



Long-Term Stress and Systemic Failure:

Taking Seriously the Fiscal Crisis of America's Older Cities

Alan Mallach and Eric Scorsone
2011



Center for
COMMUNITY PROGRESS

Turning Vacant Spaces into Vibrant Places

About the Authors

Alan Mallach is a senior fellow at the Center for Community Progress, a visiting scholar at the Federal Reserve Bank of Philadelphia, and a non-resident senior fellow at the Metropolitan Policy Program of the Brookings Institution. He is the author of *Bringing Buildings Back: From Abandoned Properties to Community Assets* and many other publications about housing and urban revitalization

Dr. Eric Scorsone is an Assistant Professor and State Extension Specialist in the Department of Agricultural, Food and Resource Economics at Michigan State University. His area of specialization is state and local public finance, law and economics, public management and intergovernmental cooperation, and he is currently providing extensive technical assistance to city governments facing severe fiscal stress in both the United States and Europe.

The Center for Community Progress

The mission of the Center for Community Progress is to create vibrant communities primarily through the reuse of vacant, abandoned, and problem properties in America's cities and towns. We accomplish this mission in the following ways:

- Community Progress is the national resource for policy, information, capacity building, and training regarding the redevelopment of vacant, abandoned and problem properties.
- Community Progress partners with federal, state and local officials and non-profit organizations that are charged with repositioning vacant, abandoned and problem properties.
- Community Progress collaborates with experts on relevant research needed to contribute to the growing body of appropriate public policy regarding the successful reuse of vacant, abandoned and problem properties.
- Community Progress is the national advocacy organization regarding the successful reuse of vacant, abandoned, and problem properties.
- Community Progress uses its expertise to improve the overall economic and social well-being of American cities and towns impacted by large numbers of vacant, abandoned and problem properties.

The authors would like to thank Peter Goodstein, Esq., Dan Kildee and Jennifer Leonard for their valuable assistance in the preparation of this paper.

Long-Term Stress and Systemic Failure: Taking Seriously the Fiscal Crisis of America's Older Cities

Table of Contents

Executive Summary	2
Introduction.....	3
1 Defining the Fiscal Challenge Facing America's Cities.....	5
Measuring fiscal health and fiscal stress	
Adding infrastructure to the equation	
Structural deficits	
Looking forward	
2 How the Features of Legacy Cities Have Made Them Particularly Vulnerable to Fiscal Stress	10
Who are the legacy cities?	
Cities are facing stagnant or declining property values	
Cities contain large numbers of vacant/non-taxpaying properties	
Cities contain disproportionately low income populations	
Cities are impacted by high health benefit and pension costs	
Cities have already cut many services and face major infrastructure problems	
3 Confronting the Fiscal Challenge: Policy Options to Address Chronic Fiscal Stress.....	15
The fallacy of accounting solutions	
Taking the fiscal crisis seriously	
4 Conclusion.....	21

Executive Summary

America's legacy cities – its older cities that have lost much of their historic population and job base – are in a severe fiscal crisis. Facing growing deficits, they are reducing services, laying off municipal employees, canceling capital projects, and cutting back on repair and maintenance of city facilities and infrastructure. While every recession creates fiscal difficulties for local governments, this one has hit older, poorer cities with particular intensity.

Some cities may experience some relief in their short-term budgetary solvency with the end of the Great Recession. For others, the problem is not one of short-term fiscal stress at times of national economic crisis. Nor is it principally a problem of poor management or inefficient service delivery, although both may be present. *The central problem is a structural one, built into the dynamics of the American city.* Where resources are not growing and in many cases actually shrinking, fiscal stress is a chronic, long-term problem that must be addressed not through band-aids, but through systemic, long-term strategies.

State intervention in local fiscal crises is usually based on the assumption that these problems can be solved through short-term or 'accounting' solutions, such as improving fiscal management, eliminating waste, and fostering greater efficiencies in municipal operations. While these steps may be needed, they are not the heart of the issue. Short-term accounting solutions leave the long-term problems at the root of the city's fiscal crisis unchanged; indeed, draconian actions can make matters even worse in the long run.

A fundamentally new approach to addressing fiscal stress in legacy cities is needed, which focuses not only on short-term cash flow and budgetary needs, but *which is designed from the beginning to foster long-term change in these cities' fiscal reality, to end the vicious cycle of decline in which they are trapped.* This means taking short-term actions while being careful not to impair the city's long-term viability, while laying the groundwork for long-term strategies to build the local economy, reuse underutilized or vacant land, and stabilize or grow the local population. It also means looking at options that have rarely been considered, recognizing the regional nature of many issues facing these cities, and crossing or redrawing municipal boundaries to find solutions.

Rebuilding the fiscal stability of legacy cities and enabling them to provide their citizens, workers and businesses with the quality of life they deserve will not come easily or quickly. It is worth doing, though, in the interest of all those who live in these cities and their regions, and to build flourishing regions in areas that are struggling today. The alternative is to allow these cities and regions to become the 'Other America' as Michael Harrington described Appalachia fifty years ago, offering little opportunity to their residents, and no longer playing a meaningful role in the nation's economic life.

Introduction

America's its older cities that have lost much of their population and jobs over the past decades, which we refer to as *legacy cities* in this paper, are in a severe state of fiscal crisis. Facing growing deficits, they are reducing services, laying off hundreds of municipal employees, canceling capital projects, and cutting back on repair and maintenance of city facilities and infrastructure. While every recession creates fiscal difficulties for local governments, this one has hit older, poorer cities with particular intensity. For these cities, particularly those like Flint, Cleveland and Dayton that are continuing to lose population and jobs, the current financial crisis is the latest and most severe blow in a long-running pattern of increasing fiscal instability and stress, to the point where their very survival as government entities is at risk.

These cities matter. Despite decades of suburbanization, central cities are still important to the future of the economies of their state and region. Despite predictions to the contrary, as transportation and communication systems have become increasingly efficient, place and density have come to matter not less, but more. States that are home to dense urban centers and regions have the strongest economies, because they offer the most conducive environments for the growth of human knowledge and the sharing of ideas that lead to innovation and growth. If a region's central city is allowed to decline, and lose its role as a center of activity and energy, the region is likely to decline with it.

For cities to succeed in that role, they must be able to offer a decent quality of public services and infrastructure. This matters at many levels. The quality of public services, as reflected in public safety, good public schools, attractive and well-utilized parks and playgrounds, well-maintained and clean streets and sidewalks, is arguably the central input defining the quality of life that the city offers. It is a critically important factor in decisions by people and businesses to move to a city, or if there, stay rather than move away. If the city's ability to provide good public services or maintain its infrastructure and facilities declines, its ability to function as a vital center of activity also declines, to the point where the city turns into an appendage rather than the heart of the regional economy.

Since the 1960s, older cities have found it increasingly difficult to find the resources to provide public services of adequate quality. Loss of population and jobs, combined with the increasing poverty of their remaining population and the declining value of their property base, have severely reduced their ability to find the revenues they need to pay for these services. As cities have attempted to continue to provide traditional municipal services, the uneven, checkerboard pattern of population loss, which has led to large parts of cities such as Detroit or Youngstown becoming largely depopulated, has led to steadily rising per person delivery costs. While the recent Great Recession has exacerbated the fiscal stresses faced by these cities, it did not cause them, nor will future national and regional economic recovery solve them. Their problems are built into their long-term economic decline, and into the long-term shift in wealth and resources from the areas within the central city's municipal boundaries to its surrounding suburban areas.

This white paper seeks to outline the fiscal and public service delivery challenges facing America's legacy cities. The first section delineates the nature of the fiscal stress facing these cities. The second section provides an analysis of the economic and public service issues facing these same communities. Finally, the third section highlights some of the potential policy solutions that may be available to address the long term fiscal and service solvency issues.

¹A second category of city that is facing problems that are almost as severe are those older industrial cities that have remained stable or even grown in population as a result of immigration, such as Springfield and Lawrence in Massachusetts, and Newark or Paterson in New Jersey. These cities, notwithstanding their population influx, continue to lose jobs, while the incoming population is often of lower income levels than those whom they are replacing, both of which factors exacerbate the city's fiscal difficulties.

1 Defining the Fiscal Challenge Facing America's Cities

Recurrent fiscal challenges

Municipal fiscal stress is nothing new. Local government fiscal crises were common during the Great Depression, when large numbers of towns and cities defaulted on municipal bond obligations. The issue again came to the forefront during the 1970s, when a series of municipal fiscal crises, most notably those of New York City and Cleveland, received wide attention.

While the fiscal crises of the Depression were generally seen as the product of a uniquely troubled economic moment, the crises of the 1970s led to questions being raised for the first time about the viability of many major urban areas. Roger Starr, then New York City's housing commissioner, raised the issue of "planned shrinkage," or the reallocation of public resources away from heavily disinvested areas, while a spate of publications on the urban fiscal crisis and the measurement of fiscal stress followed from government agencies, consulting firms and scholars.

Over the following decade, as the economy grew in the 1980s, the acute urban fiscal crisis of the 1970s abated. Some cities, including New York City, reversed years of decline, and began to regain population and jobs, as well as draw high levels of private investment. Many others, however, continued to lose population and jobs, while the costs of providing services to their populations, covering worker and retiree health care and pension costs, and maintaining or replacing decaying infrastructure, continued to rise. These trends provide the backdrop to the current fiscal crisis, triggered by the Great Recession of 2007-2009, high unemployment, falling property values and the near-collapse of the real estate development industry.

The Great Recession is officially over, and at least some of its effects are starting to abate. As jobs grow and property values stabilize, many cities may experience some relief with respect to their short-term budgetary solvency, as happened during the 1980s. Yet, if our assessment is correct, the recovery in many cities will be limited, and in some cases, illusory. For too many older American cities, the problem is not one of short-term, acute, fiscal stress at times of national economic crisis. Nor is it principally a problem of poor or inefficient fiscal management, even though that may be present. *The central problem is a structural one, built into the fundamental dynamics of the American city.* These cities are on a fiscal treadmill that demands constant growth in resources to balance constant growth in costs. Where, as is increasingly the case, resources are not growing and in many cases actually shrinking, fiscal stress is a chronic, long-term problem that must be addressed not through band-aids, but through systemic, long-term strategies.

Measuring fiscal health and fiscal stress

Before looking directly at the conditions of legacy cities that have led to their structural fiscal problems, it is worth briefly exploring what is meant by fiscal health and fiscal stress, and the differences between them. Analysts generally use four measures to evaluate local government fiscal health, shown in Table 1.

Table 1: Measures of local government fiscal health

CATEGORY	DEFINITION
Cash solvency	The liquidity and effective cash management of the local government, and its ability to pay its current liabilities.
Budgetary solvency	The ability of the government to generate sufficient revenues to fund its current or desired service levels.
Long term solvency	The impact of existing and projected long-term obligations relative to future resources, and the ability of the government to sustain solvency into the future.
Service level solvency	The ability of the local government to provide and sustain a service level that its citizens and businesses require and desire.

Fiscal health can be seen as a local government’s overall ability to maintain and pay for public services and infrastructure over both the short and the long term. Thus, budgetary, long-run and service solvency are all conditions for fiscal health. While **cash** and **budgetary solvency** are straightforward, **service level solvency** is often difficult to measure. Changes in technology, public expectations, the roles of public and private sectors, and other factors make both the appropriate level of public services and the cost to provide them constantly in flux. Measures of what is the “right” level of public service, such as the number of police officers per 1,000 population, are far from standardized; what level of service is needed can be a function of the demographic and economic condition of the population, the size and physical configuration of the jurisdiction, and the extent to which the city uses effective technology and management systems to maximize its efficiency. Still, despite these difficulties, it is important to be able to measure to some extent what represents an acceptable level of public service, and whether the city is able to provide services at that level.

Long term solvency reflects the costs the government will incur in the future, relative to the revenues likely to be available to cover those costs. This is powerfully affected by the benefits, in particular retiree health care and pensions, to which governments have committed themselves. As time passes, as more workers retire and health care costs continue to rise, these benefit costs grow, consuming an ever-growing share of the municipal budget and crowding out other important expenditures. Even if the number of current employees is reduced through layoffs or attrition, total costs and fiscal stress may continue to rise because of these long-term commitments.

Fiscal stress is associated with a city’s ability to meet its immediate financial obligations, such as payroll and vendor payments, as well as the trends in the municipal tax base relative to its financial obligations going forward. In measuring fiscal stress, analysts look at measures such as the municipality’s fund balance, cash availability, budgetary shortfalls, and trends in property values or sales receipts. Fiscal stress measures tend to emphasize **cash solvency** and **budgetary solvency**.

At present, thousands of cities, townships and villages are experiencing fiscal stress. Needless to say, their number includes most, if not all, of America’s older, shrinking cities. It is in the arena of overall **fiscal health**, however, where the most complex and troubling problems for older cities lie. While many towns and cities that lie in the path of strong economic or population growth may find their fiscal stress resolved by those factors, many older cities are faced with small and declining revenue-raising resources relative to service demands, along with high and growing long-term obligations,

which undermine both service level and long run solvency. That reality demands different policy approaches from those needed when the fiscal stress is short-term rather than long-term, budgetary rather than systemic.

Adding infrastructure to the equation

Each city has an operating budget and a capital budget. The operating budget or the ongoing expenses needed to maintain a given level of service, covers costs such as personnel, office supplies and utility costs. Since government is highly labor-intensive, personnel costs represent by far the largest part of the operating budget, often as much as 70 or 80 percent of the total. Most dollars go to employee wages and salaries, followed closely by employee benefits, which continue to grow relative to wages and salaries.

While operating budgets are well-understood, the city's physical infrastructure has an equally powerful impact on the city's budget, as well as on its long-term and service level solvency. Every substantial city maintains an extensive physical infrastructure, including sewer and water lines, roads and sidewalks, parks and playgrounds, police stations and community centers. Cities must also maintain and constantly replace an expensive array of major equipment, most prominently the vehicles used to provide police, fire, garbage collection and other services. Although school buildings are managed separately from the municipal infrastructure, the cost of building and maintaining them typically comes from the same or a similar fiscal resource base.

This infrastructure must be maintained, repaired, and replaced over time. This generally takes place through the municipality's capital budget, which may include either "pay as you go" financing from current revenues, debt financing, or a combination of both. Debt financing, whether through bond issues or long-term leases or lease-purchase agreements, represents the greater part of spending on infrastructure costs, and imposes long term obligations, often far into the future.

Legacy cities face particularly difficult problems addressing infrastructure and capital costs. Cities that have lost population often have a substantial surplus of built infrastructure relative to need. They are maintaining streets, curbs and street lights in areas of the city that have become largely depopulated, while they may have a far smaller student body than their schools can accommodate. Meanwhile, their ability to maintain and replace infrastructure has significantly declined over time. Some shrinking cities with declining tax bases have put off capital purchases and repairs in order to direct more resources to current operations and to avoid insolvency. As maintenance or replacement is deferred, roads, bridges, sewer and water lines, and vehicles deteriorate and wear out and are no longer able to meet the needs of the community. Inefficiencies, system breaks, and other problems increase the likelihood of greater costs in the future and erode the infrastructure advantage that might help these cities attract redevelopment opportunities. Instead of being an advantage, worn-out, badly deteriorated municipal infrastructure becomes an obstacle to future redevelopment.

Structural deficits

Faced with a shrinking tax base, older cities' squeeze their operating budgets in an effort to provide a steadily declining quality of service to a smaller population, while their capital and infrastructure budgets provide less and less of either new investment or maintenance of the existing capital stock. As long as the tax base continues to shrink and costs continue to rise, these cities face a structural budget deficit.

Legacy cities are caught in a difficult bind on both the spending and revenue sides of the equation. On the revenue side, despite tax rates that are typically higher – particularly with respect to property taxes – than their suburban neighbors, tax revenues continue to decline. The city of Saginaw, Michigan actually collected a smaller amount in property taxes *in current dollars* in 2008 than in 1978; in *constant dollars* adjusted for inflation, the city collected only 30% of the property tax revenues they had collected 30 years earlier. Pension and health benefit costs, aging and deteriorating infrastructure and the service demands of a disproportionately lower-income and service-dependent population continue to push up the cost of government in older cities. Those cities that have lost a large share of their peak population have the added problem of providing services across a geographic footprint that is too large relative to their existing population and tax base.

The presence of a structural budget deficit may be less evident during periods of strong national economic growth. Between 2000 and 2005, for example, rising property values in many older cities led to short-term revenue increases, buoying revenues and balancing short-term budgets. When state-level economic growth is strong, state revenues grow, and state governments often increase the amount of aid they provide their older cities.

Such growth periods only briefly mask these cities' long-term structural budget deficits. When they end, the structural deficit turns into acute short-term stress, manifested in difficulty maintaining cash and budgetary solvency. Budget gaps grow, and cash flow cannot be sustained without state assistance, tax increases, or emergency loans or bonds, increasing the city's overall debt burden. Unlike other cities, however, better economic times may not rescue the nation's older cities. In many cases, the service cuts and tax hikes they make during hard times to avoid budgetary insolvency threaten the very viability of their continued existence.

Looking forward

The Great Recession that ended in 2009 was the deepest, most sustained recession to be experienced in the United States since the Great Depression. Although it is now over, it is likely that both the overall economy and the housing market will grow at best slowly over the coming years. That reality, compounded by new accounting rules that require municipalities to recognize their long term liabilities, means that the fiscal crisis of older cities is both acute and chronic, both short-term and long-term, at the same time.

It is tempting to believe that the history of the 1970s and 1980s will repeat itself, and that economic recovery will gradually solve the municipal fiscal crisis, if not forever, at least until the next crisis. Cities like Detroit or Youngstown, however, never truly recovered from the earlier fiscal crisis, but have continued to lose ground. The prosperity of the mid-1980s and beyond, or the housing bubble of

the early 2000s, may have briefly improved their cash and budgetary solvency but did nothing to alleviate the challenges of their long run and service level insolvency.

After decades of shrinking populations, declining revenue bases, and growing costs, the simultaneous acute and chronic budget problems of these cities are not likely to disappear in the course of any future national economic recovery. In the absence of fundamental change, even if these cities can adopt balanced budgets, they are balanced only at the price of grossly inadequate public services, deferred maintenance and replacement of infrastructure and capital stock, and disproportionately high local tax rates. While the cities' only hope lies in economic revitalization and physical redevelopment, the impact of poor public services, decaying infrastructure, and burdensome taxes is likely to be a further, arguably insuperable, obstacle to revitalization or redevelopment, dooming them to permanent poverty and distress. These issues demand a fundamental rethinking of the ways in which local government operates and is financed, and how it provides services to its residents, businesses and visitors.

2 How the Features of Legacy Cities Have Made Them Particularly Vulnerable to Fiscal Stress

Of all the American cities experiencing fiscal stress, those most deeply affected are those cities that have experienced sustained population and job loss over the past decades. These are the cities for which fiscal stress is most clearly *not* an acute and potentially short-term condition, but for which it is a chronic, long-term condition that will not be significantly relieved even if and when the United States re-embarks on a course of sustained economic growth. While long-term chronic fiscal stress is not a problem limited to these cities, it is this subset of American cities in which it is most pronounced, and where the very viability of those cities is most in question. This section will look first at who these cities are, and then examine their common features that most contribute to their long-term, structural fiscal stress.

Who are the legacy cities?

While legacy cities are found throughout the United States, they are not evenly distributed around the country. They are most heavily concentrated in the nation's industrial heartland – a band stretching across the Midwestern states westward from upstate New York – with a smaller cluster in the Northeast, and scattered cities and towns elsewhere, but include other cities elsewhere, like Birmingham Alabama or New Orleans. They include large cities like Detroit or Cleveland as well as small cities like Camden, New Jersey or Youngstown, Ohio.

In addition to these large and medium-sized cities, the United States contains large numbers of even smaller shrinking places, such as East St. Louis, Illinois, East Liverpool, Ohio, or Highland Park, Michigan, some of which have lost more than two-thirds of the population they once had. Taken as a whole, we estimate that shrinking cities and their metropolitan areas contain roughly 45 million people, or 15 percent of the population of the United States.

Most of these cities were historically industrial cities, including cities like Detroit and Pittsburgh that became almost synonyms for automobiles and steelmaking respectively. These large cities were not only manufacturing cities, but they were major regional centers where the downtowns, the medical centers and universities, and the cultural and artistic hubs for major metropolitan areas were concentrated. These cities still contain medical centers, universities and cultural facilities of national importance. Smaller cities like Youngstown might be centers of smaller regions, while still smaller cities like Chester, Pennsylvania or Highland Park were satellite cities, in the shadows of larger cities like Philadelphia or Detroit. Still others are the first ring suburbs of older cities, like Dearborn Heights outside Detroit, or Euclid near Cleveland. These suburbs' downward trajectories have followed, and sometimes even exceeded the decline of the adjacent central cities.

All of these cities and towns have a series of features in common that have led them into a condition of sustained, structural fiscal stress.

Cities are facing stagnant or declining property values

A shared feature of all legacy cities is that more people are moving out than moving in. This in turn leads to weak demand for housing and non-residential facilities such as shopping centers or office space, with devastating fiscal consequences. First, since demand is weak, and largely met by existing buildings, little new construction takes place to expand the property tax base. Second, house prices are low, and in many cases declining.

The average selling price for houses in Youngstown in 2009 was \$27,560, while average selling prices in one-third of the city's census tracts were below \$15,000. The average selling price in 2009 for houses in the *highest* value census tract in Saginaw was barely \$66,000. The average selling price of houses in Detroit for the first 10 months of 2010 was \$16,036 according to the Detroit Board of Realtors. Even in healthier cities such as Baltimore or Philadelphia, house prices in many parts of those cities are under \$50,000.

Property values are not only low, but also dropping. Property values in Detroit, according to the Case-Schiller Index, dropped nearly 50% from December 2005 to December 2010, and in current dollars, are now at the same level as 1994. *In inflation-adjusted dollars, the average house in Detroit today is worth only 2/3 of what it was worth in 1994.* Table 2 shows recent house price drops in three shrinking cities in current dollars.

TABLE 2: Average house sales price in three legacy cities in 2007 and 2009

Year	Dayton, Ohio	Gary, Indiana	Saginaw, Michigan
2007	\$52,500	\$69,700	\$46,200
2009	\$41,200	\$54,400	\$35,400
% change	- 21.5%	- 22.0%	- 23.6%

SOURCE: Boxwood Means data from PolicyMap

Thus, to the extent that nearly all of these cities depend to some extent on property taxes to finance their budgets, they are faced with a shrinking tax base from which to raise revenues. Because their property tax rates are typically higher – sometimes significantly higher – than those of surrounding suburban areas, they are severely constrained in the extent to which they can raise tax rates to offset the declining tax base. Moreover, since there is a significant lag between when property values decline and when lower values are actually reflected in tax collections, the declines of recent years in all likelihood have not yet been fully felt with respect to tax collections.

Cities contain large numbers of vacant/non-taxpaying properties

The problem of the small and declining property base is made worse by the large and growing share of properties that do not pay property taxes, either because they are public or non-profit facilities such as universities, hospitals or religious institutions that are exempt by law from property taxes; or because they are vacant and abandoned, and the owner has ceased to pay the taxes that are due. In some cases, these properties have been taken by the city or county, and in others, they lie fallow and neglected.

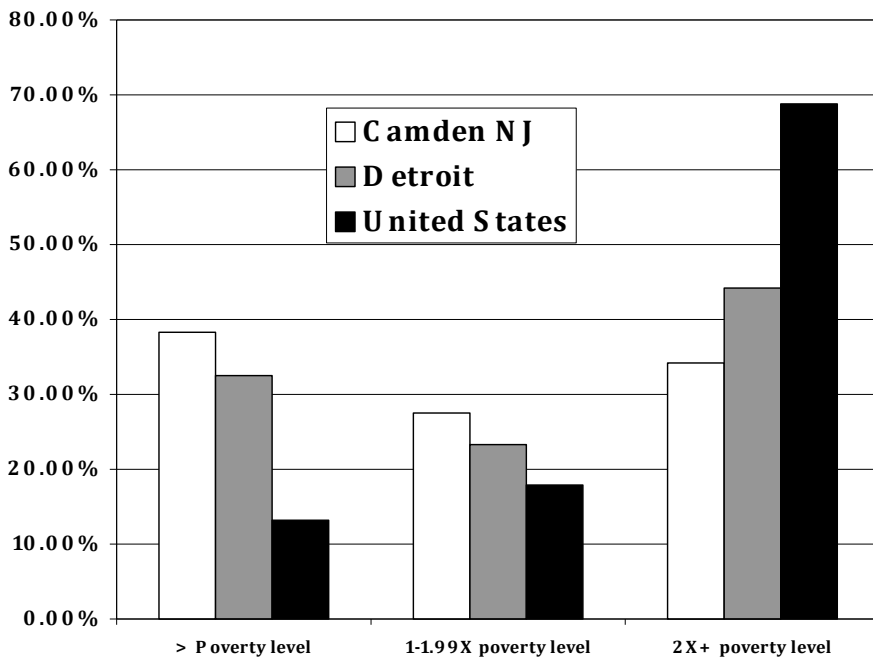
In Camden, New Jersey, 39% of the property tax base is exempt from taxation, while an additional 22% - including both low income housing projects and tax-abated economic development projects - makes payments in lieu of taxes, which are usually much less than the full taxes that would otherwise be due. *Only 39% of the city's property tax base is actually subject to the legal requirement that they pay property taxes.* Many of those do not actually pay and end up in tax foreclosure.

Many tax-exempt properties provide value to the local economy that offsets their non-taxpaying status, including jobs, services and activities that enhance the local quality of life. The same is not true of vacant, abandoned properties, which are a pure drain on the city's resources. As a recent Philadelphia study found, vacant properties reduce adjacent property values by an average of 6.5%, representing a loss of \$3.6 billion in property values - and household wealth - in the city, while costing the city over \$20 million each year to maintain. Vacant properties represent 15 to 25 percent or more of the property inventory in many shrinking cities.

Cities contain disproportionately low income populations

An important aspect of population loss in older cities is that it is most often the more affluent segments of the population that leaves, either to the city's suburbs or to other parts of the country which are seen as offering more opportunity. As a result, the remaining resident population of legacy cities tends to be disproportionately poor, as shown in Table 3, which compares the distribution of households relative to the poverty level in two such cities - Detroit and Camden, New Jersey - to that of the United States.

Table 3: Distribution of households by ratio of income to poverty level



While roughly 13% of households nationally are below the poverty level, over 38% of the households in Camden, and 30% in Detroit fall under that level. As significantly, while nearly 70% of the national population has an income that is more than double the poverty level – or roughly \$44,000 per year in 2010 for a family of four – barely one-third of the households in Camden, and less than half in Detroit have incomes above that modest level.

Thus, to the extent that many cities rely on a city income tax for a significant share of their revenues, a significant part of their population is either below the threshold for paying income tax, or pays an amount that is likely to be well below the cost of the services they require from the city. Income tax collections are also declining in many cities. The city of Dayton, Ohio estimates that its city income tax revenues in 2011 will be \$14 million less than in 2008, a drop of 13% in current dollars.

Cities are impacted by high health benefit and pension costs

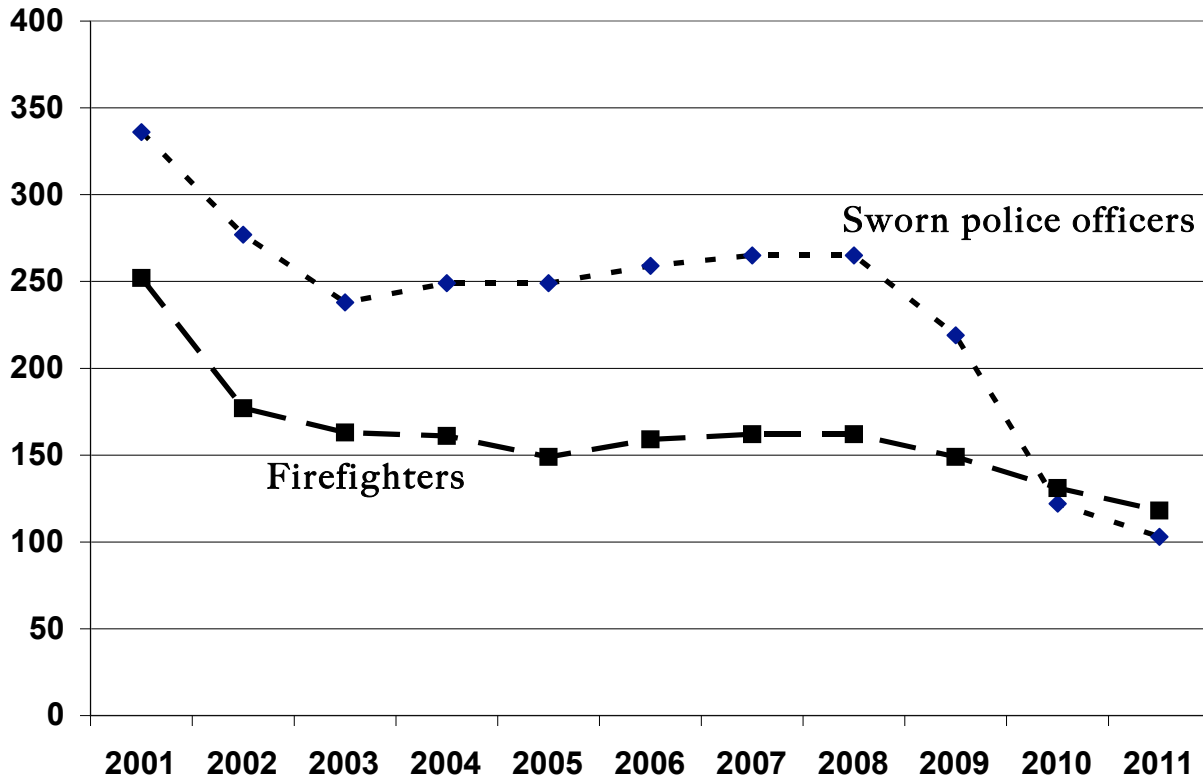
While this point has been made in the previous section, it is worth stressing in the particular context of legacy cities. The workforce of those cities is likely to be older, and more likely to be covered by union contracts, than in other localities. As a result, a large and growing part of the cities' revenue goes to cover health benefit and pension costs. 40% of Flint, Michigan's 2010 budget went for benefits and pension costs, while in Camden, the share of the budget for those costs increased from 16% in 2003 to 29% in 2009.

These figures actually understate the magnitude of the problem, because many – perhaps most – cities have under-funded their pension obligations. While Saginaw is spending close to 30% of its budget in pension contributions, that spending does nothing to cover an accumulated \$215 million in unfunded retiree health benefit obligations. Filling this gap would require the city to dedicate \$12 million per year, or nearly 40% **more** of its annual budget to this purpose.

Cities have already cut many services and face major infrastructure problems

As they face this crisis, legacy cities lack an operational cushion, either in terms of a large workforce that more than adequately covers the need for services, or a modern infrastructure in good repair. These cities have been cutting their workforce for many years, to the point where many city operations are a mere skeleton. As Table 4 shows, over 10 years, Flint has cut the number of firefighters from 252 to 118, or by over 50%. These are now among the smallest complements of public safety personnel relative to population for any city in the United States. Saginaw's municipal workforce went from 761 in the 1980s to 465 by 2008, while between 2001 and 2010 Dayton Ohio cut over 800 jobs, or nearly 30% of its total workforce. In order to continue to provide essential police, fire and sanitation services, cities have cut other services – such as parks, recreation or city planning – to the bone, or eliminated those departments entirely. As a result, the ability of these cities to deliver adequate public services, to maintain its infrastructure and physical plant, and to offer its citizens a decent quality of life, has become increasingly in doubt.

Table 4: Public safety personnel in Flint, Michigan 2001-2011



This is exacerbated by the continued deterioration of much of these cities' infrastructure. With limited ability to maintain their infrastructure, potholed streets, missing street signs, neglected parks and playgrounds and shuttered recreation and senior citizen centers are more and more common. Arguably even more serious from a fiscal standpoint - if not visible to the average citizen - is the widespread deterioration in the hidden infrastructure of sewer and water lines, including the environmental problems caused by combined storm and sanitary sewer systems.

The above factors are chronic, long-term trends affecting older distressed cities. Since the onset of the recession in 2007, these factors have been exacerbated first, by the financial downturn in the economy generally; and second, by cuts in state aid arising from the effects of that downturn on state budgets. If anything, for this class of cities, the latter has been more disastrous than the former, since they were already in a state of economic weakness to begin. Draconian cuts in state aid have already led to massive layoffs in New Jersey's older cities, including Camden, where nearly half of the police force was laid off early in 2011. All of these factors come together to create what might be considered the perfect fiscal storm for America's older, distressed industrial cities. They are experiencing long-term problems, which will not be fixed with short-term solutions.

3 Confronting the Fiscal Challenge: Policy Options to Address Chronic Fiscal Stress

America's distressed older cities – in particular its legacy cities – are on a sharp downward fiscal course, trapped in spiraling structural deficits with no visible way out. How to deal with all of these issues, while maintaining these cities as viable municipal entities that can meet their citizens' needs for basic services and a decent quality of life and enabling them to rebuild their role as centers of economic activity, is a question that is and will continue to be difficult to resolve. Nonetheless, that is the question that state and local policymakers and public officials around the nation must confront.

The fallacy of accounting solutions

Municipalities are creatures of state governments. As a result, states have been dealing with municipal fiscal issues for a long time. Many states enacted laws during the Depression to address the epidemic of municipal bond defaults that were taking place. These laws were often designed, however, less to put distressed municipalities back on their feet as to ensure that bondholders received their money. Today, many states have created legal mechanisms through which they can intervene if a city or county reaches a level of fiscal stress that jeopardizes their ability to meet their financial obligations or provide adequate public services.

These mechanisms take many forms, although they are sometimes referred to generically as **financial control boards**. In recent years, state governments have established control boards for many cities, including Pittsburgh, Buffalo and Springfield, Massachusetts. Under a 1990 statute, the state of Michigan has appointed emergency financial managers to take control of a number of cities, including at different times Flint, Ecorse and Pontiac. Michigan has recently rewritten this statute to significantly expand the powers of its emergency financial managers. Although New Jersey has a Depression-era state law which empowers the state Local Finance Board to take control of a municipality's finances, it enacted a special law in 2002 to make possible a more comprehensive state takeover of the city of Camden, which remained under state control until 2010.

All of these statutes are predicated on a central assumption, namely, that municipal fiscal problems can be solved not only through short-term solutions, but solved through 'accounting' solutions, such as improving fiscal management, eliminating waste, and finding greater economies and efficiencies in the conduct of municipal operations.² There is no question that fiscal management can be improved in most cities, and there is little doubt that waste and inefficiency are present in many distressed older cities. That is not in dispute.

²The New Jersey statute providing for the state takeover of Camden was an exception to this rule, as it included an allocation of \$175 million in state bonding authority to be used to foster economic recovery efforts in conjunction with the state takeover. For various reasons, however, neither those efforts nor the takeover of city government were effective in restoring stability or vitality to that city.

The problem is that mismanagement, waste and inefficiency are at most the visible portion of the cities' fiscal iceberg. While a financial control board can make short-term changes which may give the city – particularly if the economy is improving – a short-term boost through more efficient tax collection, the elimination of a handful of unneeded positions or the restructuring of services for greater efficiency, the long-term problems at the root of the city's fiscal crisis remain unchanged. Short-term improvements quickly reach a plateau, while the actions of the control board or emergency manager fail to address the long-term decline taking place.

The activities of control boards can potentially make matters worse. To the extent that short-term fiscal stabilization involves increasing (usually already high) local taxes, reducing (usually already limited) public services or cutting back (usually already inadequate) investment in municipal infrastructure and capital stock, it can exacerbate the existing cycle of decline by further undermining the quality of life offered its residents, or rendering the city even less attractive for investment by individuals, families or businesses. *Short-term 'solutions' may end up making a city's long-term prospects even more problematic.* Long-term structural problems demand long-term structural solutions.

Taking the fiscal crisis seriously

Given this reality, what are its implications for federal, state and local policymakers? Most importantly, it means that *we need a fundamentally new approach to addressing fiscal stress in older cities, which focuses not only on short-term cash flow and budgetary needs, but which is designed from the beginning to foster long-term change in these cities' fiscal reality, to end the vicious cycle of decline in which they are trapped.* This means taking short-term actions that do not impair the city's long-term viability while laying the groundwork for long-term strategies to build the local economy, reuse underutilized or vacant land, and stabilize or grow the local population. It also means looking at long-term strategies that have rarely been considered, including recognizing the regional nature of so many of the issues facing older municipalities, and moving across municipal boundaries to find solutions.

Improving the short-term picture

The need for long-term strategies should not negate the importance of focusing on short-term change. In addition to improving fiscal management and efficient delivery of services, cities should explore other strategies to increase revenues and better manage costs. In so doing, they must recognize that any such steps are only stop-gaps, to better set the stage for long-term change.

Increasing revenues. While increases in core property, sales and income taxes should be avoided, opportunities for finding additional revenues may well exist. Tax foreclosure reforms in Michigan showed that large amounts of money that were going to investors under the old system could be captured instead by the county government. Other taxes, such as hotel or rental car taxes, which may capture funds from tourists or nonresidents who come into shop, dine or go to a spring event or concert, can be explored. It may be appropriate to look at user fees for some non-emergency public services, as well as imposing more substantial fees on destructive activities, such as allowing properties to deteriorate or lie vacant.

Such options must be pursued carefully. *All taxes or fees have consequences.* If property taxes are too high, residents may vote with their feet by moving out of town; if sales taxes are too high, shoppers will buy their goods elsewhere. Too steep a rental registration fee and a landlord in a marginal area may choose to abandon his property rather than continue to maintain it. The economy of small cities, in particular, is highly sensitive to even small variations in fees and taxes, since alternatives to the city for residents and businesses in nearby suburban communities are close-by and often highly affordable.

Restructuring public service delivery. Although it is impossible to define with precision appropriate or minimum acceptable levels of municipal service delivery, it is clear that the quality of municipal services in many older cities has already deteriorated to the point where they are below reasonable levels, and that inadequate public services are acting as a deterrent to resident and business investment. Cities clearly lack the resources to increase spending on service delivery to adequate levels, while further cuts, in many cases, will only make the city's long-term prospects worse. The question is whether there are ways to restructure how services are delivered so that cost savings may be achieved without further deterioration in quality, or quality can be improved without additional cost.

Privatization has long since been used as a strategy by local government; while it is clear that it is not a panacea, properly designed and carried out, it can result in not-insignificant savings in some areas. The adoption of new technologies, although it may require short-term expenditures, can often significantly improve the productivity of the city's workforce; Baltimore today issues many more citations, and pursues more code violators, than it did five years ago, with a smaller code enforcement workforce. In severe cases, as noted earlier, restructuring of public employee wage and benefit programs may have to be considered.

Devolution of municipal services to special service districts has taken place in some areas, while another area with potential, which has been less explored, is the formation of partnerships with non-profit organizations, particularly community-based groups. Cleveland has entered into a compact with a number of its neighborhood-based community development corporations, under which they supplement the city's code enforcement efforts.

Taking control of the land inventory. Although not always seen as a fiscal strategy, land reutilization is critical to any long-term strategy for rebuilding distressed older cities, particularly those that have lost large numbers of population and jobs and are accumulating a growing surplus inventory of buildings and land. While reutilization may be a long-term strategy, putting in place the systems and machinery for gaining control of the land inventory needs to begin immediately, beginning with a recognition that there is no downside to "taking property off the tax rolls" when that property has long since ceased to pay any taxes. Specifically, cities – or counties – need to build:

- An efficient tax foreclosure system that maximizes public, not private benefit.
- An effective public sector or non-profit land banking mechanism, to hold and maintain vacant properties pending reutilization
- Targeted demolition strategies

As will be discussed further below, there are strong fiscal reasons to create a regional system for controlling property as, rather than limit it to the boundaries of a small, distressed city.

Tackling long-term, chronic fiscal stress

The *only* way to eliminate chronic fiscal stress and structural deficits in older, distressed cities is to place these cities solidly on the road back to being socially, economically and physically healthy communities, which have the diversity of population and agglomeration of activities to play the central role in their regions' economies. If that is to take place, many changes have to take place at many levels. Cities must be able to define and articulate their vision for their future as stronger, healthier – although in many cases smaller – cities. They must also rethink their 'business model', how they pay for and deliver public services, while partnering with business, academia and non-profit organizations to frame credible strategies for land reutilization and economic growth. State governments need to restructure how they create programs and allocate resources for cities, to focus resources on supporting systemic change in cities rather than propping up the status quo.

Where cities have lost a large part of their historic population and job base, the process of transition to a healthier city also involves re-imagining the city as a smaller city, based on its current – and realistic future – population and economic base, not the population and industry it had in 1960, or even 1920. That is likely to involve rethinking the use of surplus land and buildings, but also rethinking the pattern of service delivery and the configuration of the municipal infrastructure, as in Saginaw, Michigan, which has designated a one-half square mile area on the city's East Side as a Green Zone, which will be gradually returned to nature.

Finally, state and local government need to grapple with the underlying reality that a central reason for the fiscal crisis of older cities is the massive imbalance in public resources and service demands between the cities and many of their suburban neighbors. As vast amounts of each city's wealth, in terms of jobs, businesses, or affluent residents, have moved to the suburbs, the cities have had to deal with a shrinking resource base and an increasingly resource-dependent population within largely inflexible municipal boundaries. Suburban Haddonfield, New Jersey, only a few miles from urban Camden, New Jersey, has 10 times the per capita property tax base of its urban neighbor.

Some larger cities, such as a Philadelphia or Chicago, may be large enough and may retain enough economic resources to rebuild from within; that is not an option, however, for smaller legacy cities, which lack the internal resources to go it alone. Unless fundamental changes take place to the way in which regional resources are allocated and service delivery boundaries defined, the vision of a stronger, healthier Flint, Youngstown or Rochester may remain unreachable. This too poses a challenge for state government, which sets the ground rules for how those resources are allocated and boundaries defined.

Addressing public sector service delivery and long-term commitments. One of the knottiest issues facing older cities is the cost of municipal payrolls, and even more so, the costs of pensions and health care benefits to municipal retirees, which continue to mount even as the individuals receiving them are no longer providing services to the community. It is a difficult issue because there is a good deal of unfairness about requiring present or former municipal workers to pay for conditions they did not cause and cannot control; moreover, it is important to understand that, *whatever steps are taken to reduce payroll and long-term costs, they do not solve the structural problem.* At the same time, the shortfall in many cities is so great, and the likelihood of additional outside aid so remote, that in some cases there may be no alternative.

The issue of long-term costs is likely to become more severe in the future, because – although all but a handful of cities are currently meeting their obligations – many municipal pension funds are severely under-funded relative to their future liabilities. Pennsylvania’s Public Employee Retirement Commission found that 27 of the state’s municipalities have pension plans funded at less than 50 percent of liabilities. While this is a small percentage of Pennsylvania’s municipalities, the group includes the cities of Philadelphia, Pittsburgh and Scranton, which alone account for 45 percent of all local government employees in the state.

This is a problem that cities cannot solve on their own. Cities like Dayton or Flint simply cannot find the money internally to both meet current obligations and fully fund their future ones. One way or another, the states or the federal government will have to take a substantial part of the responsibility for finding a solution. It is critical, though, that it be a real solution that does not impose future crippling obligations on the same municipalities that it is seeking to help.

Building the strategy for a stronger city. The central element, though, in addressing long-term fiscal stress is the strategy for a stronger future city, a ‘shiny new’ Flint, Dayton or Youngstown. This is not a single step, but an extended, multifaceted process. It requires the city and its partners to think through the city’s future economic role, and how it will transition from its current situation to that role; it demands a strategy for reusing land in ways that build the economy, regenerate downtowns, revitalize neighborhoods, or create green areas similar to Saginaw’s green zone. Many cities are already thinking in these terms, not only Saginaw, but also Detroit, Youngstown and Rochester among others.

This is a very different way of thinking than the crisis-response mode that is understandably but sadly widespread among cities in fiscal crisis. It means not only looking beyond the immediate crisis, but engaging with other stakeholders, both within and outside the city, to identify the strategies and come up with resources to support them. It also demands an approach to municipal budgeting that, difficult as it may be, does not sacrifice the capacity to plan and execute long-term strategies – by laying off entire planning or economic development departments, for example – in the interest of maintaining current services.

As in other areas, state government plays a critical role. While it is unrealistic to expect significant growth in state aid for older cities in the near term, state governments continue to provide a variety of resources to local governments, not only in the form of general state aid or revenue-sharing, but through funds dedicated to economic development, transformation, brownfields cleanup and more. Each state should examine all of the resources that it *does* make available to local governments in order to determine how they can be structured to maximally encourage and support transformative change at the local level, rather than maintaining the status quo.

Bridging the regional divide. Finally, states and localities need to tackle the regional issue. The fiscal, as well as broad social and economic, disparities between many older cities and their suburban neighbors is so great as to render many older cities’ genuine return to fiscal health – within their current borders – highly unlikely. Without a far greater measure of regional cooperation and sharing of resources and services, local initiatives are likely to fall far short of what is needed to bring about true fiscal and economic stabilization.

At the most basic level, more extensive use should be made of shared service provision between municipalities or at the county level. In many parts of the country, counties have the scale of

population, area and governmental operation to be an efficient service delivery unit. The experience with county land bank authorities in Michigan and Ohio has shown that counties are a unit at which a vehicle for assembling, holding and disposing of large volumes of properties can be effectively organized.

Revenue sharing across municipal boundaries should be explored. Much as suburbanites will resent seeing “their” taxes go to benefit the central city, such sharing is in everyone’s long-term interest. In the Twin Cities region in Minnesota, all municipalities share in the taxes generated by new non-residential development, with the home municipality receiving 60 percent and the rest of the region sharing 40 percent. Municipalities with lower property tax bases receive a higher share of the regional pool. The program, which has been on the books since 1971, is credited with reducing inter-municipal property tax disparities by nearly 20 percent.

Beyond shared services and redistribution of municipal revenues, one must ask whether in some cases the actual municipal boundaries themselves remain relevant or meaningful. Consolidating municipalities, or creating unigov entities where the city and county are the same, has been carried out with success in many places, including Nashville, Indianapolis, and Louisville. While not a solution to all of the problems of the city or region, it has significantly improved the fiscal and economic climate in these areas. In these consolidations, all parties brought assets to the table; although not without opposition, they were achieved voluntarily with the support of a majority of the entire county’s population.

In other cases, however, *situations may arise where it becomes uncertain whether a particular city’s existence as a separate governmental entity – as distinct from a place where people live and work – is still viable*, and capable of being saved. When a city finally reaches the end of the road – or can see that point coming in the near future – where it can no longer carry out its fundamental responsibilities, *some* mechanism needs to be in place at the state or regional level to ensure that services continue to be provided, and that a better future can be laid out for the place and the people, if not for the city as a separate governmental entity.

4 Conclusion

Today's local government fiscal crisis has multiple dimensions. For many municipalities, fiscal stress is likely to be a short-term condition. While many local governments will recover fiscal stability as the national economy recovers, this is not the case for the nation's distressed older industrial cities. For them, fiscal recovery will remain elusive. They have been facing chronic fiscal problems for many decades; this chronic fiscal problem, exacerbated by the current recession and mortgage crisis, will remain after the cyclical economic recovery has taken place.

These cities matter. As we noted at the beginning, despite decades of suburbanization, central cities are still important to the future of the economies of their state and region. Despite the difficult economic and social problems faced by older cities, they remain the best location to redeploy the assets needed to foster the economic revitalization of regional and state economies. Neither suburban nor exurban areas can replicate the advantages of density and agglomeration available to cities.

The challenge is that, under current conditions, the fiscal state of these cities may make it impossible for them to regain that central role. Decades of population and job loss, impoverishment and declining property values, high tax burdens but inadequate municipal services, extensive but deteriorating infrastructure, and burdensome legacy costs, all stand between these cities and economic or fiscal recovery. These problems are exacerbated by systems of local government finance that are manifestly inequitable, distributing the fewest resources to cities with the greatest service demands. Given these realities, it is not surprising that older cities are in fiscal crisis, mired in structural deficits that may make it impossible for them ever to emerge on their own as healthier, stronger cities.

To meet these challenges, a new approach is needed that takes chronic fiscal stress seriously, addressing it as a long-term problem that demands long-term solutions, not short-term accounting fixes. Local officeholders and policymakers need to recognize that short-term sacrifices can only be justified if they are made in the framework of a long-term vision of a better city, and if those officeholders start acting to make it a real possibility. State policymakers must recognize that their role is the central one; as creatures of the state, municipalities are their responsibility. States, despite their own fiscal constraints, must allocate their resources in ways that foster the transformation that is needed, while giving cities and counties the tools to take the tough actions that will be needed. Federal policymakers must reassess their role, and explore how the resources of the federal government can help promote change, in partnership with state and local governments.

It will not be easy or quick to rebuild the fiscal stability of older cities and their ability to provide their citizens, workers and businesses with the quality of life they deserve. It is a task worth doing, in the interest of the millions of people who live in these cities and their regions, and the opportunity to build flourishing regions in areas that are struggling today. The alternative is to allow these cities and regions to become the 'Other America' as Michael Harrington described Appalachia fifty years ago, an area that offers little opportunity to its residents, and no longer plays a meaningful role in the nation's economic life.



421 Garland Street, Suite A
Flint, Michigan 48503
P: 877-542-4842

1001 Connecticut Avenue N.W., Suite 1235
Washington, D.C. 20036
P: 877-542-4842

1050 S. Jefferson Davis Parkway, Suite 231
New Orleans, LA 70125
P: 504-236-8333

www.communityprogress.net