%	8.1%	6.0%
Education City	3.9%	4.4%	3.8%
Non-Ed City	4.7%	10.7%	7.7%

2. Property Tax-Only Cities

Fifty of the 162 cities in this study had neither local income nor local sales tax revenue during the period under review, and thus primarily relied on the property tax for tax revenue. There are longstanding arguments as to why local governments should use property taxes for revenue. As property is a relatively immobile asset, it provides a fairly predictable source of revenue. Property values also tend to be more stable than revenues from income or sales during economic downturns. And many of the services that local taxpayers receive—police, fire, public works, transportation—are relevant to property.

However, when any tax is overused, as the property tax had historically been by city governments, its flaws become more apparent. Property taxes can distort development, discourage renovation, and are highly visible and politically unpopular. They are due in full whether one is working, unemployed, or retired. As such, property taxes were the primary target of many tax and expenditure limitation movements in the 1970s and 1980s.

a. Property Tax Share of Revenues Has Declined Faster in Property Tax-Only Cities

As limits on the property tax have increased, the percentage of city revenue provided by property taxes has declined. For those cities without either an income or sales tax, the drop-off in property tax revenue has been slightly greater than for all cities. While property tax revenue fell from 27.1 percent of general revenue for all cities in 1977 to 21.4 percent in 2000, it fell a full eight percentage points for property tax-only cities over this period (Table 16). The biggest drop (-5.6 percent) occurred during the 1977 to 1990 period, immediately after the implementation of some major tax limitation initiatives. As property values increased, property tax revenues actually rose for property tax-only cities in the 1990s, but not enough to prevent a continued decline in their share of total general revenue.

Table 16. Property Tax Revenue Per Capita				
	1977	1990	2000	1977-2000
Average	$133.72	$134.94	$138.72	
Percent Change		0.9%	2.8%	3.7%
Percent of Revenue	27.1%	24.0%	21.4%	
Property Tax City	$222.34	$210.14	$219.17	
Percent Change		-5.5%	4.3%	-1.4%
Percent of Revenue	36.7%	31.1%	28.7%	

b. Property Tax-Only Cities Have Received the Largest Increases in State Aid

Whether in response to voter imposed limits on property taxation (as in Massachusetts and California), legal challenges to the use of the property tax to fund education, or a general desire to reduce reliance on property taxes, the increase in state government aid from 1977 to 2000 was greater for property tax-only cities than the average (57.3 percent compared to 45.9 percent). Most dramatically, state aid to these local governments increased 20.7 percent from 1977 to 1990, nearly twice that of the average (Table 17). While aid to property tax-only cities continued to increase in the 1990s, its growth was outpaced by the increase in state aid to education cities, as the school finance reform movement accelerated. Nonetheless, state aid comprised nearly 7 percent more of the budgets of property tax-only cities in 2000 than it did in 1977, compared to just 2.5 percent more for average cities.

Table 17. State Aid Per Capita

	1977	1990	2000	1977–2000
Average	$110.95	$122.54	$161.87	
Percent Change		10.5%	32.1%	45.9%
Percent of Revenue	22.5%	21.8%	24.9%	
Education City	$339.06	$372.92	$509.68	
Percent Change		10.0%	36.7%	50.3%
Percent of Revenue	34.8%	36.4%	42.8%	
Property Tax City	$170.35	$205.55	$267.93	
Percent Change		20.7%	30.4%	57.3%
Percent of Revenue	28.1%	30.4%	35.0%	

c. Likely as a Response to the Tax Revolt of the Later 1970s, Property Tax Cities Increased User Charges Faster Than the Average

As with education cities, property tax-only cities did increase user charges faster than the average of cities during the 1977 to 1990 period (93.9 percent increase versus 71.1 percent)—most likely in immediate response to the tax revolt. Their increase in charges then fell behind the average in the 1990s (14.6 percent versus 22.9 percent). As noted previously, the increase in user fees more than replaces the loss in the percentage of city general revenues from property taxes for all cities over the 1977 to 2000 period. The same trend holds true for property tax-only cities, with the share of revenue from current charges increasing from 9.9 percent to 17.7 percent, while the share of revenue from property taxes fell from 42.4 percent to 34.7 percent.

d. Expenditure Growth in Property Tax Cities is Similar to All Cities

Total general expenditures in property tax-only cities (36.6 percent) only slightly lagged the overall average over the entire period (38.1 percent) (Table 20). They exceeded the average growth

from 1977 to 1990, but lagged the average in the 1990s. Thus voter animosity toward the property tax, more than growth in government spending, may explain anti-tax sentiment in these cities.

3. Sales Tax Cities

Seventy-six of the 162 cities in the study, located in 17 states, imposed a local general sales tax in each of the three years under review. Revenues from local sales taxes are the second largest source of tax revenue for all of the cities in this study.

Revenue from local general sales taxes is much more important to the cities that impose them than the averages suggest (Table 18). While the average of the 162 cities was 6.5 percent of general revenue from local sales tax revenues in 2000, over half of these cities have no local sales tax at all, thus significantly lowering the average. Cities with a sales tax acquired 13.7 percent of their general revenue that year from that source, up from 11.5 percent in 1977.

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Table 18. Local General Sales Taxes Per Capita			
	1977	1990	2000
Average	$23.78	$32.78	$42.27
Percent of Revenue	4.8%	5.8%	6.5%
Sales Tax City	$49.18	$68.21	$82.28
Percent of Revenue	11.5%	12.9%	13.7%

a. Sales Tax Cities Have Increased Their Reliance on That Revenue Source

As Table 19 portrays, sales tax cities' real increase per capita over the period from sales tax revenue (67.3 percent) far outpaces the average growth in all tax revenue for the cities in the study (26.7 percent), and also significantly outpaced the overall increases in all tax revenue in those sales tax cities (40.4 percent). This would suggest satisfaction with the revenue source, and indicates that revenue diversification is something that is worthy of consideration by those cities currently without the option.. As tax instruments may be affected differentially by swings in the economy, diversification in public finance, as in personal investing, can help guard against economic shocks.

Table 19. Growth in Tax Revenue Per Capita by Type of Tax and City			
	1977–2000		1977–2000
Average All Taxes	26.7%	Average All Taxes	26.7%
Property Tax Cities		**Income Tax Cities**	
Property Tax Revenue	-1.4%	Income Tax Revenue	57.6%
All Tax Revenue	5.0%	All Tax Revenue	44.7%
Sales Tax Cities		**Utility Tax Cities**	
Sales Tax Revenue	67.3%	Utility Tax Revenue	41.7%
All Tax Revenue	40.4%	All Tax Revenue	39.3%

b. State Governments Give Less Aid to Sales Tax Cities

Perhaps due to the additional revenue option that Sales Tax Cities have, state aid to those cities lags the average. In 2000, while the average percentage of revenue from state aid for cities in this study was 24.9 percent, Sales Tax Cities only received 18.5 percent.

c. Total General Expenditures Grew the Fastest in Sales Tax Cities

While cities with a local income tax had the largest growth in total general expenditures during the 1990s (a result of the booming economy), expenditure growth in sales tax cities outpaced all other categories of cities from 1977 to 1990 (Table 20). For the entire 1977 to 2000 period, total general expenditures grew by 44.6 percent in Sales Tax Cities compared to the average of 38.0 percent. The presence of a local sales tax would thus seem to facilitate increased spending.

Table 20. Growth in Total General Expenditures Per Capita by Revenue Source

	1977–1990	1990–2000	1977–2000
Average	20.6%	14.5%	38.0%
Prop Tax City	25.1%	9.3%	36.6%
Income Tax City	5.2%	24.4%	30.8%
Sales Tax City	27.0%	13.9%	44.6%
Utility Tax City	25.9%	12.2%	41.2%

4. Income Tax Cities

Only twenty-two cities in this study, located in eight states, impose a local income tax rendering any national average on income tax revenues nearly meaningless. While the average reliance on income tax revenues for all cities in this study was 3.4 percent in 2000, for cities that impose them it was 21.6 percent, over one-fifth of their general revenues (Table 21).

Table 21. Local Personal Income Tax Revenue Per Capita

	1977	1990	2000
Average	$14.06	$19.13	$22.17
Percent of Revenue	2.9%	3.4%	3.4%
Income Tax City	$98.97	$133.10	$155.96
Percent of Revenue	17.5%	23.5%	21.6%

a. Cities Have Increased Their Reliance on Income Taxes

As with sales tax cities, cities that have the option of using a local income tax have increased their reliance upon it, from 17.5 percent of general revenues in 1977 to 21.6 percent in 2000.[13] This again suggests satisfaction with, and taxpayer acceptance of, this revenue source. As shown in

[13] The percentage of revenue from income taxes declined from 1990 to 2000 as some income tax cities received increased revenues from general sales taxes and current charges.

Table 19, local income tax revenues for those cities that employed them were the second fastest growing sources of tax revenue from 1977 to 2000, more than double the average rate of growth for all taxes.

b. States Provide Less Aid to Income Tax Cities

As with sales tax cities, cities that impose a local income tax receive a lower percentage of their total general revenues from their respective states. Though not as dramatic as in sales tax cities, income tax cities received 22.3 percent of their general revenue in 2000 from state aid, compared to an average of 24.9 percent. Again, states may justify this based on the additional revenue option available to their local units of government.

c. The Impact of a Local Income Tax on Growth in Total Expenditures May Depend on Performance of the Economy

In contrast to cities with local sales taxes, income tax cities showed markedly slower growth in total general expenditures over the entire period (30.8 percent) than the average (38 percent). But this is almost entirely due to the remarkably low 5.2 percent increase in expenditures in the 1977 to 1990 period. As the economy improved in the 1990s, these cities showed by far the greatest increase in total general expenditures of any type of city (24.4 percent), far outpacing the average (14.5 percent) (Table 20). With a balanced budget requirement, the availability of revenues is a key element in expenditure growth, and strong economic performance seems to allow cities that employ local income taxes to expand their provision of services.

d. Local Income Taxes Appear to Substitute for Property Taxes More Than Do Sales Taxes

In addition to allowing greater expenditures, local revenue options can be viewed as a means of reducing reliance on the property tax. Cities with the local income tax option did more of the latter than did Sales Tax Cities, as their property tax revenue grew by 2.6 percent in real terms from 1977 to 2000, below the average of 3.7 percent, and substantially below the 9.7 percent growth in property tax revenue in Sales Tax Cities. (Table 22) Property tax revenues contributed only 12.0 percent of total general revenue to Income Tax Cities in 2000, compared to an average of 21.4 percent for all cities, and 17.7 percent of Sales Tax Cities.

Table 22. Trends in Property Tax Revenue Per Capita by City Revenue Type				
	1977	1990	2000	1977–2000
Average	$133.72	$134.94	$138.72	
Percent Change		.9%	2.8%	3.7%
Percent of Revenue	27.1%	24.0%	21.4%	
Sales Tax City	$96.78	$109.65	$106.14	
Percent Change		13.3%	-3.2%	9.7%
Percent of Revenue	22.6%	20.7%	17.7%	
Income Tax City	$84.20	$84.39	$86.42	
Percent Change		.2%	2.4%	2.6%
Percent of Revenue	14.8%	14.9%	12.0%	

Income tax cities also rely less on current charges, collecting 15.8 percent of their revenues in 2000 from such fees compared to 19.5 percent in sales tax cities, and 17.9 on average in all cities. Growth in current charges grew only 67.1 percent for income tax cities over the entire period, compared to an average of 110.4 percent, and 116.9 percent for sales tax cities.

5. Public Utility Tax Cities

Ninety-seven of the one hundred and sixty-two cities imposed a public utility tax in all three years. For cities in states restricted by Tax and Expenditure Limitations (TELs), like California, the public utility tax may offer city officials the most discretion in taxing authority.

a. Public Utility Taxes are a Small and Relatively Stable Source of Local Revenue

For those cities that imposed them, Public Utility Taxes provided 4.8 percent of general revenues in 1977, and 4.9 percent in 2000. The overall growth in public utility taxes in the 1977 to 2000 period was 38.0 percent, near the average of 41.2 percent for all taxes in all cities.

California Cities

California cities make up a sizable portion of the cities in this study. These cities are under the constraints of various voter initiated tax and spending rules, including Proposition 13, which places strict limitations on use of the property tax.

b. Property Taxes in California Cities Have Declined In Importance

As the voters who passed Proposition 13 in 1978 wished, property taxes have become a much less significant revenue source for large California cities. The percentage of general revenue from property taxes fell from 22.5 percent of all general revenue in 1977, to 17.6 percent in 1990, and 13.0 percent in 2000. This compares to the average drop from 27.1 percent to 21.4 percent.

c. Yet TEL-Constrained California Cities Are Increasing Expenditures Faster than Average

Table 23 shows total spending per capita and spending growth for California cities versus the average of cities, as well as a comparison to non-education cities (since schools are not under the direct control of cities in California). Surprisingly, growth in total general expenditures per capita in California outpaced both the average and non-education cities over the time period, showing the most divergence in the period from 1990 to 2000.

Table 23. Total General Expenditure Per Capita in California Cities Contrasted

	1977	1990	2000	1977–2000
Average	$466.89	$562.99	$644.43	
Percent Change		20.6%	14.5%	38.0%
Non-Education City	$348.53	$430.10	$475.42	
Percent Change		23.4%	10.5%	36.4%
California	$364.40	$449.16	$559.28	
Percent Change		23.3%	24.5%	53.5%

d. Current Charges and Selective Sales Taxes (including Public Utility Taxes) are Paying for Expenditure Growth in California

With property taxes restrained, and state aid unstable, California cities have made consistently increased use of current charges and selective sales taxes, including those on public utilities, to fund their increased services. With the greatest growth occurring in the 1977 to 1990 period immediately after Proposition 13 was enacted, revenue from current charges grew 148.8 percent for California cities compared to an average of 110.4 percent from 1977 to 2000, and went from providing 13.8 percent of all city general revenue there to 23.8 percent in 2000, almost symmetrically replacing the declining property tax share, which fell from 22.5 percent to 13 percent (Table 24). Similarly, selective sales taxes in California (primarily utility taxes) grew at nearly twice the average rate over the period of this analysis.

Table 24. California Cities Contrasted				
	1977	1990	2000	1977-2000
Current Charges				
Average	$55.22	$94.50	$116.17	
Percent Change		71.1%	22.9%	110.4%
Percent of Revenue	11.2%	16.8%	17.9%	
California Cities	$52.57	$97.69	$130.82	
Percent Change		85.8%	33.9%	148.8%
Percent of Revenue	13.8%	`20.6%	23.8%	
Selective Sales Taxes				
Average	$18.41	$26.52	$30.43	
Percent Change		44.0%	14.8%	65.3%
Percent of Revenue	3.7%	4.7%	4.7%	
California Cities	$23.03	$40.34	$51.09	
Percent Change		75.2%	26.7%	121.9%
Percent of Revenue	6.0%	8.5%	9.3%	

IV. FISCAL PRESSURE AND CITY RESPONSE, 2003 AND 2004

As the preceding analysis of fiscal trends shows, cities had very different revenue structures in 2000 than had been in place in 1977. Reliance on the property tax declined, user charges increased, and while the trends were less dramatic, the contribution of local income and sales tax revenues grew in cities that employed them. In sum, own-source revenues had become more diversified, something that most public finance economists endorse, but, in the case of fees, discretion may be reduced.

Federal aid to cities declined, while state aid grew, and a range of federal government priorities of the 1970s gave way to a greater emphasis on K-12 education. There were fewer changes on the expenditure side of the budget equation, although noteworthy declines in the 1990s in the share of the budget going to interest payments on debt and salaries put cities on stronger footing as they entered the new millennium.

These trends would turn out to be important, as the fiscal health of most cities was soon challenged by an economic downturn. While some of the changes may have lessened the its impact, this downturn was of such a magnitude, especially for state governments, that it often spurred creative responses. Analysis of the survey of city chief financial officers provides a look into this dynamic of city fiscal condition, pressure, and most importantly, response.

A. Fiscal Conditions

The country's economic slowdown began in 2001 and turned into a short-lived recession by 2002. While the actual recession did not last long in the technical sense, it had a revenue effect on all levels of government, and especially on those relying on income and sales taxes, including many cities. A recession produces lower income, and hence lower income tax revenues. Similarly, when incomes are reduced or lost, consumption falls, and with it, sales tax revenues. While the economy began to experience a modest improvement in 2002, wage growth in particular remained slow, and the recovery was less than overwhelming.

The revenue position of many cities was further weakened by slowdowns or cuts in state aid, which were experiencing revenue shortfalls of their own. Some of the cuts occurred in mid-fiscal year. Meanwhile, health care inflation, K-12 funding, and the desire to maintain or increase public safety placed continued pressure on the expenditure side of the budget. At the time of the survey, February 2004, city officials had yet to fully recover from the pincer effect of weakened revenues and expenditure needs.

1. Fiscal Conditions Worsened in 2004, Especially for Education and Income Tax Cities

Finance officers were asked to rate their city's fiscal condition as they entered fiscal years 2003 and 2004 on a scale of one to six, with one being "poor" and six "excellent." The CFOs noted a very slight worsening in their fiscal conditions, from 3.64 for fiscal 2003 to 3.51 for 2004. The

downward trend was more dramatic for the responding cities with responsibility for education, dropping from 3.75 to 3.33, and cities with a local income tax, which dropped from 3.50 to 2.83. (Table 25)

Table 25. City Fiscal Condition (1=poor, 6=excellent)						
Mean:	All	Ed Cities	Sales Tax	Inc Tax	Utility Tax	Prop Tax
Fiscal 2003	3.64	3.75	3.61	3.50	3.54	3.67
N=(respondents)	(53)	(12)	(31)	(6)	(37)	(19)
Fiscal 2004	3.51	3.33	3.57	2.83	3.62	3.50
N=(respondents)	(53)	(12)	(31)	(6)	(37)	(19)

This trend was reinforced by responses to a query on the fiscal pressure cities faced as they entered these fiscal years. Again, mean pressure increased from 4.44 to 4.59 on a scale of one to six. Income tax cities and education cities once more saw the biggest increase, while the only category to face less fiscal pressure, albeit mildly, were property tax-only cities, which benefited from the continued appreciation in the value of real estate (Table 26).

Table 26. City Fiscal Pressure (1=none, 6=severe)						
Mean:	All	Ed Cities	Sales Tax	Inc Tax	Utility Tax	Prop Tax
Fiscal 2003	4.44	4.75	4.21	4.17	4.30	4.89
N=(respondents)	(54)	(12)	(31)	(6)	(37)	(19)
Fiscal 2004	4.59	5.17	4.39	4.67	4.38	4.84
N=(respondents)	(54)	(12)	(31)	(6)	(37)	(19)

When asked to state the general goal for ending balances, the result was a mean ending balance of 10.4 percent.[14] When reporting their general fund revenues and general fund expenditures for fiscal year 2003, the result for those cities responding was a deficit of -0.5 percent. Income tax cities reported the largest deficit, at -3.6 percent, while property tax-only cities had the greatest surplus, still small, at 0.7 percent.

City officials were asked specifically if they had faced a shortfall in budgeting for fiscal year (FY) 2004, and 77 percent (41 of 53) stated that they had. For those providing the size of the shortfall, it amounted to an average of 6.4 percent of their general fund, with four cities reporting shortfalls of over 10 percent.

[14] This number is considerably lower than the 16 percent budgeted by all cities responding to the 2004 National League of Cities survey. See Michael A. Pagano, "City Fiscal Conditions in 2004," (Washington: NLC, 2005), figure 21, p. 18.

2. City Budget Problems are More Structural than Cyclical, and Involve Both Revenues and Expenditures

When asked if they considered their shortfall a structural or cyclical problem, or both, those who had a shortfall overwhelming cited both. Interestingly, however, while 11 cities stated the problem was structural, *none* claimed it to be entirely cyclical. City officials, then, feel that their budget problems are due to a fundamental mismatch between revenue raising ability and expenditure needs, and are thus likely to be long-lasting in the absence of structural changes (Table 27).

Table 27. Origin of Fiscal Shortfalls

"Did your city face a shortfall for FY 2004?"	Yes 41	No 12	
"If yes, do you consider the problem…	Structural 11	Cyclical 0	Or Both?" 32

Overall, responding cities rated expenditure pressures for existing programs and revenue adequacy as almost equally responsible for the structural problem. Problems exist on both sides of the budget equation.

B. Fiscal Pressure

The 54 survey respondents made it evident that expenditure pressures on cities continued unabated in 2003 and 2004, resulting in worsening fiscal conditions overall. These pressures included a continued emphasis on public safety with the addition of homeland security concerns; employee benefits, including the impact of inflation on the cost of their health care and the need to replenish employee pension funds weakened by the stock market decline; and in those cities with their own school districts, continuing costs related to meeting state imposed standards.

1. Employee Health Care and Public Safety are Leading Expenditure Pressures

Table 28 shows the results for specific expenditure pressures that city officials faced. Health care costs and public safety were together at the top, followed by wage demands, capital spending, and pension fund demands.

Table 28. Expenditure Pressures in Fiscal Years 2003 and 2004 (1=not at all, 6=substantial)	
Health Care	4.85
Public Safety	4.83
Wage Demands	4.25
Capital Spending	4.21
Pension Fund	4.15
Education	3.74
State Mandates	3.46
Homeland Security	3.38
Human Services	3.12
Mean	4.00
N=(respondents)	(54)

The impact of medical care inflation (health care) and the downturn in the stock market (pension funds) were clearly factors affecting city budgets. Boston's health insurance costs, for example, have increased 54 percent since 2000, while overall city spending is up only 14.6 percent. The steady increase in the cost of housing has been used by many municipal employee unions as an argument for larger-than-inflation wage increases. Several California city officials cited the high cost of workers compensation in that state. Workers' compensation costs increased a staggering 88 percent in Long Beach between 1999 and 2003, to $15.7 million. Homeland security cost pressure was ranked rather low, relative to other items on the list.

2. Pressures on Education Cities are Different

When education cities are separated out, education pressures become the third highest ranked for those cities (5.10). Pension fund and health care cost pressures, both 5.25, also rank higher for them than the averages of 4.15 and 4.85. With a larger personnel base, cities with responsibility for K-12 education have been experiencing more pressure in the latter two areas than cities overall.

3. Changes in State Aid Caused Cities Fiscal Pressure, Especially for Education Cities and Property Tax-Only Cities

Reductions or slowdowns in state aid were the leading source of revenue pressure for all cities, followed by fees and charges. Consistent with other responses, the property tax did not rate as highly (Table 29).

Table 29. Revenue Pressures in Fiscal Years 2003 and 2004 (1=not at all, 6=substantial)	
State Aid	3.79
Fees and charges	3.22
Property Tax	2.89

Seventeen cities reported actual reductions in state aid for fiscal year 2003, and 18 did so for fiscal year 2004. The great majority of the reported cuts—73 percent in 2003 and 61 percent in 2004—were in unrestricted aid, the kind most favored by city officials. The average reduction in state aid was reported to be 3.6 percent of a city's general fund budget in fiscal year 2003, and 2.9 percent in fiscal 2004.

Education cities and property tax-only cities, more reliant upon state aid, listed cuts in state aid as a greater pressure than did others. When separated, education cities rated state aid at 5.33 as a cause of fiscal pressure compared to 3.27 for non-education cities, while Property tax-only cities rated state aid pressure at 5.06 compared to 3.24 for cities with other broad local tax options. One city, St. Paul, experienced a 25 percent reduction ($33 million) in state aid over those two fiscal years.

4. Employee Unionization Increases Fiscal Pressure

City officials were asked to report the percentage of their work force that was unionized, and to estimate the strength of these unions. In those cities that had allowed unions (46), employees were on average 74.4 percent unionized, and their mean strength was estimated at 4.53 on a scale of 1 ("weak") to 6 ("very strong").

Correlation analysis reveals the reported percentage of employees unionized was positively correlated with increased spending on benefits in the late 1990s (.436*), while the strength of unions was positively correlated with increased spending on health care for employees (.393**) and wages (.366*) during that period.[15] The estimated strength of employee unions was found to be negatively correlated with city fiscal condition for 2004 (-.319*), and positively correlated with fiscal pressure in budgeting for 2004 (.335*). The existence and strength of public employee unions clearly has implications for city fiscal behavior and condition.

C. City Response

Two ways to respond to fiscal pressure are to reduce expenditures and increase revenues. With respect to both, cities generally shied away from comprehensive responses, although they would likely produce the largest and longest-lasting effects. Instead city officials tended toward incremental approaches, hoping to buy time until economic recovery and increased state aid would

[15] * = correlation is significant at 0.05 level (2-tailed), **= .01.

refill their coffers. As a rule, cities looked for the least politically painful approach, which often resulted in creative response, especially with respect to revenues.

1. Expenditure Control

a. Politically Painless Strategies Such as Hiring Freezes and Postponing Capital Expenditures Were High on Cities' List of Ways to Reduce Expenditures

On the expenditure side of the budget equation, cities responded to fiscal pressure in a variety of ways. While the relatively politically painless strategy of a hiring freeze was the most often used strategy, the more difficult strategy of targeted cuts in program areas were almost equally employed. Postponing capital spending and deferring maintenance, both fairly politically painless responses, and across the board cuts, round out the top five strategies used. Employee layoffs, the most politically painful act for chief executives, did occur in over half of the cities responding, but to an extent less than the mean response (Table 30). Significantly fewer cities reduced employee benefits or initiated early retirement programs, although several cities did note health care cost savings through increased co-pays or reduced options. For example, Oakland employees took what was in effect a 3 percent wage reduction to help fund their pension plans.

Table 30. City Responses to Budget Pressures

Fiscal Response Strategies Used	Number of Cities	Degree of Use (1=not at all, 6=substantial)
Hiring Freeze	45	4.74
Targeted Cuts	43	4.26
Postpone Capital Expenditure	39	3.95
Across the Board Cuts	37	3.68
Travel Freeze	32	3.41
Defer Maintenance	33	3.39
Employee Layoffs	29	3.10
Reduced Employee Benefits	20	2.55
Early Retirement	16	2.54
	Mean	3.51

b. Education Cities Made More Use of Personnel-Related Strategies to Curb Expenditures

With a larger personnel base, cities with responsibility for education made greater use of strategies involving employees than did those without such responsibility. For fiscal years 2003 and 2004, education cities relied more on employee layoffs (4.11 versus 2.80), hiring freezes (5.25 versus 4.63), and early retirement programs (4.60 versus 2.09) than did non-education cities. There was a very strong positive correlation between education expenditure pressures in 2003 and 2004 and the use of the early retirement strategy (.782**).

c. Some Cities Took Innovative Approaches

In open-ended responses, both Austin, TX and Jacksonville, FL gave credit to employee innovations. Faced with possible layoffs, Austin initiated a very comprehensive approach to employee involvement. Over two years the city received over four thousand ideas from its employees (nearly three thousand unduplicated), and estimates that they produced cost savings of $8.8 million, and $1.6 million in revenue gains. The average cost savings from each implemented idea was $36,975, and the average revenue idea generated $32,207. Examples with the largest gains include a citywide review of the need for cell phones and pagers ($270,000 saved), fleet management purchase of used versus new parts ($175,000), and an increase in rental rates for facilities of the Parks and Recreation Department ($202,000).

Boston instituted a position control board to strictly monitor hiring, even for budgeted positions. Oakland, CA put into effect a mandatory business shutdown for 12 days during fiscal years 2004 and 2005, yielding $2.2 and $2.4 million in savings. City services are closed to the public during those days except for essential services. Oakland also permanently closed one fire station, and put five others on a flexible deployment schedule (rotating closures) to decrease overtime costs, netting the city $3 million a year.

d. Cuts in "General Government" Expenses Were Most Popular Among Cities, Followed by Cuts to Education

Expenditure reductions, while not large, were greatest in the general government category, which may have the least perceptible citizen impact. This refers to functions such as human resources, financial and legal administration, and general public building maintenance, for example, versus areas of direct service delivery like police, fire, education, and public works/transportation. Education, capital spending, and parks and recreation were also cited as frequent targets for cuts (Table 31).

Table 31. Expenditure Reductions in Fiscal 2003 and 2004 (1=none, 6=substantial)

General Government	3.90
Education	3.44
Capital Spending	3.39
Parks and Recreation	3.25
Public Works	3.17
Social Services	2.74
Libraries	2.66
Public Safety	2.45
Mean	3.13

Reductions in education spending were much more prominent in cities with responsibility for K-12 education (4.0) than in those without it (2.33). There was little appetite for cutting public safety, as 19 of the 51 cities responding noted that there had been *no* spending reductions in this category

Somewhat surprisingly, libraries were disproportionately spared the budget axe, as were social services. When reductions did occur in these categories, they were negatively correlated with city fiscal condition in fiscal year 2004 (-.364* and -.331*, respectively), two of the very few statistically significant correlations in this category. In other words, cities had to be in particularly bad fiscal shape to make cuts in libraries and social services. Reductions in social service spending and public works were also positively correlated with city fiscal pressure for that year (.377* and .286*, respectively).

e. Personnel-Related Cuts Brought the Most Savings

Chief fiscal officers were also asked the open-ended question "Which cost-cutting strategies have produced the most savings?" Twenty of the responding cities listed "hiring freeze" as producing the most savings; layoffs were cited by ten. Personnel-heavy budgets make these categories targets for cost savings. Austin and Jacksonville again mentioned engaging employees in process improvements/innovations. In one innovative move, the city of Boston has announced its intention to save an estimated $1.5 million a year by giving some city employees and retirees the option of buying their prescription drugs from Canada.

f. The Use of Public-Private Partnerships is Mixed

Surprisingly, public-private (including non-profit) partnerships were not extensively employed to maintain and help cover the costs of services, with a mean score of 2.73 on a scale of 1 to 6 (with 1 being "none," and 6 being "substantial"). Ten of the fifty-three cities responding stated that they were not involved in any. Partnerships that were reported as examples included:

- after school programs
- summer jobs
- theater restoration
- friends of library support
- parks programs
- zoo foundation
- leisure/recreation center with YMCA
- Fourth of July fireworks

Some cities noted significant successes, however. The city of St. Paul, MN noted that it has benefited for many years from a very active Friends of the St. Paul Library organization. The group raised over $1 million to acquire a new integrated online library system, and the updating and expansion of public access Internet workstations in the main library and all branches. They also donated over $398,000 to help underwrite the costs of a bond issue to provide for an accelerated

construction schedule for renovation of the main library. Ongoing grants and donations have been used to fund homework centers, a summer reading program, collection support, recognition events for volunteers, and a web librarian. For fiscal year 2003, the group provided approximately 5 percent of the library's operating budget.

The city of Las Vegas, NV found that a recreation center run in conjunction with the YMCA came much closer to covering costs than did a comparable city-run facility. This was accomplished primarily through the imposition of higher fees.

Cities responding to this question also frequently noted specific efforts to contract out some services, including:

- ambulance service
- technology infrastructure maintenance/ownership
- garbage services (3)
- printing services
- convention center operations (2)
- auto leasing
- ice rinks and golf courses
- jail food services

For example, in outsourcing the ownership and maintenance of its desktops, servers, and operating systems to UNISYS, Minneapolis, MN is spending the same amount that it had in-house, but receiving much more value. Among other things, UNISYS is providing backup facilities/business interruption center, and is contracted to regularly update desktops and infrastructure.

Contracting out has become increasingly attractive to city officials, as it allows for a reduction in a city's responsibility to provide increasingly expensive benefits such as health care and workers compensation. But while the specific examples noted above were offered by city officials, they rate the overall use of privatization as marginal.

g. Long-Term Cost Savings Strategies Are Underused

All cities were asked to rate the general extent of their involvement in the long-term strategies presented in Table 32, and to characterize the size of their cost savings from those strategies. Department reorganization, the easiest to accomplish, was the most frequently cited, followed by performance measurement. Interlocal agreements and privatization were less used. Nineteen of the 53 cities reported not using privatization at all, followed by eleven not engaging in any interlocal agreements. One city, New Haven, did report that it planned to develop a public wastewater utility with neighboring (user) towns, creating a new revenue stream for four years.

Table 32. Adoption of Long Term Cost Savings Strategies (1=not at all, 6=substantial)	
Department Reorganization	3.50
Performance Measures	3.06
Interlocal Agreements	2.69
Contracting out	2.43
Mean	2.92
Size of Savings from Long Term Strategies	
Department Reorganization	2.81
Interlocal Agreements	2.31
Contracting out	2.20
Performance Measures	2.11
Mean	2.36

While the cost savings estimates lagged extent of use, it is interesting to note that interlocal agreements moves slightly ahead of privatization in terms of providing cost savings, and that use of performance measures was estimated to produce the least financial reward. In an interview, the mayor of St. Paul cited consolidation/regionalization as the idea potentially offering the most expenditure relief for his city.

While the assumption is that unionized employees resist such cost-saving innovations as privatization, performance measure, or public-private partnerships, there were no significant correlations between percentage of employees unionized or strength of employee unions and their use.

2. Revenue Boosting

a. To Enhance Local Revenues, Many Cities Dipped into Reserves, and Raised Existing Fees and Charges

On the revenue side of the equation, the response to fiscal pressure that was employed to the greatest extent was the use of reserves, followed by increases in existing fees and charges, the only two strategies to score above three. New fees and charges were imposed, but to a lesser extent. The use of reserves takes nothing new from the taxpayer, while fees and charges are better tolerated by citizens as paying for a clear benefit received. In most cases, cities do not have the option of increasing their income or sales tax rate, so their low score is understandable (Table 33).

Table 33. Extent of Use of Revenue Strategies Fiscal 2003 and 2004 (1=not at all, 6=substantial)	
Used Ending Balances	3.96
Increased fees	3.35
Imposed new fees	2.63
Increased Property Tax	2.04
Increased Sales Tax	1.68
Borrowed	1.63
Increased Utility Tax	1.25
Increased Income Tax	1.00
Mean	2.07

b. When Increased, Property Taxes Provided Significant Revenue, Though Less for Cities with Other Revenue Options

While property tax rates were only raised minimally, when cities were asked in an open-ended question to name their largest revenue-producing action for fiscal year 2004, by far the most frequently offered response was an increase in property taxes, noted by twelve cities. A relatively small change in a large tax source can produce significant revenue.

Cities with diversified revenue bases relied less on increasing property taxes than were other cities. While property tax-only cities reported a reliance of 2.89 on the increased property tax rate strategy, sales tax cities reported 1.52 and income tax cities 1.20.

c. Cities Are Creative in Using Fees

When asked for examples of fees and charges, the most frequently offered were recreation fees (10), including fees for parks and golf. Increases in solid waste removal fees and parking fines were the second most frequently mentioned (five each). Three city officials noted increased fees for developers, while three others noted increased burglar alarm fees for false alarms.

Several cities took interesting approaches to fees and charges. Oakland tied its fee increase across the board to the percentage increase in salaries of city employees, while Austin tied them to inflation. Several cities took a cost-recovery approach to increasing fees and charges. For example, Chicago tied its fee for building permits to the cost of providing the service, as did Austin. Chicago officials note that they have made a determined effort to tie the fee of providing a service directly to the cost for as many services as possible, including elevator and other building code inspections. The feeling there, as elsewhere, is that when possible taxpayers should not have to pay out of the general fund for the cost of services that they do not use. Miami, FL created a task force to assure compliance with existing fees.

Allentown, PA first performed a cost analysis on all of its fees over fifteen years ago in an attempt to equate them with net costs. Fresno also took a comprehensive approach. A study

revealed that the city was recovering only 46 percent of the costs associated with fees reviewed. As a result, 77 fees for additional services were added, and 103 fee increases proposed. Fresno began a program of full cost recovery for citations and arrests, for example, and estimates that this alone generates several hundred thousand dollars a year.

Two years ago the city of Colorado Springs imposed a fee on street cuts, per cut and per lineal foot. While some of the new revenue comes from developers, approximately 75 percent comes from the city's own utility company. The total raised is approximately $1 million a year. Kansas City reported increasing its payment in lieu of taxes rate from 5.9 percent to 7.9 percent on its utility company and other enterprises such as water and sewer, and Minneapolis imposed for the first time a payment in lieu of taxes on its water and sewer enterprise, transferring $4.5 million to the general fund. Las Vegas increased sewer service and connection rates by 40 percent over two years.

One of the more interesting approaches to raising revenue was developed by the city of St. Paul. Revising and greatly expanding upon a program that had been in existence since 1909, officials imposed a right of way maintenance assessment charge for summer and winter street services. The program previously included sweeping and patching city streets. The new program added snow plowing, sidewalk repair, litter pickup, ordinance enforcement and emergency service, snow plowing (including sanding and salting, and snow removal), snow emergency (including tagging and towing), sidewalk maintenance and repair, and boulevard tree maintenance and trimming. Charges are levied per lineal foot of street frontage. This expansion accomplished several purposes. It removed the cost of these functions from the city's general fund budget, ultimately netting the city $6 million annually. The program also allows the city of St. Paul to receive payment from non-profits, including churches, which are otherwise tax-exempt, and thus do not pay for city services. Even some state agencies have been paying. Private taxpayers so far have been able to deduct the fee. The city of Milwaukee likewise began charging a separate snow and ice removal fee in 2002, and expects to raise $2.4 million, also tapping tax-exempt non-profits.

Finally, the Las Vegas City Council approved a rather unique (and progressive) approach to fees. The city is increasing fees by a larger amount in neighborhoods with higher incomes. There will be exceptions for after-school and aquatics programs, and the city plans to offer scholarships and subsidies for those unable to afford the higher fees. The increase is estimated to bring in an additional $600,000 a year.

d. Cities Have Also Utilized Other Creative Revenue Raising Strategies

Cities were also asked to list any creative sources of revenue that their city used. Three reported selling delinquent tax liens, which in one city, Syracuse, generated $3 million, an 85.3 percent advance rate. Long Beach, CA credited advertisements on city vehicles (excluding public safety vehicles) with bringing in slightly over $1 million in fiscal year 2004. In 2003, St. Paul began using up to $5 million a year of sales tax proceeds for debt service instead of for new capital project spending.

Most states restrict the use of gasoline tax revenues to street construction and repair. Columbus has begun using gas tax revenue to support street-related activity, like median mowing and tree removal, without objection.

Other actions noted by chief financial officers as providing substantial revenue included contracting out excess jail capacity to the INS in Atlanta ($1.8 million) and Las Vegas (approximately $5 million), and selling city-owned properties in Trenton ($2.8 million). In 2002 Chesapeake, VA increased its tobacco tax from 25 to 50 cents per pack, bringing in approximately $4.65 million a year, twenty percent of which must be used for economic development. Minneapolis has for several years borrowed from its revenue-producing water and sewer departments to pay operating expenses.

Chicago won approval for a one-half cent tax on prepared food. The levy was billed as essential to an anti-litter campaign, a response to the wrappers and other waste often found on the ground near fast-food restaurants. The $8 to $10 million to be generated annually is used to fund clean-up efforts, removing that cost from the general fund budget.

Miami noted the imposition of a half cent sales tax to help fund mass transit, while Oakland reported revenue success from repairing parking meters and increasing efforts to collect fines.

e. Tax and Expenditure Limitations Affect Revenues, as Does Taxpayer Opposition to New Taxes

City officials were asked how much of an impact statutory or constitutional revenue/expenditure limitations (TELs) have on their city's ability to budget (on a scale of one ("none") to six ("significant")). The mean response of 4.11 suggests that TELs are more important than not. As to be expected, their impact (4.5) is greater in California cities subject to Proposition 13, among other constraints. Taxpayer opposition to taxes is generally found to have a bigger impact (4.62) on the fiscal condition of cities than TELs. In California, perceived taxpayer opposition is seen as slightly less of an impediment to budgeting than are TELs, while the reverse holds true for responding cities in other states.

f. The Changing Economy and Tax-Exempt Property Hurt Cities that Rely on the Property Tax

Much has been written about the impact of the changed economy on city and state finances. The shift from manufacturing to service industries was found to have a mean effect of 3.78 on revenue raising for all cities, but as would be expected had a greater impact (4.24) for property tax-only cities, as the property tax benefits from a manufacturing base.

A large amount of tax-exempt property—i.e. property owned by government and non-profit organizations that receive city services and exempt from the property tax—can also pose a problem for cities. Existence of tax-exempt property ranked third behind "statutory or constitutional tax

limitation" and "local taxpayer opposition" in its effect on keeping the property tax yield below its potential. Two mayors interviewed stated that this was one of the most important revenue issues in their cities. Responding cities estimated that on average, 23.3 percent of their property is tax-exempt, with six cities reporting the amount to be over 50 percent. When asked to estimate the percentage of lost property tax revenue that is recaptured through payments in lieu of taxes, nearly 70 percent put the figure at just 0 to 5 percent.

g. Some Cities Would Like to be Able to Increase Spending, but Lack Revenue

City officials for the most part are satisfied with their city's level of expenditures (24 of 52 rate their level as "correct"), but more characterize them as low or too low (19) than high or too high (9). They also estimate their capital backlog at 4.29, closer to substantial than to none. Clearly many city officials would like their city to do more.

The problem is again found on the revenue side. When asked to rate a list of problem areas for their cities, inadequate tax revenue was, at 4.23 , second ranked behind improving education at 4.68. Congestion and unemployment were ranked ahead of crime (Table 34). Several officials whose city governments did not hold direct responsibility for providing K-12 education indicated that it was a problem for their city nonetheless, given its impact on unemployment and other social problems.

Table 34. Magnitude as Problem for City (1=not at all, 6=substantial)	
Improving Education	4.68
Inadequate Tax Rev	4.23
Congestion/Trans.	3.60
Unemployment	3.56
Crime	3.25
Mean	3.86

h. The Majority of City Officials Would Like the Option of Adopting a New Tax Source

Finally, city officials were asked if from a fiscal perspective their city would favor the option of adopting a new tax. Twenty-nine of the fifty-three respondents said that they would. (Table 35) For those that offered specific taxes, the leading tax suggested was a local sales tax (6), followed by income or payroll tax (4), and meals tax and utility tax (2 each); one city suggested a hotel tax. Two city officials noted that they would like to extend their sales taxes to services, while one mentioned taxing the Internet.

The political problem of overcoming the taxpayer opposition cited above limits the likelihood of imposing new taxes, however. Interestingly, property tax-only cities were less likely (8 out of 19) to want a new revenue source than cities that have alternative revenue sources (20 of 34).[16] There are

[16] Numbers do not add to "all" due to an overlap in city categories.

several explanations for these results. Cities that rely on other revenue sources, such as local income or sales taxes, may find them unstable, and wish to further diversify their revenue systems. Or it may suggest that cities with diversified revenue sources have found them to be beneficial, and are more likely to want to expand their use than cities without the experience. Officials in property tax-only cities may be concerned by the general anti-tax sentiment they encounter in their cities. What is undeniable, however, is that more city officials would like expanded revenue options than would not.

Table 35. Would Your City Favor Adopting a New Tax Source					
City Type:	All	Property Tax	Utility Tax	Sales Tax	Income Tax
Yes	29	8	19	17	4
No	24	11	18	14	1

D. What Cities Did in the Good Times

In addition to questions about cities' response to recent fiscal pressures, cities were asked to generalize on the actions that their city may have taken in the late 1990s, when the economy was strong. While they took some fiscally prudent actions, their expansion of spending in personnel-dominated areas set the stage for some of the pressure they would later experience.

1. Cities Increased Spending in the Late 1990s, But Also Built Up Reserves

Table 13 shows that cities clearly expanded spending during this period, which produced fiscal pressure when revenues fell. They did, however, disproportionately increase capital spending, as well as build up reserves. These are probably two of the wisest actions cities can take in good fiscal times, as capital spending does not involve large recurring costs and the building reserves provides a cushion for any economic downturn. Tax rates were reduced a little, but to do so puts elected officials in the position of having to raise them should fiscal conditions worsen. Contributions to pension funds, another shrewd fiscal move in good times, rated fourth (Table 36).

Table 36. Actions Taken in the Late 1990s (1=none, 6=substantial)	
Expanded Spending	3.86
Capital Spending	3.76
New Services	3.39
Built Up Reserves	3.26
Reduced Tax Rates	2.90
Pension Fund Contributions	2.52
Reduced Debt	1.76
Reduced Fees	1.44
Mean	2.86

2. The Largest Spending Increases Were in Public Safety, Employee Health Care, and Education

In response to a query on specific areas in which spending was increased in the late 1990s, public safety was the clear program area winner, followed by education. (Table 37) Education received a score of 4.36 overall, but it was the number one area of spending for cities with responsibility for education, at 5.11. City officials also noted significant spending increases for employee benefits, especially in health care, but also in wages. Capital spending also had a greater than average emphasis.

Table 37. Areas of Increased Spending in the Late 1990s (1=none, 6=substantial)	
Public Safety	4.71
Employee Health Care	4.49
Education	4.36
Employee Benefits	3.92
Capital Spending	3.78
Employee Wages	3.76
Public Works	3.60
Parks and Recreation	3.29
Libraries	2.86
General Government	2.85
Social Services	2.62
Mean	3.66

3. Other Than Building Reserves, Cities Took Few Steps to Ease Future Pressure

CFOs were asked if there were any specific actions they had taken in the 1990s that helped ease the pain of the downturn. Candidly, ten of the thirty-eight who responded to the question said "no." The most frequently cited productive action was the building up of reserves (8 cities). Charlotte, for example, increased its reserve goals from 8 percent to 16 percent. Two cities noted specifically designating what were seen as short term revenues exclusively for capital purposes. Minneapolis began the early stages of a five-year business plan, while Chicago took the wise move of diversifying its revenue base in *good* times.

V. SUMMARY AND CONCLUSION

Along with their federal and state counterparts, city government officials have ridden a fiscal roller coaster since the late 1990s. The relatively prosperous times at the end of the last decade turned into a period of fiscal strain after 2001 and the effects of that downturn lingered for most cities. A review of the long-term fiscal trends that preceded this latest fiscal shock, along with an analysis by city chief financial officers of the causes of their current fiscal problems and how they responded, offers important insight into the fiscal situation of cities as they move forward.

Several important findings emerge from the analysis of fiscal trends over the twenty-three year period from 1977 to 2000. Local government is the level of government generally most favored by citizens, yet general expenditures in these cities grew more slowly than did other types of government. Spending on the high priority areas of police and education did grow more than other areas, especially in the 1990s, but cities were generally fiscally conservative during the decade, even with the opportunity of growing revenues.

On the revenue side of the equation, the 1977 to 2000 time period saw a huge shift in intergovernmental aid, as state governments provided a greater share of city revenue while the federal government's contribution dramatically declined. An increased reliance on state aid comes at a price, however, as cities have become more dependent revenues outside of their direct control, and also increasingly targeted to one category of expenditure, K-12 education.

The data also suggests that where possible, city officials have embraced local tax diversification. The number of "property tax-only cities" in this study fell from 64 to 50 over the 1977 to 2000 period. And cities that have local income and/or sales tax options now rely upon them more.

Finally, there is no denying the increased role that fees and current charges are playing in city finances. While better tolerated by citizens than taxes, fees and charges have weaknesses, as they can place a disproportionate burden on low income citizens, reducing participation in activities that may be beneficial to local citizens, such as library use and recreation. And as they are most often tied to the service area that generates them, they do nothing to boost the discretionary revenue that city officials most favor.

These trends have had lasting impacts on city finances as they have shaped the fiscal environment within which cities currently operate.

From fiscal year 2003 to 2004 CFOs indicated that fiscal conditions in their cities declined, while budget pressures increased. CFOs characterize the problem as mostly a structural one, despite the recent economic downturn. Revenue inadequacy is seen as an significant concern in many cities, while expenditure pressures, especially in public safety, education, and employee benefits remain strong. Many city officials would like provide their citizens with new and expanded services, but are restrained from doing so by limited tax options, tax and expenditure limitations, and/or taxpayer opposition to raising revenues.

While expenditure pressures and revenue adequacy were rated as near equals in terms of *causing* budget problems, city *responses* to budget pressure in the past two years focused more expenditure restraint and reduction than in revenue raising. Many of the expenditure actions cities took were those that were relatively politically painless, but their cost savings might be difficult to replicate should fiscal pressures persist. Further, actions such as deferred maintenance and delayed capital spending can result in higher costs in the future. Indeed, in an interview one mayor and chief financial officer stated that their greatest source of expenditure pressure was making up for previously deferred maintenance of streets and sidewalks. Disappointingly, cities are not doing much in the way of public-private partnerships, or other long-term expenditure reduction strategies.

There were some innovations noted on the revenue side of the budget equation, however, especially with respect to fees and charges. But while they are apparently acceptable at present levels, their use may eventually be limited by citizen opposition, and the that fact that many innovations—including the use of reserves, selling of tax liens, sale of city owned property, and internal borrowing—were “one time” responses that can’t be replicated again in the near term.

A majority of the city officials would like to see their revenue base diversified. This is clearly one approach to overcoming a structural budget deficit, and cities with these options have tended to increase reliance upon them. This diversification of city revenue has its upside and downside, however. While increasing user fees may be a good way for cities to collect additional revenue, an over-reliance on fees limits the flexibility of city officials to use these resources for general expenditure needs. And while revenue diversification from increases in city income and sales taxes does not decrease flexibility, their revenue yield can be more erratic than that from the property tax. This are all important factors for cities to consider in their ongoing efforts to improve their overall fiscal situation.

In sum, cities, like their counterparts at the federal and state level, face the unenviable task of trying to satisfy citizen wants without alienating voters by increasing taxes. Without the deficit financing option available at the federal level, and, lacking the revenue options and broader base of state government, city officials face a difficult balancing act. The long-term efficacy of recent short-term responses is yet to be determined.

APPENDIX

State	City Names	City Types							Survey Respondent
		California City	Non-Education	Education	Utility Tax	Property Tax	Income Tax	Sales Tax	
Alabama	Birmingham		X				X	X	
Alabama	Huntsville							X	
Alabama	Mobile		X		X			X	
Alabama	Montgomery		X					X	
Alaska	Anchorage			X		X			
Arizona	Phoenix		X		X			X	
Arizona	Tucson		X		X			X	
Arkansas	Little Rock		X		X				X
California	Anaheim	X	X		X			X	
California	Berkeley	X	X		X			X	
California	Fremont	X	X		X			X	X
California	Fresno	X	X		X			X	X
California	Garden Grove	X	X		X			X	
California	Glen Dale	X	X		X			X	
California	Huntington Beach	X	X		X			X	X
California	Long Beach	X	X		X			X	X
California	Los Angeles	X	X		X			X	
California	Oakland	X	X		X			X	X
California	Pasadena	X	X		X			X	X
California	Riverside	X	X		X			X	
California	Sacramento	X	X		X			X	
California	San Bernardino	X	X		X			X	
California	San Diego	X	X		X			X	
California	San Francisco	X			X			X	
California	San Jose	X	X		X			X	
California	Santa Ana	X	X		X			X	
California	Stockton	X	X		X			X	
California	Sunnyvale	X	X		X			X	
California	Torrance	X	X		X			X	
Colorado	Aurora		X					X	X
Colorado	Colorado Springs		X		X			X	X
Colorado	Denver		X		X			X	X
Colorado	Lakewood		X		X			X	
Colorado	Pueblo		X		X			X	X
Connecticut	Bridgeport			X		X			X
Connecticut	Hartford			X		X			
Connecticut	New Haven			X		X			X
Connecticut	Stamford			X		X			
Connecticut	Waterbury			X		X			
Florida	Ft. Lauderdale		X		X	X			

Florida	Hialeah		X		X				
Florida	Hollywood		X		X	X			
Florida	Jacksonville		X		X				
Florida	Miami		X		X	X			X
Florida	Orlando		X		X	X			X
Florida	St. Petersburg		X		X	X			
Florida	Tampa		X		X				
Georgia	Atlanta		X		X	X			X
Georgia	Columbus		X		X				
Georgia	Macon		X		X				
Georgia	Savannah		X		X	X			
Hawaii	Honolulu		X		X	X			
Illinois	Chicago		X		X			X	X
Illinois	Peoria		X					X	
Illinois	Rockford		X						
Indiana	Evansville		X						
Indiana	Ft. Wayne		X						
Indiana	Gary		X			X			
Indiana	Hammond		X			X			
Indiana	Indianapolis		X						
Indiana	South Bend		X			X			
Iowa	Cedar Rapids		X			X			
Iowa	Des Moines		X		X	X			
Kansas	Topeka		X		X			X	
Kansas	Wichita		X		X	X			
Kansas	Kansas City		X		X				
Kentucky	Lexington-Fayette		X		X		X		
Kentucky	Louisville		X				X		
Louisiana	Baton Rouge		X		X			X	X
Louisiana	New Orleans		X		X			X	X
Louisiana	Shreveport		X		X			X	
Maryland	Baltimore			X	X		X		
Massachusetts	Boston			X		X			X
Massachusetts	Cambridge			X		X			
Massachusetts	Fall River			X		X			X
Massachusetts	New Bedford			X		X			
Massachusetts	Springfield			X		X			
Massachusetts	Worcester			X		X			X
Michigan	Ann Arbor		X			X			
Michigan	Detroit				X		X		
Michigan	Flint		X						
Michigan	Grand Rapids		X				X		X
Michigan	Lansing		X				X		
Michigan	Livonia		X			X			X
Michigan	Warren		X			X			

Minnesota	Minneapolis		X		X	X			X
Minnesota	St. Paul		X		X				X
Mississippi	Jackson		X		X	X			X
Missouri	Independence		X		X			X	
Missouri	Kansas City		X		X		X	X	X
Missouri	Springfield		X		X				
Missouri	St. Louis		X		X		X	X	
Nebraska	Lincoln		X					X	
Nebraska	Omaha		X		X			X	
Nevada	Las Vegas		X		X	X			X
New Jersey	Elizabeth					X			
New Jersey	Jersey City					X			
New Jersey	Newark								
New Jersey	Paterson			X		X			
New Jersey	Trenton					X			X
New Mexico	Albuquerque		X		X			X	X
New York	Albany		X		X	X			
New York	Buffalo			X	X	X			X
New York	New York City			X	X		X	X	
New York	Rochester			X		X			
New York	Syracuse			X		X			X
New York	Yonkers			X				X	X
North Carolina	Charlotte		X			X			X
North Carolina	Durham		X			X			X
North Carolina	Greensboro		X			X			
North Carolina	Raleigh		X			X			X
North Carolina	Winston Salem		X			X			
Ohio	Akron		X				X		
Ohio	Canton		X				X		
Ohio	Cincinnati		X		X		X		
Ohio	Cleveland		X				X		
Ohio	Columbus		X				X		X
Ohio	Dayton		X				X		
Ohio	Toledo		X				X		X
Ohio	Youngstown		X				X		
Oklahoma	Oklahoma City		X		X			X	X
Oklahoma	Tulsa		X		X			X	X
Oregon	Portland		X		X	X			
Pennsylvania	Allentown		X				X		X
Pennsylvania	Erie		X				X		
Pennsylvania	Philadelphia		X				X		
Pennsylvania	Pittsburgh		X				X		
Rhode Island	Providence			X		X			X
South Carolina	Columbia		X			X			
Tennessee	Chattanooga								
Tennessee	Knoxville								

Tennessee	Memphis			X		X			
Tennessee	Nashville			X	X			X	
Texas	Amarillo		X		X			X	
Texas	Arlington		X		X			X	
Texas	Austin		X		X			X	X
Texas	Beaumont		X		X			X	X
Texas	Corpus Christi		X		X			X	X
Texas	Dallas		X		X			X	
Texas	El Paso		X		X			X	X
Texas	Ft. Worth		X					X	
Texas	Garland		X		X			X	
Texas	Houston		X		X			X	
Texas	Irving		X		X			X	X
Texas	Lubbock		X		X			X	
Texas	San Antonio				X			X	
Texas	Waco		X		X			X	X
Utah	Salt Lake City		X		X			X	
Virginia	Alexandria			X	X				X
Virginia	Chesapeake			X	X			X	X
Virginia	Hampton			X	X			X	
Virginia	Newport News			X	X			X	
Virginia	Norfolk			X	X			X	
Virginia	Portsmouth			X	X			X	
Virginia	Richmond			X	X			X	
Virginia	Roanoke			X	X			X	
Virginia	Virginia Beach			X	X			X	X
Washington	Seattle		X		X			X	
Washington	Spokane		X		X			X	
Washington	Tacoma		X		X			X	X
Wisconsin	Madison								
Wisconsin	Milwaukee		X			X			X