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Municipal advisory board: Sense of fiscal limits

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THE MUNICIPAL ADVISORY BOARD

A sense of fiscal limits

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The real world of politics and municipal finance was brought to the research study by a Municipal Advisory Board of mayors, municipal officials, government experts, and academic scholars. The Board offered guidance to the research staff on the direction, scope, and focus of the study. The following edited transcript reflects concerns expressed at an August meeting of the board. Participating in this portion of the discussion were: Fred Armstrong, controller, Indianapolis, Ind.; Peter Bearse, Princeton University; Clark Burris, controller, Chicago, Ill.; Arthur Holland, mayor, Trenton, N.J.; Walter Kelleher, former mayor, Malden, Mass.; Arthur Naftalin, former mayor, Minneapolis, Minn.; Mason Neely, finance director, East Brunswick, N.J.; and Florence Rubin, League of Women Voters. The moderators were: James Howell, First National Bank of Boston, and Charles Stamm, Touche Ross.

BEARSE: The basic question is: what do we really mean by fiscal stress? We need to come up with indicators for people on the firing line. What kind of data, what kind of information system does one need in order to manage a city's financial affairs? Perhaps it's a matter of looking at the behavior of a city over a period of years and asking: what are the warning signals, and what should I do in response to them? Take the pension fund problem. People who have worked on this recognize that we've got a time bomb here. Another warning signal can be the rise in short-term debt.

NEELY: And what about your long-term debt that is authorized but not issued? How much hidden debt is there out there, because people are afraid they're going to lose their rating or they won't be able to issue the debt. Instead, they're building progress out of borrowed funds or fund surpluses, and this authorized debt doesn't show up on the balance sheets. It's just not recorded.

ARMSTRONG: There's also the question of whether it is social factors or economic factors that are causing your fiscal stress. Indianapolis used to have a strong welfare program with a year's residence requirement, and you had to have a meaningful job as a taxpayer before you were eligible. Then we dropped those requirements about four years ago, and the welfare rolls went sky high. So social programs can have their own impact.

HOLLAND: Perhaps the point is, if you're in need of money in this country, you go after whatever's available. Out of general revenue sharing, for example, one affluent county in New Jersey built bridal paths. One township in our county, which did not need public works money, nevertheless applied for sewer money under the program.

NEELY: The risk is rewarding inefficiency. If people who operate inefficiently get more money, you will encourage inefficiency.

HOLLAND: The latest CETA legislation provides very rigid requirements on accountability and against abuses. We supported it because people who spend money properly don't want to have it cut off.

NAFTALIN: It's clear that some cities have extended themselves beyond the realities of their economic base. But it is a very subjective question: what *are* the realities of an economic base? Clearly, many northern cities extend themselves beyond their limits, if you compare some of the growing sunbelt cities. But you get involved in a choice of values there. I'm uncomfortable with that kind of measurement.

BEARSE: One of the things you can do with a complete data base is see the trade-off between the current expenditures burden and the capital expenditure ratio, whether you're trading off the future for present expenditures. If you look at that in relation to things like the tax base, you'll get a sense of your limits, at least with respect to debt.

HOLLAND: I like what Peter is saying about debt and time, for I really believe people do use current funds to rob the future. And then all of a sudden they have a crisis, for the waterworks has not been maintained and it just cannot handle the capacity, and they're faced with an emergency and they rob the future again.

BEARSE: One of the reasons, of course, that it *is* easy for public officials to postpone maintenance is

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that there is no accounting for depreciation of capital in the public sector.

BURRIS: Even if the ability of the government to maintain a physical plant does not come through in any financial report, I think there are indicators that can be identified. I know that as the tax base decreases it becomes more and more appealing to forego the maintenance of any plant, because that's a benefit that will be received in the future. But like unfunded liabilities in a pension fund, it is a problem that is not going to go away—in fact, it's going to multiply.

NEELY: When older cities with very little debt surplus are putting almost all their tax dollars and federal dollars into current expenses, they're building a situation that is very much like New York City.

KELLEHER: If I were looking for a city that I thought was going to be in trouble, I would look at the property tax bill in terms of the value of property. I'd put an arbitrary limit on the ratio between them. And I would measure the extent to which intergovernmental transfers are aiding current operating programs, as opposed to building an economic base. As I look at Proposition 13 and some of the tides that are running politically, I get the horrors about what is going to happen—particularly to the major cities of the country—if suddenly the federal or state money for operating programs is drastically reduced. If cities are putting their intergovernmental transfer money into operating expenses and nothing into capital development, I would be very fearful that those cities might face a great danger of becoming literally bankrupt, if there is (1) any change downward in annual appropriations by either Congress or the state legislature, and (2) no substitute municipal tax money available to fund programs that the city is politically unable to eliminate.

BEARSE: This gentleman has just said something very important, and I want to make sure it's not lost. If you want to find the real fiscal limits for a city, which is what we're groping for, you could do that by looking at property tax rates over a time period in relation to some notion of true value, and then plot that ratio in a curve. I'll bet you could find a saturation point that could be defined in terms of property tax rates.

KELLEHER: The Massachusetts Supreme Court ordered 100 percent valuation on properties, and cities generally have resisted it for the reason that when you go 100 percent under existing state law, you dilute the abatement of taxes for the elderly. And that puts an awful lot of elderly homeowners of single family homes out of business. You look at a city that has gone to 100 percent valuation, and immediately you see "for sale" signs all over town. These people now become candidates for public housing for the elderly, and the whole thing is completely counterproductive.

NEELY: An interesting situation is happening in Cleveland. The city planned to use a $15 million sinking fund, which was to pay revenue notes to help the board of education to meet current obligations. There were objections raised by the bank, and the state supreme court stopped it. "You have a trust," the court said, "you can't use debt service money to pay that." When voters turned down an increase in property tax, Cleveland didn't have enough money to keep its schools open. So it's an interesting issue—what do you do with sinking fund money that is available to pay bondholders? Do you use it for debt, or do you put it into current operations to keep the schools open? Cleveland is going to give us an idea of what is going to happen when social issues face financial interests. Cleveland citizens simply refused to accept a tax increase, even if it meant schools would not open. That is the perspective from which Peter is talking, of cities sacrificing their future. I sometimes wonder, is the threat of bankruptcy more real than what we think, or is it just a matter of fouled up management in a few cities?

RUBIN: Turning down a tax increase reflects that sense of limits that we are looking for. It was a real limit felt by people directly affected. But the problem is not just trying to quantify the sense of limits. For there are political limits and there are fiscal limits, and they are not always the same. But that is another discussion.

HOLLAND: You mentioned fouled up local management. I don't agree about the quality of people it implies. Before we leave, I'd like to balance it with two anecdotes. First, I was talking to my governor one day and began something with "Suppose you were mayor . . ." And he immediately said: "I wouldn't *want* to be a mayor." Then there was Lyndon Johnson talking to the mayors back in 1966 at a congressional conference. He said that when the burdens of the presidency seemed overwhelming, he would console himself with the thought that it could be worse, that he could, after all, be the mayor of a city. . . .