CITY BUDGETS IN AN ERA OF INCREASED UNCERTAINTY

Understanding the fiscal policy space of cities

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He has published nine books, including Metropolitan Resilience in a Time of Economic Turmoil, Terra Incognita, Cityscapes and Capital, and The Dynamics of Federalism, and over 100 publications on urban finance, capital budgeting, federalism, infrastructure, urban development and fiscal policy. Since 1991, he has written the annual City Fiscal Conditions report for the National League of Cities and recently completed a 4-year project on the Fiscal Policy Space of Cities funded by the John D. and Catherine T. MacArthur Foundation to research city fiscal behavior and city financial adaptations during the Great Recession.

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Amid recent proposed changes by federal leadership, it is highly likely that cities will confront a new era of federal austerity and greater devolution or decentralization to states and localities. This paper examines the extent to which cities can take on greater fiscal responsibilities based on their "fiscal policy space," a framework for understanding cities' fiscal capacity and adaptability. The paper includes a typology that assesses 100 large cities on their fiscal capacities, especially in relation to constraints imposed by states or cities' own tax misalignment with their economic bases. It closes with implications for local and state actions.[1]

CITY FINANCES WITHIN AMERICAN FEDERALISM

With each new administration comes the inevitable question about the way it will refashion the connections between Washington, D.C. and state and local governments, including cities. The Nixon administration combined categorical programs directed at cities into block grants and created a no-strings-attached General Revenue Sharing program with states and local governments; the Carter administration created new grants-in-aid programs to support city governments; the Reagan administration blocked categorical grants and reduced or eliminated others; the Clinton administration revamped the federal-state welfare system; the second Bush administration provided additional grants for law enforcement equipment and training in response to the attacks of Sept. 11; the Obama administration expanded some state and local funding under the American Recovery and Reinvestment Act in 2009. It is not unexpected, then, that Trump administration proposals would also include changes in the intergovernmental system in terms of flows of funding and assignment of responsibilities.

Federalism, as it is commonly understood, refers to an intergovernmental system where authority and responsibility are constitutionally separated between a central or national government and subnational or state governments. Over the course of its history, the American federal system has undergone fundamental shifts in flows of funding and assignment of responsibilities in response to changes in economic and political circumstances. Scholars generally point to three periods in the development of the American federal system over time—a long period of dual federalism where federal and state-local roles were largely separate and distinct (roughly pre-1930s); followed by a period marked by expansion, cooperation, and creativity (roughly from the 1930s to the 1970s); then followed by an era of devolution, competition, and increasing antagonism (roughly 1980 to the present). These theories correspond with changes in public attitudes and presidential leadership.[2]

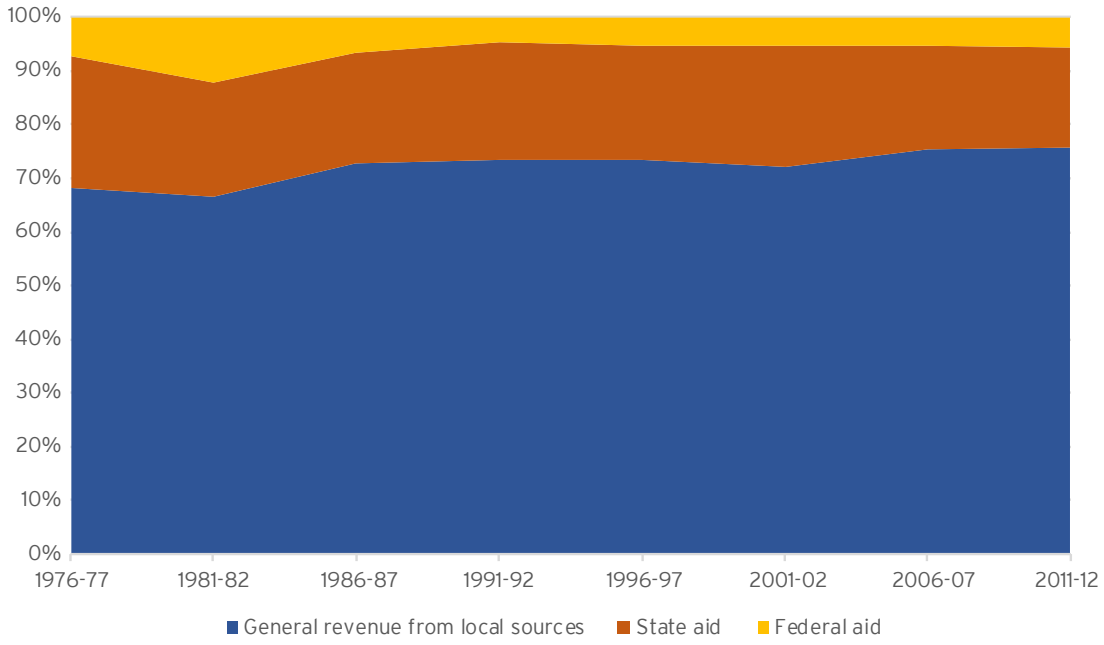
Correspondingly, flows of intergovernmental revenues, and the mechanisms through which these flows occur, have changed as the locus of control and authority has shifted between levels of government. By way of illustration, the nation's largest unrestricted grant program, the State and Local Fiscal Assistance Act or General Revenue Sharing (GRS) as it was popularly known, was created in 1972 and eliminated in 1986, reducing direct monetary transfers to cities and local governments by some $4.5 billion. The impact of defunding GRS on cities and other local governments varied across the political landscape.[3] Some cities had relied on GRS to support infrastructure projects, others to support public safety, and still others to hold down or reduce local property tax rates. With the demise of GRS, cities with the financial capacity to continue the projects supported by GRS did so; those that could not, did not.[4]

Overall, fiscal transfers from the federal government, which reached a zenith in the late 1970s at approximately 15 percent of total municipal revenue, returned within a decade to a much lower level (Figure 1). With the end of federal GRS, direct federal aid to municipalities fell to around 6.4 percent of total municipal revenues in 1987, a proportion that has remained fairly steady in the past 30 years. State aid to municipalities has hovered around 22 percent of total municipal revenue since 1980, declining to 18 percent by 2012, meaning that municipalities are raising some 75 percent of total municipal revenue with their own tax and fee powers.

FIGURE 1

Most municipal revenue comes from local sources

Share of U.S. municipal budgets from federal, state, and local sources



Source: Authors' analysis of the U.S. Census of Governments

Yet, even though contemporary federal aid is a relatively minor amount of municipal revenue overall, levels of federal aid vary dramatically by city and, therefore, necessitate varying levels of fiscal policy adjustments by cities. City reliance on federal aid varies widely, much like cities themselves—the nature of an intergovernmental system comprised of 19,522 municipalities, ranging in population size from a few dozen to New York City's 8.5 million. Small cities receive practically no federal aid, while the nation's largest cities receive more. Chicago, for example, receives federal funds that amount to approximately 15 percent of its total revenue in fiscal year 2017, with more than $100 million dedicated to affordable housing and the homeless and $178 million to infrastructure.[5] For many cities, especially smaller jurisdictions, federal agency support is quite inconsequential or invisible, and often comes in targeted forms, such as EPA loans for wastewater or water upgrades.

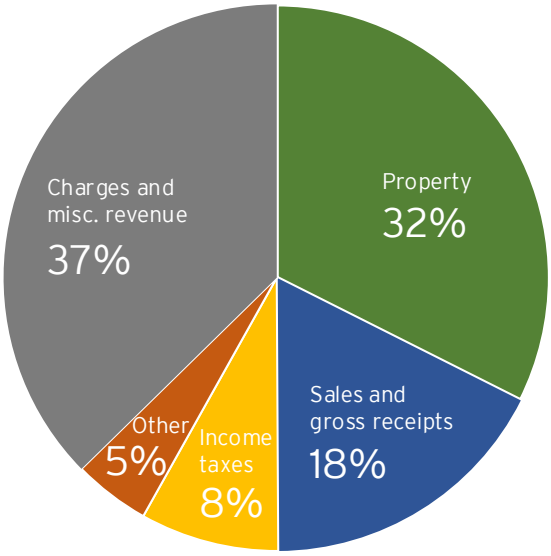
And all municipalities are subject to federal regulations that typically require compliance with national goals and standards and are often imposed as unfunded mandates.[6]

Municipal governments raise revenues in a number of ways. Property taxes have historically provided the largest contribution to municipal coffers, while sales taxes and, for some cities, income taxes have also contributed. However, non-tax revenues, including fees, special taxes, charges, and fines, play a substantial and growing role in funding municipal services (Figure 2). This reliance on non-tax fees increased most notably in the early 1980s, as federal funding to cities diminished and states placed restrictions on property tax rates.[7] Today, these fees account for more than one-third of locally raised municipal revenue. As will be documented in the case studies near the end of this paper, non-tax fees played an important role

FIGURE 2

Property taxes, sales taxes, and fees comprise most of locally-collected revenue

Sources of municipal revenue in the United States, 2012



Source: Authors' analysis of the U.S. Census of Governments

in closing budget gaps during the Great Recession. How President Trump's administration and its proposals change the nature of the federal system and flows of funds and responsibilities among levels of government remains to be seen. Modern presidents have been less prone to utilizing approaches to federalism (such as "state's rights" or "local control") to guide their policymaking and more likely to vary their approaches based on level of policy priority—often centralizing funding and authority around their core priorities and decentralizing funding and authority on lesser priorities. Signs from the Trump administration point to similar pathways, with perhaps a more overtly hostile and antagonistic overall approach to state and local fiscal capacity and authority, as outlined below.

The intergovernmental system in an era of Trump and state preemption

At the time of this writing, it is approximately one and a half years into the Trump administration's tenure, and what we know is limited to budget and policy proposals made and actions taken to date. Those proposals and actions point to a new era likely to be characterized by antagonism, greater fiscal obligations for state and local governments (as likely under infrastructure reform), increased regulatory interference in some arenas (particularly on immigration policy), and heightened uncertainty.[8]

President Trump's 2018 budget proposal, for instance, aimed to eliminate or reduce a large number of programs that are directed at city and local governments and metropolitan regions and to significantly reduce federal funding commitments to state governments for entitlement and safety net services. The Trump administration's proposals signaled a major shift in cities' budgeting environment, as they would eliminate many programs, including the Community Development Block Grant ($3 billion), the Transportation Investment Generating Economic Recovery or TIGER program ($500 million), the Choice Neighborhood program ($125 million), the HOME program ($950 million), the Social Service Block Grant ($1.4 billion); a range of regional economic development and workforce agencies; and many more programs directed at local governments and their residents.[9]

While a new federal budget agreement has been adopted that allows for increased spending levels through 2019, including preservation of some health care programs, the extent to which the Trump administration and Congress will work together on an appropriations bill that meets the higher spending caps is still uncertain. In other words, it is possible the Trump administration will maintain previously proposed cuts to domestic spending programs and social safety net programs. Such reductions would potentially force states to reduce eligibility and services to residents in need of those services, placing greater demand for local services. The unpredictable nature of annual budgeting in Washington also creates overall uncertainty for state and local actors.

The tax reform legislation passed by Republican majorities in Congress and signed by President Trump in December 2017 also contains a number of provisions that limit state and local efforts to raise revenue. The legislation establishes a cap on individuals' state and local tax (SALT) deductions, raising state and local tax burdens on high-income earners and thereby making future state and local tax increases more politically difficult to enact. By lowering top-end tax rates for individuals and corporations, the reform bill will likely raise the cost of tax-exempt municipal bonds, which are critical investment tools for infrastructure and other local capital improvements. And changes to the standard deduction, estate tax, and individual tax rate calculations put state governments at risk of losing revenue, unless they make changes of their own.

Meanwhile, the administration's proposed expansion of infrastructure financing will likely rely heavily on state and local contributions alongside private sector ones, adding to the multiple pressures on state and local resources.

The Trump administration has also been liberally wielding its administrative and regulatory authorities to try and force cities and local governments to enforce changes in federal immigration policy, significantly increasing tension among federal leaders and so-called "sanctuary cities," leading to concerns that federal funding might be withheld from cities.[10] Separate from actions undertaken by the Trump administration and Congress, city and other local governments are also confronting increasing preemption of local authority from their state governments. Preemption of local authority is not a new phenomenon, particularly given that city governments are, by law, incorporations under state law and therefore subject to the rules and policies established by those state governments. But, in recent years, largely driven by one-political party's domination of state legislatures and gubernatorial administrations, many states have increasingly moved to preempt local authority on tax policy, infrastructure, and social issues.[11]

The potential impacts of federal proposals and state preemption on cities and cities' fiscal positions, however, can be summarized in

much the same way as the impact of previous programmatic shifts in prior eras—namely that the impacts will vary because cities' fiscal architectures vary, and the capacity of cities to respond to substantial shifts in their financial environments varies. Policies that would cut or reduce local services and authority are likewise expected to elicit responses from city governments that reflect the peculiar features, constraints, and demands of those cities. City fiscal behavior, then, reflects the diverse and complex environment within which cities operate, their legal and constitutional possibilities, and their continuous assessment of fiscal policy options so that they can adapt and thrive as critical public-service providers as well as protectors of the health, safety, and welfare of their people.

HOW WILL CITIES RESPOND? UNDERSTANDING THE FISCAL POLICY SPACE OF CITIES

Given new policies and pressures from federal and state governments, cities and other local governments will necessarily adapt. This framing paper seeks to understand how and why local governments choose different pathways to rebalance their revenue and spending needs. In particular, this paper introduces the fiscal policy space framework, which analyzes the fiscal policy environment for municipalities based on three sets of factors: state-local policy, economic and fiscal tax base alignment, and the local demand for services. This framework reflects the *actual* constraints and opportunities within which cities operate and make policy decisions.

Following an explanation of the fiscal policy space framework and its findings, this paper takes a closer look at how cities with different constitutional, tax base, and political constraints fared during a recent fiscal shock: the Great Recession of 2008 and 2009. The paper offers short profiles of seven cities ranging from most constrained (such as Milwaukee and Boston) to least (such as Raleigh). Though an economic recession differs in important ways from drastic cutbacks in federal funding flows, both events place additional stress on municipal budgets. In studying cities' responses to the Great Recession, this paper seeks to shed light on how cities might respond to proposed federal cutbacks or expanded fiscal responsibilities, as have been proposed by the current administration.

The paper concludes with takeaways from the fiscal policy space analysis, including for federal, state, and local policymakers. This analysis suggests that although many cities may be willing, many probably do not have the capacity to absorb the proposed cutbacks and continue to deliver essential, high-quality services to their constituencies.

A framework for understanding a city's fiscal policy space

Cities face external forces, such as a deep recession, emergencies that demand public services, or new federal policies that require cities to adjust and adapt. How cities adapt depends in large part on their capacity to control resources and manage change. Three principal attributes of cities' capacity to adapt to changing environments are: (1) the *state-local framework*, including most importantly the constraining effects of the state and the state's financial support of its cities; (2) the *alignment* between a city's economic base and its fiscal architecture; and (3) the *demands* of the city's citizens and customers to provide an acceptable level of services. These three attributes create a lens through which we can understand the decisionmaking room for city officials to respond to external forces. We refer to this decision making room as a city's fiscal policy space (FPS). The larger a city's FPS, the better positioned it is to respond to a changing environment. The more constrained the FPS, the less its capacity to respond. Our normative assessment is that while federal and state funding flows remain essential to the functioning of cities and the well-being of their residents, fewer constraints on city policymakers create opportunities for decisions and outcomes that are better targeted to the needs of the community. The more local autonomy a city possesses, the more likely the needs of the city can be addressed by adoption and implementation of appropriate fiscal powers.[12] This is not to diminish the importance of federal and state support for city activities. While the rhetoric of city leaders, when confronting federal retrenchment, often preaches "going it alone," federal and state funding works in tandem with greater local fiscal authority to help cities function and to enable and amplify local investments.[13]

To better understand cities' fiscal policy space, we collected data for 100 large cities that vary in terms of revenue structures and geographical location, and for which we have available data. A key challenge in selecting a sample of cities that is economically representative of the municipal sector is that economic output data are not collected regularly for a wide range of cities. For example, gross domestic product (GDP) estimates are typically available for metropolitan areas but not as readily or regularly available for individual cities. As a result, the project team used a selection method that attempts to crudely approximate the relative economic and fiscal importance of large cities within metropolitan areas. We selected cities on the basis of their relative population size and the relative population size of their metropolitan statistical area (MSA), based on the 2011 census estimates. To be included in the sample, a city must be among the largest U.S. cities *and* be within the largest MSAs in the United States. For example, a smaller city located in a large MSA, or a larger city located in a smaller MSA, would not be included in the sample. The selection method employed also attempts to recognize the importance of the major cities within the nation's largest metropolitan regions, which in combination represent the economic engines of the U.S.[14] In some cases, however, the available data are limited to a slightly smaller overall sample of cities, as noted in the relevant sections to follow.

State-local framework

One important dimension of the fiscal capacity of U.S. cities is the state and local regulatory system in which cities operate. Cities' fiscal structures are "nested" within a constitutionally constructed system that influences and constrains cities' relative autonomy in a federal system. Revenue access, functional responsibility, and legislative authority of municipalities and other local governments are guided by the rules and regulations of the higher-order governments: their states and the federal government. An understanding of the administrative relationships among and between levels of government, from this perspective, derives from the constrained choices of one level of government imposed on it by other levels of government.

The classic description of local governments' life cycles was presented by Judge John Dillon from the state of Iowa in 1868: "Municipal corporations owe their origin to, and derive their powers and rights wholly from, the legislature. It breathes into them the breath of life, without which they cannot exist. As it creates, so it may destroy." States create local governments through powers of incorporation, and states can abolish local governments, regulate their behavior, limit their taxing authority, and in all ways make them comply with state demands within constitutional limits. Those who believed that "localism" or local autonomy best reflected the wishes and interests of the citizenry have clamored ever since to loosen the strictures of Dillon's Rule by supporting greater local autonomy (or what's referred to as "Home Rule"), which would favor expansive local powers to tax, legislate, provide services, and otherwise meet the needs of local citizens. Thirty-six states have granted some form of Home Rule to local governments (typically municipalities), and eight states have provided Home Rule statutorily. In the following three subsections, we closely examine the state-local framework through general taxing authority, state tax and expenditure limitations, and state aid.

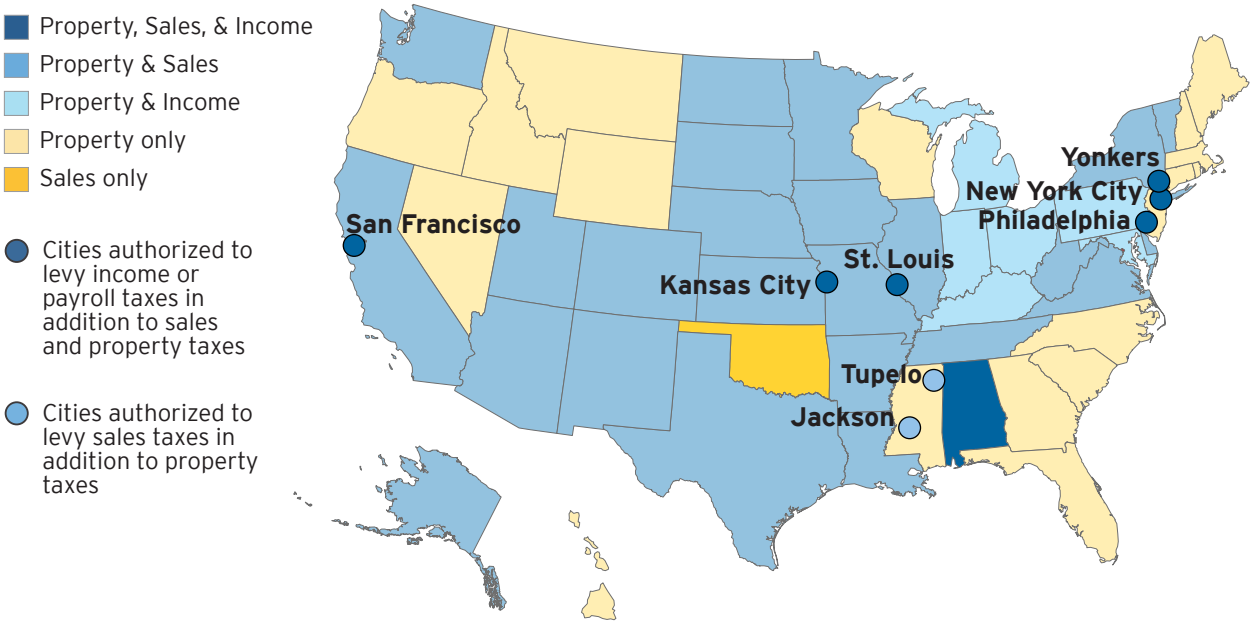
General taxing authority

Cities' authority to collect general taxes is not designed by the cities themselves. Cities' tax authority and constraints on that authority are imposed by the state, except in the cases of home-rule states. Nevertheless, states permit their cities to authorize the imposition of certain taxes, the most ubiquitous of which is the ad valorem tax on real estate ("property tax") which nearly every city levies. Since the introduction of the retail sales tax by New York City in 1934, more cities have been permitted to adopt it and expand their revenue portfolio.[15] Today, more than half of the nation's municipalities are permitted to collect a retail sales tax or share a county-wide sales tax for general operations (see Figure 3).[16] While most U.S. cities (more than 55 percent), rely on a blend of both the property tax and the sales tax as the dominant revenue sources, the cities of Oklahoma rely almost exclusively on the retails sales tax as their general revenue source for operations, while the property tax is typically set aside to retire debt obligations. Municipal taxes on income or wages are less common, with approximately one in 10 cities permitted to levy an income tax. Most of those municipalities are concentrated in the

FIGURE 3

Most states authorize cities to levy one or two general taxes

Municipal general taxing authority by state



Note: the City and County of San Francisco currently levies a local payroll tax that is being phased out in 2018 in parallel with phasing in a local gross receipts tax on businesses.

Source: Authors' analysis

states of Ohio, Pennsylvania, and Kentucky. Both Ohio and Kentucky permit their cities to levy the income tax at the place of residence and the place of employment, which has the effect of exporting taxes to nonresident users of city services and is often referred to as a "commuter tax."[17] The three general taxes are permitted in only a handful of cities; Alabama, for example, permits its cities to adopt an income tax, and some 18 cities have done so, in addition to the sales and property tax.

State tax and expenditure limitations

Another way that state and local tax systems are constrained is through voter- or state-imposed (constitutional or statutory) tax and expenditure limitations (TELs). TELs can constrain the property tax in particular, and they also are designed to constrain overall revenue spending increases.

Locally, the most common TELs affect local property taxes, while effects on general revenue and spending limits are less common. There are three types of property tax limits: 1) those that cap the property tax rate at a fixed amount, 2) those that limit the growth in a property's assessed value from one year to the next, and 3) those that limit the growth of the total levy (revenue) collected from a single property from one year to the next.

The first two types of property tax limits are not, by themselves, highly restrictive. For instance, a municipal government could circumvent a property tax cap (type 1) by raising the assessed value of the property, or could circumvent an assessment limit (type 2) by raising the property tax rate. We therefore make a distinction between "nonbinding" and "potentially binding" property tax limits, as can be seen in Figure 4.[18] Potentially

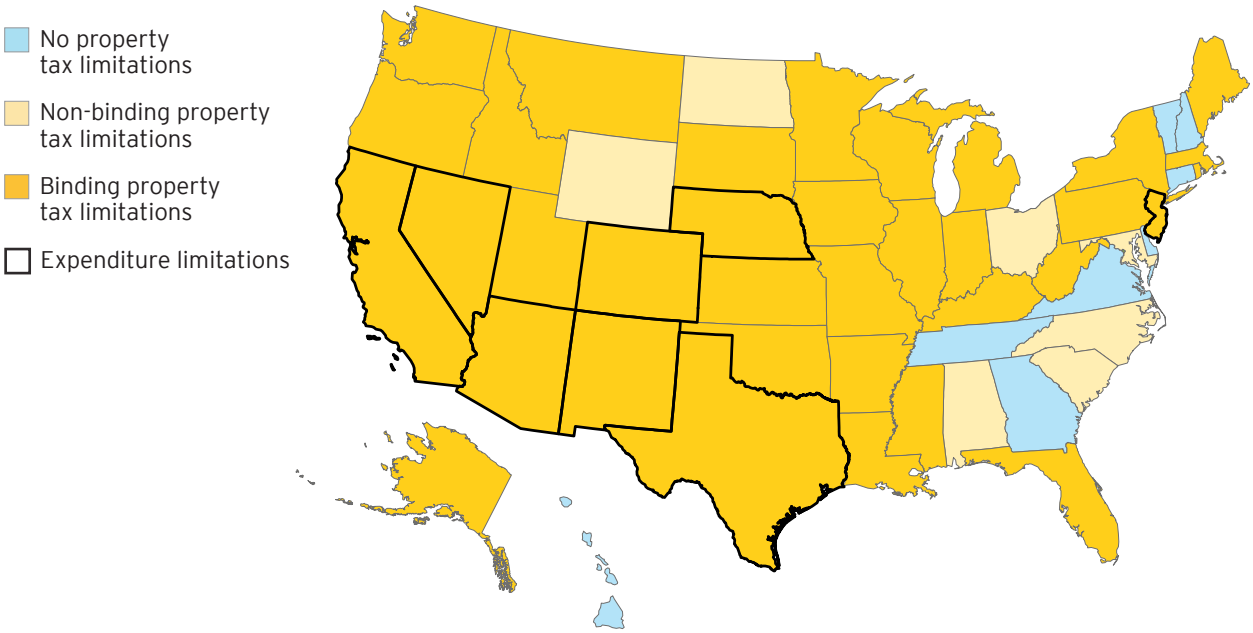
binding limits are those with either a levy limit (type 3), because it caps the bottom-line level at which the levy might increase, or some combination of rate (type 1) and assessment (type 2) limits together, which negates the ability of localities to circumvent the limits. Figure 4 illustrates which states impose no property tax limitations, which impose nonbinding TELs, and which impose potentially binding TELs. Additionally, some states—particularly in the Southwest—impose general revenue and spending limits on municipalities, which significantly limit local spending power. States with these additional limitations are outlined in black in Figure 4.

TELs are an important factor in shaping the local fiscal policy space, particularly those that limit local property tax authority and growth (and, therefore, TELs are particularly important in cities that rely on property taxes as a major revenue source). Most property tax limitations are imposed by state governments, but several cities also have imposed TELs as additional constraints on local property taxes. Specific TEL terms and conditions vary across states and over time. For example, California imposes a 2 percent limit on annual property tax levy growth, whereas Pennsylvania, which also limits local property tax levies, sets the growth limit at 10 percent. Property tax limits can also be amended by state legislators or voters. The difference between nonbinding and potentially binding TELs can be seen clearly when analyzing a city's "TEL gap." Many municipalities set property tax rates below their maximum allowable threshold. (After all, for both political and economic reasons, municipal leaders face intense pressure to keep property taxes low.) The difference between a municipality's maximum

FIGURE 4

Most states impose binding property tax or expenditure limitations on cities

Municipal tax and expenditure limitations by state



Source: Fiscal Policy Space project and Michael A. Pagano, "The Success and Challenges of the US Federal System: State-Local Finances," in GianCarlo Pola, ed. Principles and Practices of Fiscal Autonomy (Ashgate Publishing, 2015), p. 83

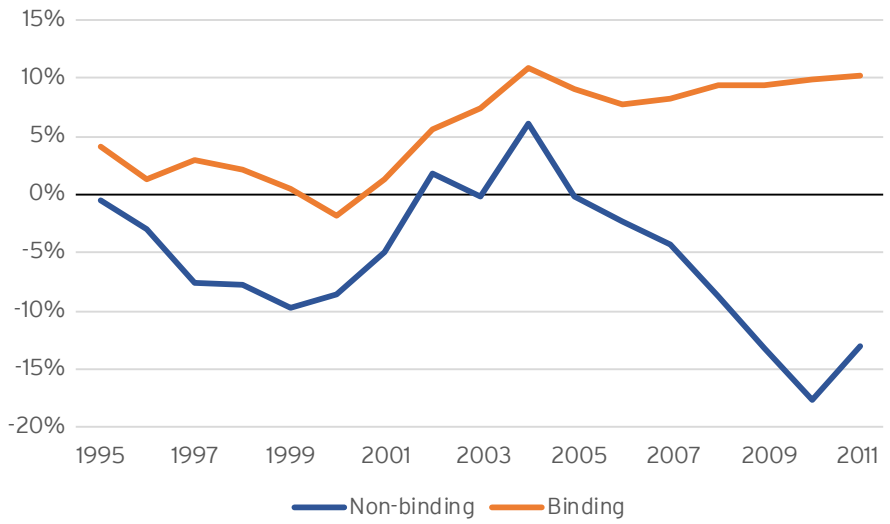
allowable property tax levy and its actual tax levy is what this paper defines as the "TEL gap." This gap is a crucial element of a city's fiscal flexibility: A large TEL gap suggests that a state's property tax limitation is less restrictive, while a small TEL gap reflects a more restrictive property tax limitation.

To calculate the strictness of a city's property tax limitations, we standardized the gap by calculating the ratio between the gap and the actual levy, which is depicted on the y-axis of Figure 5. We first compared the maximum allowable rates for growth imposed by state TELs with the locally imposed TELs. If there was discrepancy between the two, we used the more restrictive limit to estimate the legal ceiling.[19] We also identified an interaction between the TEL gap and the degree to which a TEL binds the city's ability to raise revenues. Nonbinding TELs, defined as imposing only a rate limit or only an assessment limit, can create an abundant gap for property taxation because cities can circumvent the rate limit by raising assessments or bypass the assessment limit by raising the property tax rates.[20] In other words, the space available between their existing tax capacity and their ability to raise additional capacity, as needed, is larger because they can circumvent the TEL restrictions. Dividing cities into binding and nonbinding groups, we find that cities subject to nonbinding TELs or with no TELs had higher average TEL gaps than cities with potentially binding limits, as would be expected. We also find higher TEL gap averages between 2001 and 2007 for the cities with nonbinding limits, whereas the average TEL gap for cities with potentially binding limits remains negative, pointing to less fiscal policy space. Figure 5 suggests that potentially binding TELs are, in fact, more restrictive because they limit the upside for additional property tax growth and, therefore, constrain the fiscal policy space of cities confronted by those limits.

FIGURE 5

Cities with binding tax and expenditure limitations have less space to raise rates

Average "TEL gap" among cities with binding and non-binding TELs



Source: Authors' analysis

Our analysis of the TEL gap in cities yields two important, if preliminary, conclusions. First, cities with potentially binding TELs are more likely to approach or reach their limit, compared to cities with nonbinding TELs. In other words, as intended, the fiscal policy space of TEL-constrained city governments is reduced. Second, for those cities that possessed some degree of space—that is, not operating at the limit's ceiling, it appears that they use this space over time, presumably by taking actions to increase the rate or levy and thereby approach the ceiling imposed by the TEL.

It is also worth noting that cities with potentially binding TELs may actually, in some instances, exceed the limits, which is a function of the limits being "potentially" binding (i.e., but allowing some limited space for exceeding the limit, such as through voter approval or in the case of fiscal emergencies). Cities with nonbinding TELs often occasionally exceed their limits, as the nonbinding nature of the limits permits those cities to take local actions to circumvent the limit.

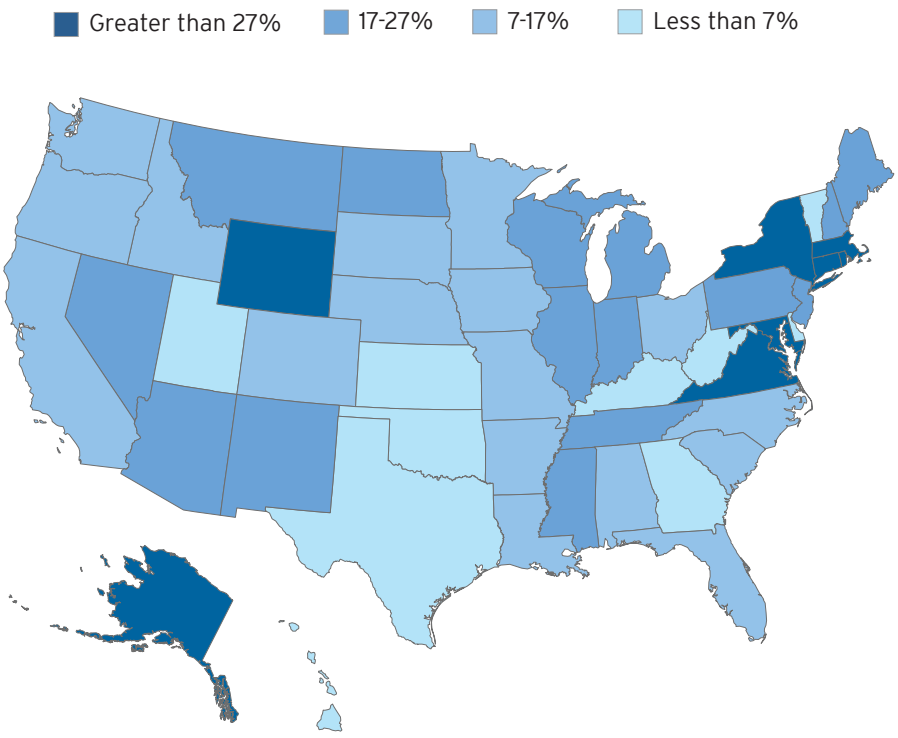
State aid

A final component of the state-local framework is state funding for municipalities, referred to here as state aid. State aid can be offered to offset constraints and regulatory requirements imposed by limited taxing authority and TELs. A recent report categorized states by the percentage of state aid provided to municipalities, which can be seen in Figure 6.

FIGURE 6

States in the Northeast and Mid-Atlantic offer the most aid to cities, while several states in Appalachia and the Great Plains offer the least

Share of municipal general revenue from state sources



Source: Christiana McFarland and Christopher Hoene, Cities and State Fiscal Structures (Washington, DC: National League of Cities, 2015), p 9.

As the map shows, states with the greatest amounts of state aid in 2012 are located in the Northeast and Mid-Atlantic regions, while states in Appalachia and the Great Plains offer the least. Those with the highest percentage of aid, aside from Wyoming, all had a similarity: Namely, elementary and secondary educational systems were under the control of the municipal government. Accordingly, in these states, state funds targeted for education were channeled through local governments, boosting the proportion of state aid.[21] However, excluding states with an education responsibility, cities whose states do not permit them to impose more than one general tax did not receive more state aid as a percentage of municipal general revenue than others. In fact, cities in six states with access to only the property tax received less than 14 percent of their revenue from the state, which is below average across all states. In other words, while state aid might theoretically balance out state-imposed tax limitations for municipalities by providing additional funding, in practice, the municipalities that are most limited by the state-local regulatory framework are no better off.

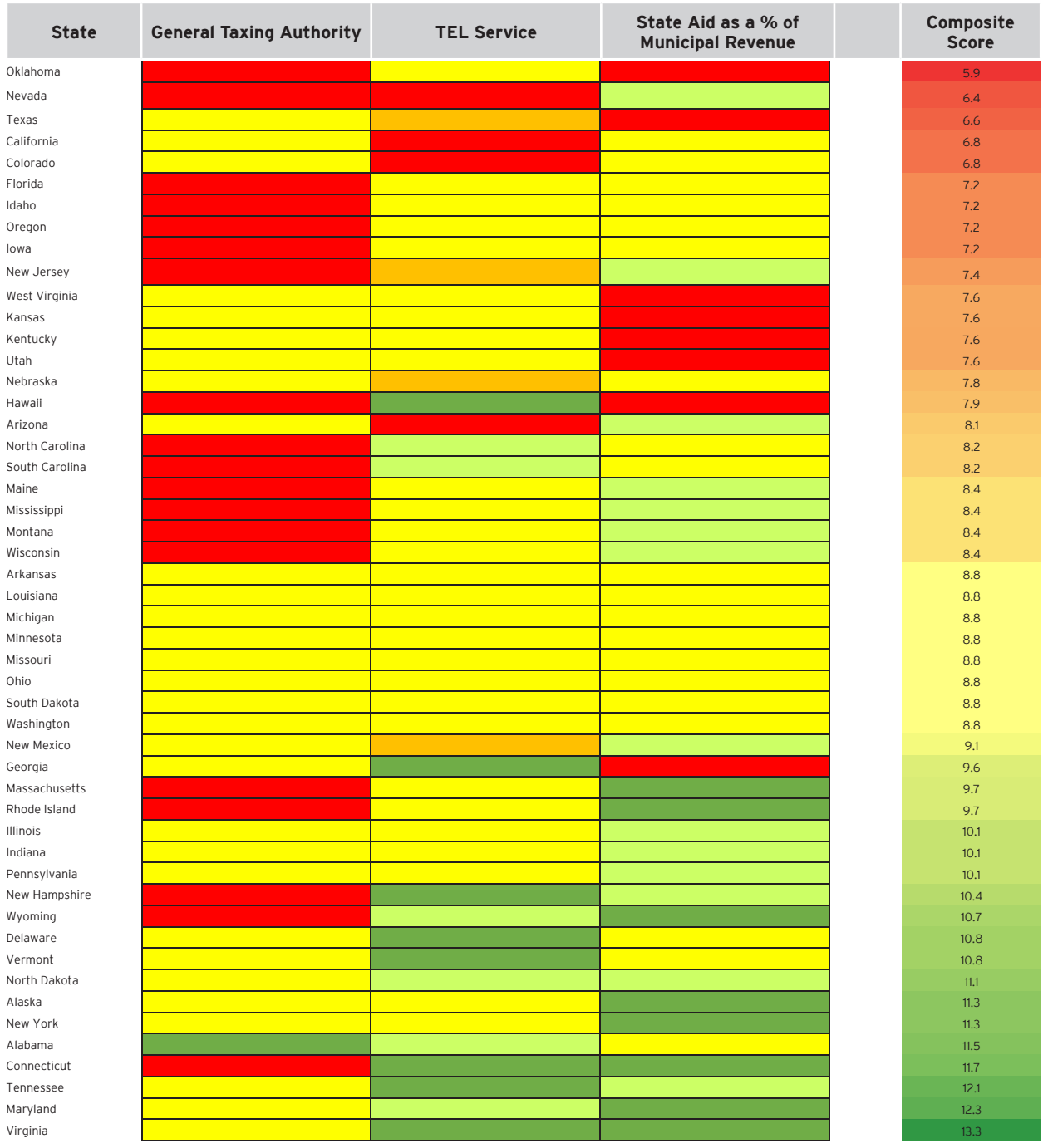
Summary

The attributes of the state-local fiscal structure create a necessary foundation for improving our understanding of the fiscal policy space of cities. The picture that emerges of state-city fiscal regimes is one of constrained fiscal policy spaces (see Figure 7). Few cities are given an array of fiscal policy tools to navigate business cycles, in essence expanding their fiscal policy space. Many of the cities that are allowed more fiscal autonomy and capacity in terms of state-local tax structures are also confronted by potentially binding TELs or limited levels of state assistance. Many cities lacking fiscal autonomy and capacity receive more state aid or are less constrained by TELs on the limited revenue authority that they do possess. There are no examples in which all cities of a state have access to broad fiscal autonomy (with local tax authority for property, sales, and income taxes) and capacity (in terms of own-source revenue and reliance upon a mix of all three local tax sources), greater state aid, and freedom from TELs. Those states that offer cities the most fiscal policy space, such as Virginia and Tennessee, are characterized by offering cities access to, and the ability to rely upon, two local tax sources (usually property and sales, although not universally), no TELs or nonbinding TELs, and higher levels of state aid. There are, in contrast, cities in many states with little or no fiscal autonomy, limited capacity, low levels of state aid, and potentially binding TELs. States that impose the most stringent constraints and provide the least state aid to possibly offset such constraints are listed in the graphic below. Of the 12 most severely constrained states, only three are granted the authority to tax more than real estate, and only two of the most constrained states (Nevada and New Jersey) provide above-average state aid to their municipalities. Moreover, five of the 10 most constraining states impose a very severe TEL on their municipalities. The evidence indicates that states in general are not compensating cities that operate under severe TEL restrictions or limited general taxing authority with state aid. In fact, of the eight states whose financial support amounts to more than 27 percent of municipal revenue (the green colored states), six also are ranked among the least TEL-constrained states.

FIGURE 7

Cities face vastly different fiscal constraints depending on their state-local framework[22]

State-local frameworks, ordered by severity of constraints on cities



Most constrained: municipalities are authorized to levy just one general tax; have both property tax and revenue or expenditure limitations; or receive far below-average state aid

More constrained: municipalities have expenditure limitations

Moderately constrained: municipalities are authorized to levy two general taxes; have binding property tax limitations; or receive below-average state aid

Less constrained: Municipalities have non-binding property tax limitations or above-average state aid

Least constrained: municipalities are authorized to levy three general taxes; have no tax or expenditure limitations; and receive far above-average state aid

Note: The composite score was calculated by weighting each of the three factors equally and scoring them on a 5-point scale. The lowest scores equate with the most severe constraints. The maximum score is 15; the minimum is 3.
Source: Authors' calculations

Local alignment of tax revenues to the economic base: The fiscal base

Another dimension to local fiscal revenue capacity is the extent to which a city's choice of taxes and fees are aligned with the city's underlying economic base or what is considered to be the city's economic engine. Poor alignment can result in the over-reliance of local revenues on certain sectors, sometimes taxing that sector too high, which can result in economic inefficiencies and other adverse outcomes. Poor alignment is not always a matter of choice, but of history and statutory strictures. A tax on real property reflected at one time the wealth of an individual and, as such, generally reflected one's ability to pay or contribute to financing public services. As other sources of individual wealth (income, capital gains, and other less tangible gains than those from property) have grown, the alignment with city revenue sources has decreased. Similar dynamics are in play with sales taxes, which are largely still dependent on purchases of goods and some services, although economic activity has increasingly moved into non-taxed services.

The fiscal architecture of municipalities has changed over time. Cities have expanded their taxing authority. Some cities have raised substantial revenues from a telecommunications tax (e.g., Florida and Illinois cities),[23] others have imposed a tax on real estate transactions, and most cities levy a business, building permit, and construction fee on builders. Municipalities attempt to design a fiscal architecture or create a revenue system that connects to the underlying economy of the city. At the same time, they attempt to design a fiscal architecture that is stable over the course of a business cycle. The property tax has the upside of being generally stable over time, rising incrementally during growth periods and declining relatively slowly during recessionary periods.[24] This is due to the periodic assessments of properties that are reflected in tax bills many months or even years after the assessment is completed. Due to assessment practices, then, the property tax's response to changes in the business cycle is not as elastic as the other two general tax sources, sales and income. Because income and sales taxes are collected at the time the work is realized (income, wages) or the time of the sales transaction, they are much more responsive to shifts in the underlying economy; that is to say, they are more elastic. Cities, with sufficient authority to adjust their revenue portfolios, do so with the understanding that the more balance between elastic and inelastic sources and the better aligned the fiscal architecture is to the city's underlying economic base, the more predictable and resilient the city's revenue system will be. The flexibility to redesign those systems is, in many cases, severely constrained by the state.

Kansas City, Mo. is a case in point. It has the authority to impose a property, sales, and income (earnings and profits) tax. At the start of the Great Recession, Kansas City's earnings tax receipts dropped 10 percent between fiscal year 2008 and fiscal year 2010, while sales tax receipts plummeted 15 percent. Property tax receipts, however, actually increased by 10 percent, resulting in a decline in total tax revenue of 8.5 percent. Had the city relied only on the property tax, revenues would have increased until fiscal year 2013, then dropped to fiscal year 2009 levels. Fiscal year 2017 property tax receipts were slightly less than fiscal year 2010 receipts. Had the city relied only on the sales tax, it would have suffered a 10 percent decline between fiscal year 2008 and fiscal year 2012 and then experienced such strong growth that by fiscal year 2017, sales tax receipts would be 33 percent higher than 2008 levels. And had the city collected only the earnings tax, it would have experienced revenue declines of 10 percent between fiscal year 2008 and fiscal year 2012, and then growth again such that by fiscal year 2017, the city collected 11 percent more earning taxes than in fiscal year 2008. Yet, because Kansas City has such a diverse tax portfolio, its total tax receipts returned to fiscal year 2008 levels by fiscal year 2013.[25]

Yet, a tax on income or wages, which most states impose as a primary revenue generator for state budgets, is not an option for most municipalities. And even those cities permitted to tax consumption via a sales tax are not permitted by state governments, in most cases, to broaden the sales tax base by including services. Moreover, an increasing proportion of retail sales is no longer transacted within a city's borders, as e-commerce has bypassed brick-and-mortar sales and, in many cases, become lost revenue to cities.[26]

To better understand the alignment between a city's economic base and its fiscal architecture, we create an index called "the fiscal base." This index is a composite of two important measures of the connection between a city's economic base and its taxing authority. One, the "tax base," measures the extent to which the city's property or sales tax base per capita is above or below the mean value for all cities. The second measure of "fiscal base" is the city's "tax share," which measures the share of a city's own-source revenues that come from property or sales taxes.

The index measures each city's alignment by averaging its tax base and tax share scores for property and sales taxes. Cities with higher-than-average per capita property values and higher-than-average shares of property tax revenue within their budgets, for instance, demonstrate alignment between their economic base and their fiscal architecture, and score highly. On the other hand, cities with lower-than-average per capita property values but higher-than-average shares of property tax revenue within their budgets demonstrate misalignment, and score lower.

Additionally, cities' authority to levy income taxes is measured: Cities that can levy income taxes score higher than cities that cannot.

The composite "fiscal base" index is calculated as the sum of a city's alignment scores across property, sales, and income taxes. Cities can score between 0 and 2 in each tax category. As a result, city scores on the composite "fiscal base" index can range from 0 to 6, though cities surveyed in this report scored between 1 and 4.5. The fiscal base index, then, is an estimate of the extent to which a city's economic base (defined as real estate values, retail sales, and income) aligns with a city's fiscal architecture that derives resources from those three broad categories. The higher the score, the better the alignment. Figure 8 presents the cities in our sample arranged by their fiscal base scores.

Cities with relatively high indexes, such as Birmingham, are those that have a higher than average property and/or sales tax base in per capita terms and, in Birmingham's case, can also collect a tax on wages; moreover, they derive a higher-than-average amount of property and/or sales tax revenue per capita. As the "tax base" expands (that is, as real estate, retail sales, and income grow), more revenues are captured by the city because its tax base is better aligned with its fiscal architecture. Low tax bases that are not well aligned or do not connect to a tax lever (e.g., a city with no retail sales taxing authority) generate fewer revenues.

The contemporary fiscal architecture of many municipalities has not adjusted to the rapidly changing underlying city economy. Even as cities serve as economic engines of regional and national economies, the capacity of some cities to tap into that wealth for the purpose of providing for the health, safety, and welfare of their residents is severely challenged.

As seen in Figure 8, cities with diversified revenue sources score higher on the fiscal base index, as they are better able to manage changing business cycles and economic conditions. Yet, even cities with non-diversified revenue sources can score highly as long as their underlying base, such as real estate, is large and growing. For example, although some cities have substantial retail sales, a low share of sales tax in its own-source revenue indicates that the city has quite limited access to

FIGURE 8

Cities whose economies align with their tax structures have stronger fiscal bases

Cities' fiscal base rankings according to 2010 property, sales, & income tax alignment

Least aligned — Moderately aligned — Most aligned

City	Composite fiscal base score	Property tax score	Sales tax score	Income tax score
Birmingham	4.5	0.5	2	2
New York City	3.5	1	0.5	2
Raleigh	3.5	2	1.5	0
Austin	3	1.5	1.5	0
Baltimore	3	1	0	2
Fort Wayne	3	1	0	2
Greensboro	3	1.5	1.5	0
Huntsville	3	1	2	0
Kansas City	3	0	1	2
Louisville-Jefferson	3	1	0	2
Omaha	3	1	2	0
Pittsburgh	3	1	0	2
Seattle	3	1.5	1.5	0
Albuquerque	2.5	1	1.5	0
Charlotte	2.5	1.5	1	0
Denver	2.5	1	1.5	0
Durham	2.5	1.5	1	0
Grand Rapids	2.5	0.5	0	2
Honolulu	2.5	2	0.5	0
Houston	2.5	1	1.5	0
Indianapolis	2.5	0.5	0	2
Jacksonville	2.5	1.5	1	0
Knoxville	2.5	1	1.5	0
Lexington-Fayette	2.5	0.5	0	2
McAllen	2.5	0.5	2	0
Montgomery	2.5	1	1.5	0
Philadelphia	2.5	0	0.5	2
Salt Lake	2.5	1	1.5	0
San Diego	2.5	1.5	1	0
San Francisco	2.5	1.5	1	0
Santa Rosa	2.5	1	1.5	0
St Louis	2.5	0	0.5	2
Tampa	2.5	1.5	1	0
Tulsa	2.5	0.5	2	0
Virginia Beach	2.5	2	0.5	0
Winston-Salem	2.5	1	1.5	0
Akron	2	0	0	2
Anchorage	2	2	0	0
Bakersfield	2	1	1	0
Baton Rouge	2	0.5	1.5	0
Boston	2	2	0	0
Cincinnati	2	0	0	2
Cleveland	2	0	0	2
Columbus	2	0	0	2
Corpus Christi	2	0.5	1.5	0
Dallas	2	1	1	0

City	Composite fiscal base score	Property tax score	Sales tax score	Income tax score
Dayton	2	0	0	2
Detroit	2	0	0	2
Fresno	2	0.5	1.5	0
Lincoln	2	0.5	1.5	0
Little Rock	2	0.5	1.5	0
Los Angeles	2	1.5	0.5	0
Lubbock	2	0.5	1.5	0
Memphis	2	1	1	0
Mobile	2	0	2	0
Oxnard	2	1	1	0
Phoenix	2	0.5	1.5	0
Portland (OR)	2	2	0	0
Reno	2	1	1	0
Richmond	2	2	0	0
Stockton	2	1	1	0
Toledo	2	0	0	2
Atlanta	1.5	1.5	0	0
Boise	1.5	1.5	0	0
Bridgeport	1.5	1.5	0	0
Colorado Springs	1.5	0.5	1	0
El Paso	1.5	0.5	1	0
Fayetteville	1.5	0.5	1	0
Madison	1.5	1.5	0	0
Minneapolis	1.5	1.5	0	0
Oklahoma City	1.5	0	1.5	0
Riverside	1.5	0.5	1	0
Sacramento	1.5	1	0.5	0
San Antonio	1.5	0.5	1	0
Shreveport	1.5	0	1.5	0
Spokane	1.5	0.5	1	0
Wichita	1.5	0.5	1	0
Worcester	1.5	1.5	0	0
Buffalo	1	1	0	0
Cape Coral	1	1	0	0
Chattanooga	1	1	0	0
Chicago	1	1	0	0
Des Moines	1	1	0	0
Hartford	1	1	0	0
Jackson	1	1	0	0
Las Vegas	1	1	0	0
Milwaukee	1	1	0	0
Orlando	1	1	0	0
Providence	1	1	0	0
Rochester	1	1	0	0
Springfield	1	1	0	0

Note: See Appendix A for methodology.

Source: Authors' calculations

that component of its economic base. In other words, only a small proportion of retail sales in these cities has been accessed for municipal revenue purpose. Increased access to important components of the local economy will improve alignment with the dynamic economic activities.

Yet, the authorization of local revenue sources is largely a state government authority and does not tend to change much over time. Cities should continue to encourage their states to expand the taxable base (e.g., broaden the sales tax base) and to allow access to taxes and fees that better reflect demand for city services (e.g., lodging taxes). Although it should come as no surprise that cities strategically encourage economic growth and development in sectors that can be taxed, thereby significantly contributing to the fiscal benefit of the cities, cities should also identify tax and fee strategies that fairly distribute service costs to users while ensuring that residents and users have access to those services. A balanced portfolio with a diversified source of taxes and fees that closely align to the economic base of a city can better ensure its long-term fiscal health than a highly-constrained, narrow tax base that is imposed by the state.

The third dimension of cities' fiscal capacity is the level of local demand for services. Cities' political cultures and propensities can affect the demand for a certain level and quality of services. Some cities are faced with high budgetary demands, thereby constraining those cities' ability to respond to additional demands; while others are faced with low budgetary demands, allowing at least a hypothetical possibility of addressing changing service demands. Local ideology, resident demands, and other interest group demands can affect fiscal policy decisionmaking differently and thus are separate concepts in measuring the local political space. We, therefore, create a composite measure of demand composed of ideology, resident demand, and interest group demand.

We examine political ideology using traditional measures of voting in presidential elections, reflecting that ideological leanings and party allegiances undergird much of American political life and policy preferences. While many local elections are officially nonpartisan and preferences for some local services (e.g., filling potholes) may transcend ideological differences, overall preferences for local public goods and services will also be influenced by ideology. More liberal cities are associated with more expansive fiscal policies and allegiances to public employees, the poor, and people of color, whereas more conservative cities are associated with fiscal conservatism, preferences for fewer and lower taxes, and pursuit of local policies and practices that favor businesses and a more friendly business climate.[27] We use a measure of voting in presidential elections that is available longitudinally and that is closely associated with more time-limited local measures of political ideology.[28]

We use housing affordability to represent resident demands. We capture local resident demands in a rent-to-income ratio. Housing affordability has been shown to predict certain orientations to residential policy among city officials, who were apparently cognizant of residents' affordability problems.[29] Homeowners are generally thought to be more sensitive than renters to increases in local taxes or indebtedness (given homeowners pay property taxes), whereas renters, low-income households, and racial minorities are often thought to hold more fiscally expansionary views. Local resident demands are represented in a rent-to-income ratio, a measure of unaffordability of rental housing in the city, where higher values indicate greater rental housing unaffordability. Finally, interest groups' influence on the local political space focuses on public sector unions (or other associations of municipal employees) that bargain for or protest against particular types of fiscal changes. We use the percentage of public sector workers covered by a collective bargaining agreement in a metropolitan area in a

given year to represent interest group demands.[30] Cities with a larger percentage of unionized public sector workers will tend to exact pressure on fiscal policymakers for certain types of fiscal changes, such as less contracting or outsourcing of services. In addition, more public sector unionization should generate more pressure to retain existing spending commitments (especially for personnel) and support higher taxes and more revenue. The extent to which public sector unionization will constrain or expand cities' fiscal policy space will obviously vary widely across cities, just as levels of public sector unionization across cities also vary widely. But, in general, it can be expected that public sector unionization will be associated with a preference for higher levels of services and resistance to budget cuts and privatization.

The three variables of the composite demand scale—local ideology, public unionism, and housing affordability—might well have interactive, contingent, and nonlinear effects on fiscal policymaking. High values on the demand scale indicate greater pressure, which would make budget cuts, contracting out, or austerity policies more difficult. Low (negative) values indicate less fiscally expansionary pressure. Figure 9 presents cities according to their constituencies' estimated demand for services, indexed across the three variables. Cities that face the greatest demand—the ones that have high rental unaffordability, vote more Democratic, and have higher rates of union density—tend to be more populous and located in the Northeast, Midwest, or West Coast; many of these cities are often characterized as older industrial cities in the "frost belt." These cities include New York, Hartford, Detroit, Providence, Boston, and Los Angeles. On the other end of the spectrum are cities that face the least demand from constituents, which tend to be mid-sized cities located in states in the South, Great Plains, and Mountain West. These cities include Anchorage, Salt Lake City, Virginia Beach, Boise, and Oklahoma City, followed by an array of cities in the South.

It is also important to note that the factors affecting demand preferences in cities change slowly over longer cycles. Our analysis of demand scores from 2002 onward suggests that scores have largely been consistent over that time. In other words, cities with high estimated demand for services today, such as Hartford and Boston, ranked similarly highly in 2002, while cities with low estimated demand for services, such as Colorado Springs and Lubbock, Texas, had among the lowest demand in 2002 as well.

Long-term liabilities

The three broad attributes—the state-local framework, fiscal base, and service demand—influence and shape the fiscal policy space within which city officials operate and make policy choices when examining contemporary operations. Yet, even as the FPS provides a general assessment of budgetary pressures on the cities' finances, it ignores the long-term liabilities that cities have accumulated. We readily acknowledge that it is critical to understand the long-term liabilities that also crowd out current fiscal policy options, which are unrelated to the contemporary situation and to constraints imposed by states. Three critical long-term liabilities are underfunded infrastructure assets, pensions, and other post-employment benefits.

Underlying cities' abilities to create and sustain economic growth is the fiscal capacity of the nation's municipalities that construct, maintain, and operate the infrastructure upon which economic development is built. The consequences of the Great Recession have been severe for cities and the economic regions that they comprise. The capacity of cities and regions to make significant investments in future economic growth, particularly through infrastructure investment, has been compromised by underlying economic conditions that have undermined the fiscal capacity of city governments to raise adequate resources and fund investment and services at appropriate levels. Research on the fiscal condition

of cities shows that infrastructure is usually the one arena where cities scale back quickly in response to recessions, which means it should also be the arena where they scale up quickly during periods of growth (although it is not clear the latter always happens, giving rise to the deferred maintenance challenge).[31]

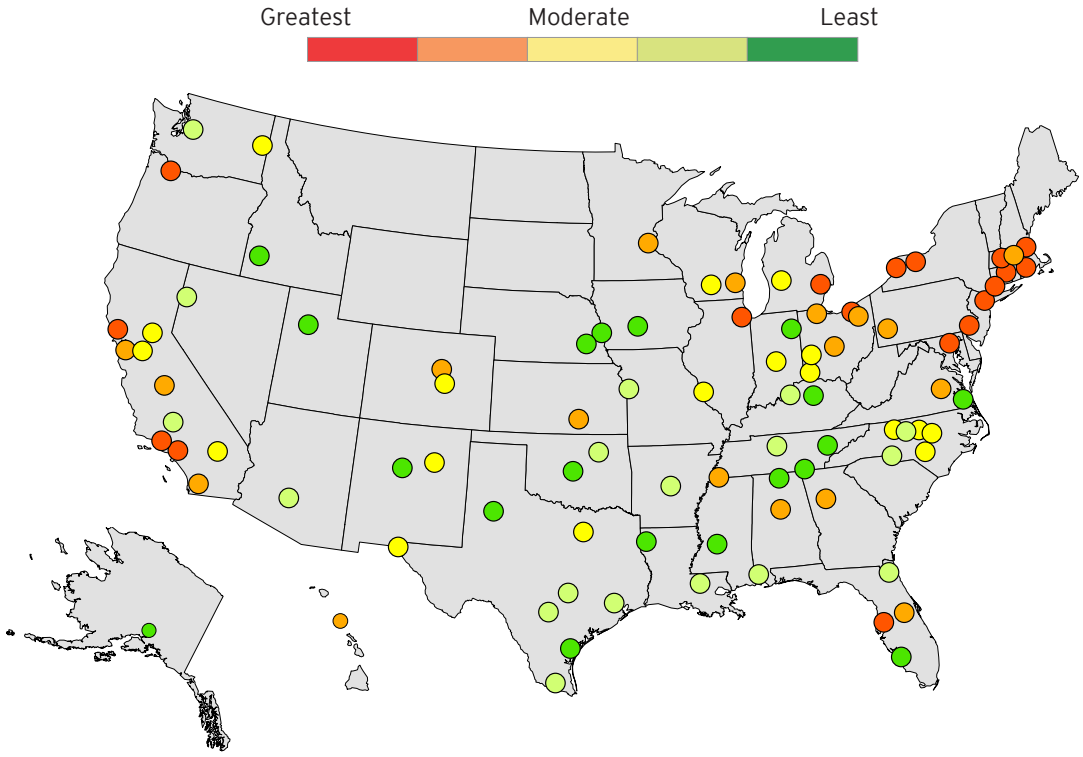
The growing backlog in deferred maintenance is a cost that does not show up on an expenditure sheet unless the city measures actual, rather than predicted, depreciation. Instead, maintenance deferral today pushes the actual cost of repairing or replacing the asset to future users. By deferring maintenance activities to some future date, cities' budgets are not as stressed as they would be if they attended to their maintenance needs. Research clearly demonstrates that infrastructure maintenance is often a casualty to economic slowdowns and reduced revenue flows. While deferring maintenance costs saves resources today, the effect of such an action is to place future budgets in even more jeopardy, thereby constraining the future fiscal policy space of cities.

Pension liabilities, often coupled with other post-employment benefit (OPEB) liabilities, constitute another set of long-term liabilities that certainly influence fiscal policy options of municipalities. As changes are made to the structure of pension and OPEBs, the attraction of the next city workforce needs to be given greater consideration. One of the challenges here is that city politics is often focused on the near term—as is the case with deferred maintenance decisions—when what is really needed is longer-term planning and

FIGURE 9

Cities with greater rental unaffordability, higher shares of Democratic votes, and larger public unions face greater fiscal pressures

Index of city service demand



Source: Authors' calculations

attention to whether a city has a viable plan for adequately funding its obligations over multi-decade timelines.

Ultimately, then, cities' responses to pressures from long-term liabilities are also shaped by the FPS. These three long-term liabilities coupled with the three major attributes of the fiscal policy space framework represent the critical set of conditions and pressures that cities must confront when deciding on their fiscal futures.

Pulling it all together: Cities by their total fiscal capacity constraints

Should the Trump administration's policies contribute to shocks to municipal fiscal systems, how might we expect cities to adapt? How might federal grants be redesigned to better support cities operating under severe constraints of their FPS? Finally, how can city and state officials consider how to better align cities' economic base with their fiscal architecture?

City behavior during the Great Recession offers some insight into how we might expect cities, during the Trump era, to adjust to sudden shocks to their fiscal systems. A glimpse at cities that cover the continuum of "least" to "most" constrained through the lens of the fiscal policy space framework could be instructive of the framework's importance in describing the decisionmaking room within which policy officials operate. We classified cities along a continuum from "least" to "most" constrained based on four factors:

- Tax authority (Authority): the number of general taxes available to cities;
- Property tax gap (Gap): the difference between the legal property tax levy and the actual levy;
- Fiscal base alignment (Base): the alignment between the city's economic base and its fiscal architecture; and,
- Demand for services (Demand): based on partisanship, housing affordability, and public union density.

Cities with access to more than one general tax source were classified as above the mean, while cities with only one general tax source were classified as below the mean. And for the remaining three factors, data from 2010 to 2015 were used to categorize the sample cities in our database into the above-the-mean and below-the-mean categories.[32] Cities that were classified as "below the mean" on all four measures were considered to operate within the most constrained fiscal policy space; cities that were classified as "above the mean" on all four measures were classified as the least constrained.

In Figure 10, we categorize cities by the severity of FPS constraints identified above. The cities on the left side of the table are classified as the most constrained. Five cities—Boston, Springfield, and Worcester in Massachusetts; Milwaukee, Wis.; and Rochester, N.Y.—score below the mean on all four factors, while 12 cities score below the mean on three of the four factors. These 17 cities are grouped by the cluster of "constraining factors" that they score "below" the mean. For example, Chicago and Denver score below the mean on the measures of demand (i.e., demand for services is higher than the average, thereby constraining the city's FPS), property tax gap (i.e., their levy is at or near the maximum), and fiscal base alignment. The only factor in which Chicago and Denver score above the mean, signifying less constraint on their FPS, is the "tax" variable which means that both can access at least two general tax sources (property and sales taxes).

The third column lists the cities that score below the mean on two of the four factors, and the fourth column lists the cities that score below the mean on only one factor. At the other extreme, the 14 cities on the right side of the table score above the mean on all four factors, meaning they enjoy relative local autonomy to adjust their fiscal policies in response to changes in their environment, compared with the other cities in this sample. Each one has access to two general taxes (property and sales) and room to raise property taxes (they could legally raise tax levies

without reaching a TEL limit); current demand for services is generally low, and their economic bases are fairly well connected to their taxing authority.

What this table illustrates is that cities' fiscal policymaking environment, as defined as the interaction of the four factors identified earlier, constrains cities in different ways. City officials work within their environments to respond to the daily challenges of providing services and ensuring adequate financial resources are collected. This is not to say that the cities we've classified as "least constrained" increase service delivery or provide more services than those that are less constrained. Rather, the observation is that those "least constrained" cities have the capacity to respond to challenges that arise in their cities. Whether or not they actually augment services, spend more on public safety, or invest in and maintain their infrastructure better than others is not addressed. Instead, it illustrates the relative decisionmaking authority they possess. When confronted with a shock to their systems—whether from an economic crisis, demographic shift, policy changes, or a natural disaster—cities that are least constrained have more options to pursue because they have more fiscal policy space than cities that are the most constrained.

FIGURE 10

Cities' fiscal policy space varies greatly

Sample cities' fiscal policy space, from most to least constrained

Source: Authors' calculations

	Four factors	Three factors			Two factors					One factor				Zero factors
Constraint	**Most constrained**	**Base+Gap+ Demand**	**Base+Demand+ Authority**	**Base+Gap+ Authority**	**Demand+Base**	**Demand+Gap**	**Gap+Base**	**Authority+ Demand**	**Authority+ Base**	**Demand**	**Base**	**Gap**	**Authority**	**Least constrained**
Tax Authority (Authority)	■		■	■				■	■				■	
Prop. Tax gap (Gap)	■	■		■		■	■					■		
Fiscal Base Alignment (Base)	■	■	■	■	■		■		■		■			
Demand for services (Demand)	■	■	■		■	■		■		■				
Cities:	Boston	Chicago	Bridgeport	Madison	Akron	Birmingham	Baton Rouge	Atlanta	Anchorage	Baltimore	Bakersfield		Greensboro	Albuquerque
	Milwaukee	Denver	Buffalo		Cleveland	New York	Boise	Honolulu	Cape Coral	Philadelphia	Chattanooga	Louisville	Jacksonville	Austin
	Rochester	Detroit	Hartford		Fresno	San Francisco	Colorado Springs	Tampa	Charlotte	Pittsburgh	Cincinnati	Salt Lake City	Raleigh	Ft. Wayne
	Springfield	Minneapolis	Miami		Los Angeles	Grand Rapids	Corpus Christi		Durham	San Diego	Dallas	Huntsville	Tulsa	Houston
	Worcester		Orlando		Memphis		Lubbock		Fayetteville	Santa Rosa	Dayton		Winston-Salem	Indianapolis
			Portland		Oxnard		San Antonio		Las Vegas	Columbus	Des Moines			Kansas City
			Providence		Richmond		Spokane		Oklahoma City		El Paso			Knoxville
					Toledo				Reno		Jackson			Lexington
					Wichita						Lincoln			McAllen
											Little Rock			Nashville
											Mobile			Omaha
											Montgomery			Seattle
											Phoenix			St. Louis
											Riverside			Virginia Beach
											Shreveport			
											Stockton			
											Sacramento			

■ Below-average fiscal space ☐ Above-average fiscal space

THE GREAT RECESSION AND CITY FISCAL BEHAVIOR: HOW SEVEN CITIES RESPONDED TO THE GREAT RECESSION

To explore how fiscal policy space shapes their behavior, seven cities were selected that span the range of "most constrained" through "least constrained." These include cities scoring below average on all four constraining factors (Milwaukee and Boston), three factors (Orlando), and one factor (Columbus, Sacramento, Dallas, and Raleigh), although Raleigh's lone constraint is mitigated, as explained below, placing it closer to the "least constrained" category.

Seven city profiles by FPS constraint

Below average on all four factors (Fiscal Demand Gap Tax)	Below average on three factors	Below average on two factors	Below average on one factor	Least constrained: Above average on all four factors (Fiscal Demand Gap Tax)
Milwaukee Boston	Orlando (Tax Fiscal Demand)		Dallas (Fiscal) Columbus (Demand) Sacramento (Fiscal) Raleigh (Tax)	

Boston, facing four constraining factors, does not have the authority to levy income or sales taxes and must rely on property taxes as its major general tax source. The city also operates under a stringent property tax limitation, further constraining its fiscal policy space. In addition, the city relies on intergovernmental funds and transfers from both federal and state governments. However, during the years after the Great Recession, state transfers declined from $418 million in 2008 to $310 million in 2011. Yet, due to a resilient real estate market that did not mirror precipitous declines in other areas of the nation, growth in property tax receipts continued throughout the recession—a reflection of the relative health of Boston's real estate market. In 2009, property tax receipts amounted to $1.4 billion for the city's governmental funds, increasing to $1.5 billion in both 2010 and 2011 and then to $1.6 billion in 2012. Even though Boston's budget did not suffer a precipitous decline in revenue during the Great Recession, the city implemented policies to ensure a balanced budget, such as delaying the promised 2010 employees' pay raises to the next fiscal year to reduce salary costs, transferring $5 million more in reserves than initially budgeted, and transferring $3 million from the Parking Meter Fund.[33]

Boston: With a severely constrained fiscal position and declining state aid, the city of Boston could have faced major budgetary shortfalls during the Great Recession. Fortunately, the city's comparatively strong real estate market and its aligned, property tax-based fiscal architecture enabled Boston to manage the economic downturn with only limited cost-cutting policies.

Milwaukee, also facing four constraining factors, suffered a significant decline in its property values during the Great Recession. Total assessed value in 2008 was $29.4 billion, which gradually declined to $25.3 billion in 2013. In response to declining property tax collections, and not having the authority to tax retails sales or income, Milwaukee increased the property tax rate every year, from $8.09 per $1,000 of assessed value for 2009 to $9.25 for 2012.[34] However, the increase in the property tax rates did not substantially increase property tax revenues due to the decrease in assessed property value caused by the slumping housing market and home foreclosures. During the period, the property tax rate increased by 14.3 percent, while property tax revenues grew only by 4.6 percent, from $237 million in 2009 to $248 million in 2012.[35] With the annual changes in the property tax rate enacted in response to the recession, it is also worth noting that Milwaukee had come within less than 1 percent of the total allowable levy under the state's property tax levy limit.

State aid also slightly declined, from $272 million in 2009 to $259 million in 2013. The combination of state aid and property tax revenue contributes approximately two-thirds of Milwaukee's budget. As the property tax rates neared the levy limit and state aid declined, the city was also forced to pursue other fiscal policy actions during the Great Recession. In 2009, Milwaukee increased fees for solid waste, sewer maintenance, storm water and overnight parking permits, and it introduced a new lease agreement that generated an additional $3 million in revenue. Milwaukee also reduced personnel expenditures through hiring freezes, eliminating positions, and reducing employee health insurance options. In each year during the Great Recession, Milwaukee also required between two and four mandatory furlough days on the members of the Common Council, the mayor and most city employees.

Milwaukee, a city that faced severe fiscal constraints, increased its property tax rates as much as possible in response to declining property values, but still experienced overall declining property tax revenues. State aid also diminished. The city's fiscal policy actions were primarily to reduce spending and personnel cuts, while raising fees. Even with these actions the city still faced sizeable budget shortfalls in the years following the recession.

The cumulative result of these actions was that by 2012, the General Fund was still in deficit, albeit a modest deficit of $14 million. The financial situation of the city during the Great Recession was ameliorated somewhat when the city received $203 million in federal aid via the American Recovery and Reinvestment Act of 2009, which provided funding for public safety, energy efficiency and environmental quality, infrastructure and transportation improvements, public health, and job creation and workforce development.[36]

Orlando scores below average on three of the constraint indicators. It is permitted access to only one general tax: the property tax. Consequently, Orlando relies on property taxes as its major revenue. The Great Recession had a dramatic impact on Florida local governments, as the property values plummeted in 2009 and continued to decline in the following several years. Orlando's property values did not start to rebound until 2013. In 2009, property tax revenues increased by 14.9 percent ($17.8 million) due to an increase in the property tax rate enacted by the city in 2008.[37] In the subsequent three years, however, property tax revenues declined—from $137 million in 2009 to $99 million in 2012. As a result, the city faced a $40 million gap in its 2010 budget and implemented a series of cost-cutting measures, including a 12 percent reduction for all city departments; elimination of a full-time mounted patrol; elimination of a public arts coordinator position and city-supported museum exhibits; a reduction in the maintenance of City

Orlando, a highly constrained city due to its reliance on property taxes, faced a major budgetary shortfall during the Great Recession. Declining property values placed significant pressures on the municipality's budget that were not fully ameliorated by a property tax rate increase prior to the recession. In the immediate aftermath of the recession, the city of Orlando was forced to make major service cuts and reductions in personnel to stabilize its budget.

Hall; an almost complete reduction of all holiday decorations; a drastic reduction in landscaping, irrigation, and mowing cycles; reduced pool and community center hours; and the elimination of 313 positions, including police and fire department personnel. In 2011, when taxable property declined by 15 percent, the city reduced another 400 positions and delayed payment of cost of living increases. In 2012, the city avoided eliminating any additional positions. Throughout the period of reduced finances, the city was able to maintain its increased property tax rate (from 2008), despite continued decline in the city's taxable property values, and maintain unassigned reserves.[38]

Columbus faced moderate fiscal constraints due to its above-average demand for services by its constituents. The city does have access to two general taxes: the property and the income tax.[39] The case of Columbus illustrates the differences in how the two taxes respond to economic shifts. As property value assessments are made intermittently, most cities continued to see their property tax receipts remain stable or even increase in 2008 and 2009, even after the real estate bubble burst, before declining in following years. By contrast, income taxes are withheld in the same way as the federal income tax is withheld by employers and remitted to the city monthly, and are thus more responsive to changes in unemployment and reduced incomes (much like sales tax receipts that are immediately affected by economic downturns).

As a result, Columbus maintained somewhat stable property tax receipts during 2008 and 2009, but still saw a declining budget due to a sharp downturn in income tax collections. The city's general fund budget declined from $671 million in 2008 to $616 million in 2009. In response, the city eliminated over 100 positions, closed a third of the city parks, and mounted a campaign to increase the income tax from 2 percent to 2.5 percent. With unanimous support of the City Council and 51.7 percent of the voters,[40] Columbus increased its income tax rate, effective October 1, 2009.[41] As a result, actual income tax receipts increased from $385 million in 2009 to $478 million 2010, an increase of $93 million. After initial enactment, the city reported continued growth in local income tax revenues by $21.3 million and $18.0 million, respectively, in 2011 and 2012. These increases allowed Columbus to restore some services that were reduced in earlier years.

Columbus, a moderately constrained city, experienced an initial and significant reduction in revenues due to declining income tax collections. In response, the city, with voter approval, increased its local income tax rate to stabilize its budget, allowing it to restore services that were cut in earlier years.

Sacramento, facing a below-average fiscal alignment, was severely affected by the Great Recession. Additionally, Sacramento was not able to entertain a general property tax increase option during the recession. The city's property tax rate is restricted by a binding TEL—Proposition 13, enacted in 1978, caps the property tax rate and growth in assessed values for tax purposes. The Great Recession hit the city's budget very hard. In fiscal year 2009, the budget was $965.5 million, and by fiscal year 2012, it had dropped to $797 million.

The city's response to the budgetary reduction was to reduce its reserves and to cut back personnel. In fiscal year 2009, General Fund reserves amounted to $72 million; by fiscal year 2012, the city's reserves were reduced to only $10.5 million. Between fiscal year 2009 and fiscal year 2011, the city reduced municipal staffing by 570 full-time positions (actual staffing in fiscal year 2009 was 4,943, in fiscal year 2011 it was 4,373) and especially in police and fire personnel—which amounted to a reduction of 90 persons. The city, in late 2012, turned to the voters and requested a hike in the sales tax by half a cent (Measure U on the ballot). The reduction in city employees and city services was instrumental in encouraging voters to agree to the sales tax increase. Although it was approved, it is a time-limited increase, as it is set to expire in March 2019.

Sacramento, a moderately constrained city, experienced significant reductions in revenues. With binding property tax limitations due to California's Proposition 13, the city made major reductions in personnel and drew deeply from its reserves. By late 2012, the voters were convinced to temporarily increase the sales tax by half a percent, which is set to sunset in 2019.

Dallas was above average on three of the four measures, limited primarily by below-average fiscal alignment. Dallas experienced a sharp decline in total taxable property value during the Great Recession, from $90.5 billion in 2009 to $82 billion in 2012, or a decrease of 9.4 percent. In 2009, property tax revenue totaled $662.4 million, or 46 percent of total revenues, then declined to $637 million in 2010. To offset the decline in property tax revenues, Dallas increased revenue streams from charges for services, such as increasing storm water rates and mineral lease revenues. The city also created new fees such as nonresident accident response fees and recapture of indirect costs on grants and contracts in fiscal year 2009, as well as annual food inspection permit fees, multi-tenant registration fees, and non-resident accident response fees in fiscal year 2010. As a result of these actions, the city increased charges for services by $14 million in 2009 and $26 million in 2010. The city cut expenses in fiscal year 2011 when it decreased public safety government expenses by $18 million and general government expenses by $13 million. Offset by an increase of $20 million in streets, street lighting, sanitation, and code enforcement activities, the city was able to reduce total expenses by $12 million.

Dallas' total revenues grew from $1.44 billion in 2009 to $1.76 billion in 2010, only to slip back to $1.5 and $1.47 billion in the succeeding years.[42] Yet, expenditures actually declined slightly from 2009 to 2010, allowing the city to build a cushion to weather the effects of declining revenue. In part, the city's budget benefited by having access to both a property and a sales tax. While sales taxes declined by $23 million in 2009, property taxes increased by $38.8 million. In 2010, both sales and property taxes fell by a combined $27.3 million, so in 2011, Dallas opted to use up some of its fiscal policy space by raising the property tax rate. The property tax rate was well below the legal property tax limit of $25 per $1,000 in assessed value. The gap between the legal maximum and the actual levy gave the city room to increase the property tax rate from $7.479 to $7.970 per $1,000 of assessed value in 2011, which had the effect of increasing the total property tax levy by $22.1 million in 2011. In fact, by 2011, combined revenue

Dallas, which faced fewer constraints, was able to raise its property tax rate to counteract reductions in both sales and property tax revenue during the Great Recession. The city also increased fees and charges and reduced expenditures on public safety, street lighting, and code enforcing to manage through the recession.

from the property tax and the sales tax had returned to pre-recession levels.

Raleigh is one of the least fiscally constrained cities surveyed, rating above average on three of the four FPS constraints. And even on the one factor, it scores low (having access to only one general tax source, the property tax). Raleigh is in a more enviable position than most cities that are authorized to levy only one general tax in that it shares a county-imposed sales tax.[43] During the Great Recession when most cities struggled with economic hardship and had to make severe expenditure cuts and personnel layoffs, Raleigh adopted policies that allowed it to enjoy a comparatively strong and structurally healthy fiscal position. However, the Great Recession still had its negative effects. Just prior to the Great Recession, Raleigh expanded its capital and operating spending in 2009 by nearly $100 million, financed by a five-cent (per $100 of assessed value) property tax levy increase, half of which was to support operational expenditures and the other half capital expenditures. In 2010, the recession began to impact the city's finances, with county-shared sales tax receipts dropping by 3 percent, forcing the city to eliminate 85 vacant positions and reduce pay-go capital spending by 57 percent. The county-shared sales tax receipts fell another 10 percent in 2011, prompting a round of additional reductions in positions and in pay-go capital spending by another 30 percent. Yet, unlike many cities that, in light of declines in tax revenues, reduced their reserves during the Great Recession, Raleigh actually increased its reserves.[44] In fiscal year 2008, the fund balance or reserves in the General Fund amounted to $137 million; at the end of the recessionary period, the fund balance had increased to $210 million.

Raleigh, a less constrained city, increased its property tax rate in 2009 using available property tax space. Confronting declining sales tax revenues from 2010 to 2011, the city was nevertheless forced to make modest cuts in staffing and capital spending to weather the recession.[45]

The glimpse into the responses of seven cities to the Great Recession reveals some clear FPS patterns. Not surprisingly, given the scope of the Great Recession, all of the cities—with the notable exception of Boston—experienced declines in their primary sources of tax revenue: property, sales, and income. And, for the most part, all of the cities took various actions to reduce spending obligations—implementing across-the-board or targeted spending cuts by program, reducing staffing levels, and suspending pay and benefit increases. However, the scale of those spending-side responses, their revenue responses, and their use of reserves varied by their available FPS. Cities with relatively more FPS—namely, Raleigh—raised their property tax rates and maintained or increased reserves, which also allowed them to mitigate spending-side cuts and recover more quickly as the economy rebounded. Similarly, slightly more constrained Columbus was able to raise its income tax rate—with voter (demand-side) approval—helping it better weather the downturn. Cities without any available tax policy space due to severe state-imposed property tax limitations, such as Sacramento and Boston, had fewer options. Without viable tax revenue options to pursue, Sacramento made much larger spending-side cuts and drew down its reserves at much more dramatic levels until late 2012, well after the Great Recession ended, when it temporarily increased its sales tax. Confronted with declining economic conditions and state aid, Boston might have faced similar realities to Sacramento had it not been for an unusually resilient housing market that propped up its property tax revenues during the recession (and allowed it to not have to directly confront high levels of demand with draconian service cuts). Milwaukee, with a more constrained FPS overall, but the ability to control the property tax, was unable to weather the hit of the Great Recession. Unlike Boston, Milwaukee's housing market suffered deep declines, constraining

revenues—despite the city raising the property tax rate—to the point where it has virtually no FPS left to maneuver. Confronted with declining state aid, the city might have faced a deeper level fiscal crisis without temporary federal aid.

What is clear is that cities with minimal FPS are much more vulnerable and much less resilient when confronted with external shocks and are, therefore, dependent upon underlying economic health and periods of economic recovery to pull them back from the brink of fiscal crisis in the periods after economic downturns. This is a particularly troubling reality in that many of these cities' overall fiscal health has not returned to pre-Great Recession levels, meaning that many of these cities are particularly vulnerable to destabilization through a combination of federal retrenchment, state preemption actions, and economic downturn.

WHAT THE FPS TELLS US ABOUT HOW CITIES MIGHT RESPOND TO INTERGOVERNMENTAL RETRENCHMENT

As outlined at the outset of this paper, cities—particularly larger cities and metro areas—are very likely heading into a period of increasing intergovernmental retrenchment, from federal budget cuts, tax policy changes, and increasing regulatory interference at the federal level to increasing preemption activity in many states.

The extent of intergovernmental retrenchment, at one level, might be viewed as akin to a significant economic shock, with recession-like implications for cities. Cuts in federal aid for programs such as housing and community development, low-income assistance, environmental mitigation, and economic and workforce development will surely have a financial impact on cities that rely on those federal funding streams to support activities. Similarly, reductions in local fiscal authority—through state preemption of local tax authority or service-level authority—will pinch cities' abilities to respond to other changing conditions.[46] Beyond those actions, federal policies that restrict overall economic output—restricting trade and immigration, cutting funding for health care that both increases the number of uninsured and decreases support for the health care industry as a sector, and tax cuts that restrict the overall scope of federal investment—are likely to disproportionately impact the economic conditions of the nation's most economically important cities and metro areas. Federal tax cuts could also have an indirect preemptive effect by reducing the available fiscal policy space available to state and local governments. For example, reducing the state and local tax (SALT) deduction on federal taxes will likely make it more difficult for states and local governments to increase those taxes in the future to meet local demands for services.

At another level, unlike a recession, intergovernmental retrenchment could have much longer-lasting effects because it would likely be more difficult to undo. In the current era of American federalism—defined by increasing antagonism—flows of federal and state aid, in addition to local taxing authority, have tended to decline over time. The past four decades suggest that, once removed, funding and local autonomy are extremely difficult to restore. In many ways, even if the immediate, annual impacts of intergovernmental retrenchment do not appear to be recession-like in scale, the medium- to longer-term term impacts are likely to be more significant. This has been the experience of cities more generally over time—the elimination of the federal General Revenue Sharing program, the elimination or reduction in state general revenue sharing programs, and the rise of state preemption and federal regulatory interference. On the cusp of this potential shock, understanding cities' fiscal constraints is more important than ever.

Our analysis of the fiscal policy space reveals three broad takeaways:

1. Cities will not respond uniformly to external pressures. Rather, we can expect cities to cope differently depending on their fiscal policy space. The FPS provides a lens through which others can understand the breathing room accorded a city and its prospects for adapting successfully.

2. No amount of fiscal policy space or autonomy will make cities entirely recession-proof. Just as cities operate within a broader governance structure of federalism, their economies are deeply interconnected with broader regional

economies and other external forces. As can be seen in the case studies, cities' ability (or inability, in the case of Orlando, Milwaukee, and others) to levy an income tax does not fully buffer them against a calamitous decline in property values.

3.. While not a panacea, expanded fiscal policy space enables cities to adapt to the needs of their citizens and make smart decisions about how to best provide government services during times of fiscal stress.

Additionally, our analysis carries implications for federal, state, and local leaders:

- **Federal leaders** should recognize that municipalities face varying fiscal constraints, and therefore will have different capacities to respond to federal initiatives and programs (such as an infrastructure initiative that leverages private capital and local revenues). Officials might consider altering existing funding formulas to even out disparities in municipal fiscal constraints, incentivizing states to loosen up fiscal restrictions and/or penalizing states that impose particularly onerous fiscal constraints on their local governments.

- **State leaders** should consider how existing regulatory constraints and funding formulas affect cities' abilities to serve as partners in advancing shared economic and social priorities, including infrastructure investment, education, and public safety. States with regulatory frameworks that disadvantage city governments by constraining their authority to levy taxes or establish stable fiscal bases would do well to update them.

- **City leaders** should think critically about how their fiscal infrastructure fulfills the needs of their city and its constituents. A city whose primary sources of economic growth do not contribute their fair share to public services may want to adjust tax rates accordingly. Tailoring public investments that enhance both private sector economic growth and fiscal returns to those investments is a critical public policy challenge for cities. Additionally, while expanding municipal tax authority is a difficult process, it can be done, either by petitioning state legislators to change state laws or, for some cities, asking city councils or voters to support rate hikes or new taxing authority. City leaders should consider how their existing tax base supports their efforts to deliver high-quality public services to their constituents, and advocate for reforms if needed.

In conclusion, the policy pathways suggested by the fiscal policy space framework—providing greater municipal fiscal autonomy, encouraging cities to better align their tax structures with their underlying economic systems, and reconciling the public's demand for services with their willingness to pay for them—are not "easy fix" solutions. In fact, these policies would require the reversal of trends that have acted to limit cities' fiscal policy space over the past several decades. But if cities are to successfully design, fund, and implement policies that provide high-quality educational opportunities, safe streets and neighborhoods, modern transportation networks, affordable housing options, and economic opportunities for all residents, they will need significant fiscal resources and flexibility. This imperative is particularly salient in an era of federal devolution of power and responsibility.

Ultimately, expanding the fiscal policy space of cities will serve to increase economic growth, prosperity, and inclusion for the nation as a whole.

APPENDIX A: METHODOLOGY OF FISCAL BASE INDEX

Cities with higher per capita real estate values and retail sales score higher than cities with lower per capita real estate values or retail sales.

The property tax base is the value of real estate in a city standardized by population. The sales tax base is the value of total retail sales in the city standardized by population. A city is assigned a score of 1 if its per capita property or real estate (retail sales) value is within 0.5 standard deviations of the mean value for all the sample cities' per capita property (sales) value; a city is assigned a score of 0 if its per capita property (sales) value is less than -0.5 standard deviations of the mean value of all cities; a city is assigned a score of 2 if its per capita property (sales) value is greater than +0.5 standard deviations above the mean value of all cities.

In addition to the assignment of value for the "tax base" for property and sales, we assign a score of 2 to cities with access to an income or wage tax; those without an income or wage tax are assigned a 0. Because income/wage taxes are levied on all residents, they reflect changes in the income or wage rate of a city.

The second measure of "fiscal base" is the city's "tax share," which is defined as the share of property (sales) tax collections as a percentage of the city's own-source revenues. A score of 1 is assigned to a city if its share of property (sales) tax collection is within 0.5 standard deviations around the mean value of all cities' property (sales) tax contribution to own-source revenues; 0 is assigned to a city if its share of property (sales) tax collection is less than -0.5 standard deviations below the mean value of all cities; 2 is assigned to a city if its share of property (sales) tax is greater than +0.5 standard deviations above the mean value of all cities.

The composite "fiscal base" index is calculated as the sum of the tax base score and tax share score (divided by two) and the "income tax" score. The values of the index for the sample cities vary from 1 to 4.5. The fiscal base index, then, is an estimate of the extent to which a city's economic base (defined as real estate values, retail sales, and income) aligns with a city's fiscal architecture that derives resources from those three broad categories. The higher the score, the better the alignment.

ENDNOTES

1 Throughout this paper we refer to "municipalities"—municipal incorporations under state law—and "cities" interchangeably.

2 Christopher Hoene, "Fiscal Federalism and Intergovernmental Revenues in the US," in *The Dynamics of Federalism in National and Supranational Political Systems, Michael A. Pagano and Robert Leonardi, eds. (New York, NY: Palgrave, 2007).*

3 See, e.g., Bruce Wallin, *From Revenue Sharing to Deficit Sharing: General Revenue Sharing and Cities (Washington, DC: Georgetown University Press, 1998).*

4 See, e.g., Paul Courant, Edward Gramlich, and Daniel Rubinfeld, "The Stimulative Effect of Intergovernmental Grants, or Why Money Sticks Where It Hits." In P. Meiszkowski and W. Oakland (Eds), *Fiscal Federalism and Grants-In-Aid (Washington, DC: The Urban Institute, 1979), pp. 5-21.*

5 Alejandra Cancino, "BGA Analysis: Trump's 'Sanctuary City' Plan Could Cost Chicago $3.6 Billion," December 9, 2016. And at: http://www.bettergov.org/news/bga-analysis-trumps-sanctuary-city-plan-could-cost-chicago-36-billion.

6 Congressional Research Service, *Unfunded Mandates Reform Act: History, Impact, and Issues, by Robert Jay Dilger (August 7, 2017). Accessed at:* https://fas.org/sgp/crs/misc/R40957.pdf.

7 Hoene, Christopher. 2004. Fiscal structure and the post-Proposition 13 fiscal regime in California's cities. *Public Budgeting and Finance 24(4):51-72.*

8 See, e.g., Special Issue: The "Shifting Sands" of American IGR in an Era of Flux and Uncertainty: What's Happening and What to Expect, Guest Editor: John Kincaid, *State and Local Government Review, 49:3 (September 2017).*

9 OMB, *Budget of the US Government: A New Foundation for American Greatness, FY2018 (Washington, DC: US Government Printing Office, 2017).*

10 An injunction by a federal judge on September 15, 2017, challenges the administration's withholding of federal funds from sanctuary cities.

11 Nicole DuPuis, Christiana McFarland, et al., *City Rights in an Era of Preemption: A State-by-State Analysis (Washington, D.C.: National League of Cities, 2017).*

12 For analyses of local autonomy, see, e.g., Hal Wolman, Goldsmith M, "Local Autonomy as a Meaningful Analytical Concept: Comparing Local Government in the US and the UK." *Urban Affairs Quarterly, (September 1990): 3-27; Richardson, Jesse J. Jr, Meghan Zimmerman Gough, and Robert Puentes, Is Home Rule the Answer? Clarifying the Influence of Dillon's Rule on Growth Management. (Washington, DC: Brookings Institution Center on Urban and Metropolitan Policy, 2003).* http://www.brookings.edu/es/urban/publications/dillonsrule.pdf.

13 For instance, see, "Eight Years Later, What the Recovery Act Taught Us About Investing in Transportation" (Washington, DC: Brookings Institution, 2017). https://www.brookings.edu/blog/the-avenue/2017/02/22/eight-years-later-what-the-recovery-act-taught-us/.

14 Richard Shearer, Alec Friedhoff, Isha Shah, and Alan Berube, *Metro Monitor An index of inclusive economic growth in the 100 largest US metropolitan areas (Washington, DC: The Brookings Institution, 2017) and at:* https://www.brookings.edu/wp-content/uploads/2017/02/metro-monitor_full_af2.pdf.

15 Michael A. Pagano, "Creative Designs of the Patchwork Quilt of Municipal Finance" in Gregory Ingram and Yu-Hung Hong, eds. *Municipal Revenues and Land Policies (Cambridge, MA: Lincoln Institute of Land Policy, 2010), pp. 116-140.*

16 Many states allow their municipalities to impose a sales tax for special purposes, e.g., tourism. In this section, we are referring to cities with sales tax authority for general purposes. For a listing of states that permit their cities access to the sales tax for special purposes, see Whitney Afonso, "State LST Laws: A Comprehensive Analysis of the Laws Governing Local Sales Taxes," *Public Budgeting and Finance 37:4 (Winter 2017): 25-46.*

17 For a discussion of the tax exporting characteristics of the local-option property, sales and income taxes, see Helen Ladd and John Yinger, *America's Ailing Cities: Fiscal Health and Design of Urban Policy (Baltimore: Johns Hopkins University Press, 1989).*

18 D. R. Mullins and P. G. Joyce, "Tax and Expenditure Limitations and State and Local Fiscal Structure: An Empirical Assessment," *Public Budgeting and Finance*, 16 (1996): 75-101; D.R. Mullins and B.A. Wallin, "Tax and Expenditure Limitations: Introduction and Overview," Public Budgeting and Finance, 24 (2004): 2-15; Shu Wang, "Effects of State-Imposed Tax and Expenditure Limits on Municipal Revenue Reliance: A New Measure of TEL Stringency with Mixed Methods,"*Publius: The Journal of Federalism* 48:2 (March 2018): 292–316.

19 Given that a limit can be imposed on the property tax levy, property tax rate, and assessment growth and given that cities can be subjected to different combinations of these limits, we used the following matrix to estimate the legal ceiling.

	Levy=0	Levy=1
Rate=0, Assess=0	$AssessValue_{t-1}*p\text{-}rate_{max}$	$Levy_{t-1}*(1+LevyCap)$
Rate=1, Assess=0	AssessValue*RateCap	$\min[Levy_{t-1}*(1+LevyCap), AssessValue*RateCap]$
Rate=0, Assess=1	MaxAssess*p-rate	$\min[Levy_{t-1}*(1+LevyCap), MaxAssess*p\text{-}rate]$
Rate=1, Assess=1	MaxAssess*RateCap	$\min[Levy_{t-1}*(1+LevyCap), MaxAssess*RateCap]$

Notes: This table outlines all the combinations for calculating P(max), the maximum levy allowed by state-imposed TELs. The maximum levy can be inferred given the maximum property tax rate and the maximum assessment, or by applying the maximum allowable rate for levy growth to the base value, usually the actual levy of the prior year. The notations are as below: "Rate", "Assess" and "Levy" denotes the enactment of rate, assessment, and levy limit, respectively (=1 if enacted). "LevyCap" denotes the maximum allowable rates for growth for levy. "RateCap" denotes the property tax rate cap. "AssessValue" denotes the assessment of a city in a given year. "P-rate" is the actual property tax rate of a city in a given year. "MaxAssess" denotes the maximum assessment a city is allowed to collect given the assessment limit; here MaxAssess=AssessValuet-1*(1+AssessCap), where "AssessCap" is the maximum allowable rates for growth for assessment.

For the cities with no TELs, we used the maximum property tax rate across all cities in a given year to identify the TEL gap. Although these cities are not subject to any legal limits on property taxes, in practice their levy is not infinite. The maximum tax rate in the sample provides a reasonable estimate for the highest possible level of tax levy. Using the same approach, we also calculated the revenue gap for the cities subject to general revenue and expenditure limits.

20 Wang contends that "A negative TEL gap suggests that the property tax levy in a city exceeds the levy ceiling imposed by TELs. This is possible through voter override of TELs and TEL exemptions that allow additional property taxes to be levied for special purposes." Shu Wang, "Effects of State-Imposed Tax and Expenditure Limits on Municipal Revenue Reliance: A New Measure of

TEL Stringency with Mixed Methods," *Publius 48:2 (2018), p. 304.*

21 Christiana McFarland and Christopher Hoene, *Cities and State Fiscal Structures (Washington, DC: National League of Cities, 2015).*

22 The composite score was calculated by weighting each of the three factors equally and scoring them on a 5-point scale. The lowest scores equate with the most severe constraints. The maximum score is 15; minimum is 3.

23 Yonghong Wu and David Merriman. 2011 "Illinois' Municipal Telecommunications Tax: Revenue Potential and Tax Base Elasticity," *Urban Affairs Review 47:6 (2011): 838-860.*

24 E.g., Joan Youngman, *The Good Tax (Cambridge, MA: Lincoln Institute of Land Policy, 2016).*

25 City of Kansas City, Comprehensive Annual Financial Report, 2017. page C-7. https://doc-0k-38-apps-viewer.googleusercontent.com/viewer/secure/pdf/bgr2edsv56ka2tfnoe40hgfeacov7fb0/5guac0oldeah7d8pim1r4n2tapo2rdf/1525720125000/drive/08207444786190102847/ACFrOgDRvWgRTYPswRJ88RzH05reKyZVCvORiUyLu6B0VY5NeZJjMNWIf4NdYB3FFvZpg2sKKLfad1uRTd-WWWiPmwYR6vLmGDWIVJeki7_FMgj7C5RDSUhJ50bEIyk=?print=true&nonce=1aeld8psp4e3g&user=08207444786190102847&hash=l5nnkg4kennuqf2bq00iq5un45ip664g.

26 The U.S. Supreme recently decided the Wayfair case (South Dakota v. Wayfair, Inc., et al., No. 17-494, Decided June 21, 2018) that will now require sellers to collect sales tax even if the seller does not have a physical presence in the buyer's state. This decision will allow cities to recoup sales taxes that, prior to this decision, had been lost. For discussions of the lost sales tax revenue prior to the Wayfair decision, see John Mikesell, "The American Retail Sales Tax: Depression's Child in the New Economy of the 21st Century," prepared for the conference "Public Finance and the New Economy", Georgia State University, April 27, 2018. See also, John F. Due, *State and Local Sales Taxation, Structure and Administration (Chicago: Public Administration Service, 1971); Donald Bruce, William F. Fox, and LeAnn Luna, "State and Local Government Sales Tax Revenue Losses from Electronic Commerce," University of Tennessee, April 13, 2009.*

27 For a discussion of the political dimensions associated with local demands for services, see Paul G. Lewis, "An Exploration of the Political Dimensions of Cities' Fiscal Policy Space," available at SSRN: *https://ssrn.com/abstract=2907067* or *http://dx.doi.org/10.2139/ssrn.2907067.*

28 See Paul G. Lewis, "An Exploration of the Political Dimensions of Cities' Fiscal Policy Space," available at SSRN: *https://ssrn.com/abstract=2907067* or *http://dx.doi.org/10.2139/ssrn.2907067 and Chris Tausanovitch and Christopher Warshaw, "Measuring Constituent Policy Preferences in Congress, State Legislatures, and Cities," Journal of Politics, 75:2 (2013), 330-342.*

29 Paul G. Lewis and Max Neiman, *Custodians of Place: Governing the Growth and Development of Cities (Washington, DC: Georgetown University Press, 2009).*

30 The municipal-level data are unavailable, and Anchorage, AK, and Lincoln, NE, are missing from the source data for the final two years (2007, 2012). For documentation, see http://unionstats.gsu.edu and Barry T. Hirsch and David A. MacPherson, "Union Membership and Coverage Database from the Current Population Survey: Note," *Industrial and Labor Relations Review, 56 (2)(January 2003): 349 54 and Paul G. Lewis, "An Exploration of the Political Dimensions of Cities' Fiscal Policy Space," available at SSRN: https://ssrn.com/abstract=2907067* or *http://dx.doi.org/10.2139/ssrn.2907067*.

31 The National League of Cities' City Fiscal Conditions Survey, a national mail and online survey of finance offices in U.S. cities, conducted annually since 1986, has shown that in the initial years after the onset of an economic downturn, cities scale back commitments to infrastructure (capital spending) significantly. For instance, see Michael A. Pagano and Christopher W. Hoene, *City Fiscal Conditions in 2002*, *Cities Confront Tough Choices as Fiscal Conditions Decline*, *City Fiscal Conditions in 2003*, *City Fiscal Conditions in 2009*, and *City Fiscal Conditions in 2010* (National League of Cities: Various years) which document cities' reduced commitments to infrastructure following recession in the early 2000's and the Great Recession. Inter alia, see, Charles Levine, Irene Rubin, George Wolohojian, eds., *The Politics of Retrenchment* (Newbury Park: Sage Publications, 1981); U.S. General Accounting Office, *Distressed Communities: Capital Investments Were Postponed in Texas as Local Economies Weakened* (Washington, DC: GAO, 1991); Gary Reid, "California Cities and Proposition 13," *Public Budgeting and Finance* 8 (Spring 1988): 20-37; Harold Wolman, "Understanding Local Government Responses to Fiscal Pressure," *Journal of Public Policy* 3 (August 1983): 245-64.); Michael A. Pagano, "Fiscal Disruptions and City Responses: Stability, Equilibrium and City Capital Budgeting," *Urban Affairs Quarterly* 23 (September 1988): 118-137.

32 Above the mean for the Fiscal Base measure was defined as any city that scored 2.5 or higher (see Figure 8).

33 City of Boston, MA Annual Budget Fiscal Year 2012, July 1, 2010; Letter of Transmittal. https://www.boston.gov/sites/default/files/fy12-volume1-letter-of-transmittal.pdf.

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39 In the classification scheme, we calculate a 'property tax gap' as the difference between the legal levy and the actual levy. In the case of Columbus (and Ohio cities), the 'tax gap' does little to constrain the city's behavior. The state allows all local governments within a county to divide the first 10 mills of property tax collections according to the county's interests. After that millage is set, the only way to increase it is through a referendum. Consequently, Columbus' city council has not placed a property tax levy on the ballot. Indeed, the millage rate for Columbus is 3.14, where it has been since 1956.

40 Columbus Underground. (2009). *Columbus City Income Tax Has Been Approved.* http://www.columbusunderground.com/columbus-city-income-tax-has-been-approved.

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