The Heritage Foundation Backgrounder

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THE REBIRTH OF URBAN AMERICA

INTRODUCTION

In early 1988, the Reagan Administration will be required by law to produce its fourth, and last, President's National Urban Policy Report. At about that same time, the 1988 presidential candidates will start being pressured to announce urban policy proposals to secure the support of urban leaders. As they compete for mayoral endorsements, many will succumb to the myth, perpetuated by urban interest groups, that cities need large doses of federal economic support. Yet the urban environment is greatly changed from that of the troubled 1970s and early 1980s.

By almost any measure, the nation's urban areas are in far better condition than during the 1970s. Ronald Reagan argued in 1981 that the best help the federal government could give U.S. cities was a growing economy, not more federal aid. That strategy appears to have been sound. The control of inflation and five years of strong economic growth have stabilized budgets and tax rolls and enabled many cities to run consistent surpluses. Further, the Reagan Administration policy of expanding and streamlining block grants to replace highly regulated categorical programs has spurred local creativity. And the new emphasis on federalism, combined with constraints on federal support to cities and states, has stimulated a renewed and healthy cooperation between lower levels of government in addressing local problems and opportunities. Thanks in large part to these positive economic and policy trends, most urban areas outside the oil-dependent states now are enjoying revived economies. In fact, the capacity of most local governments to provide for their residents far exceeds that of the debt-ridden federal government.

Nevertheless, demands for continued and increased federal aid still bring applause at conferences of urban officials, and mayors continue to lobby Congress successfully for more programs. Under heavy big city pressure, for instance, Congress recently passed a bill authorizing over $800 million in aid for the urban homeless, tied into already generous urban aid programs. Further, the authorization bill for the Department of Housing and Urban Development (HUD), which is now under consideration by Congress, would continue urban aid under the Community

Development Block Grant (CDBG) and Urban Development Action Grant (UDAG) programs, while funding new and expanded programs for housing and urban rehabilitation. Congress has even resisted all attempts to shut down the Commerce Department's Economic Development Administration (EDA), which duplicates many HUD programs, and has authorized new mass transit construction assistance in areas incapable of using existing transit funds efficiently or effectively.

Solid Foundation. The 1988 National Urban Report, the Reagan Administration's FY 1989 Budget, and Ronald Reagan's final State of the Union Address next January need to emphasize that U.S. cities are in excellent health. And Congress should formulate urban policies for the 1990s that recognize the true condition of cities and their suburbs, the dominant and growing role of suburbs in contemporary urban life, and the political and fiscal strength of state and local government. The federal government should welcome wholeheartedly this rebirth of local government and call a halt to its lingering subsidy and regulatory intrusions into urban economic and fiscal affairs. Furthermore, to end its distortion of decision making by cities, Congress should put a halt to authorizing further funds for CDBG, UDAG, and the EDA, subsidizing mass transit construction, and attempting to micromanage the economic decisions of localities with subsidy carrots and regulatory sticks. The vitality of American life and government, the French observer Alexis de Tocqueville pointed out, begins at the bottom. It is upon that repaired and solid foundation that the urban policy of the 1990s must build.

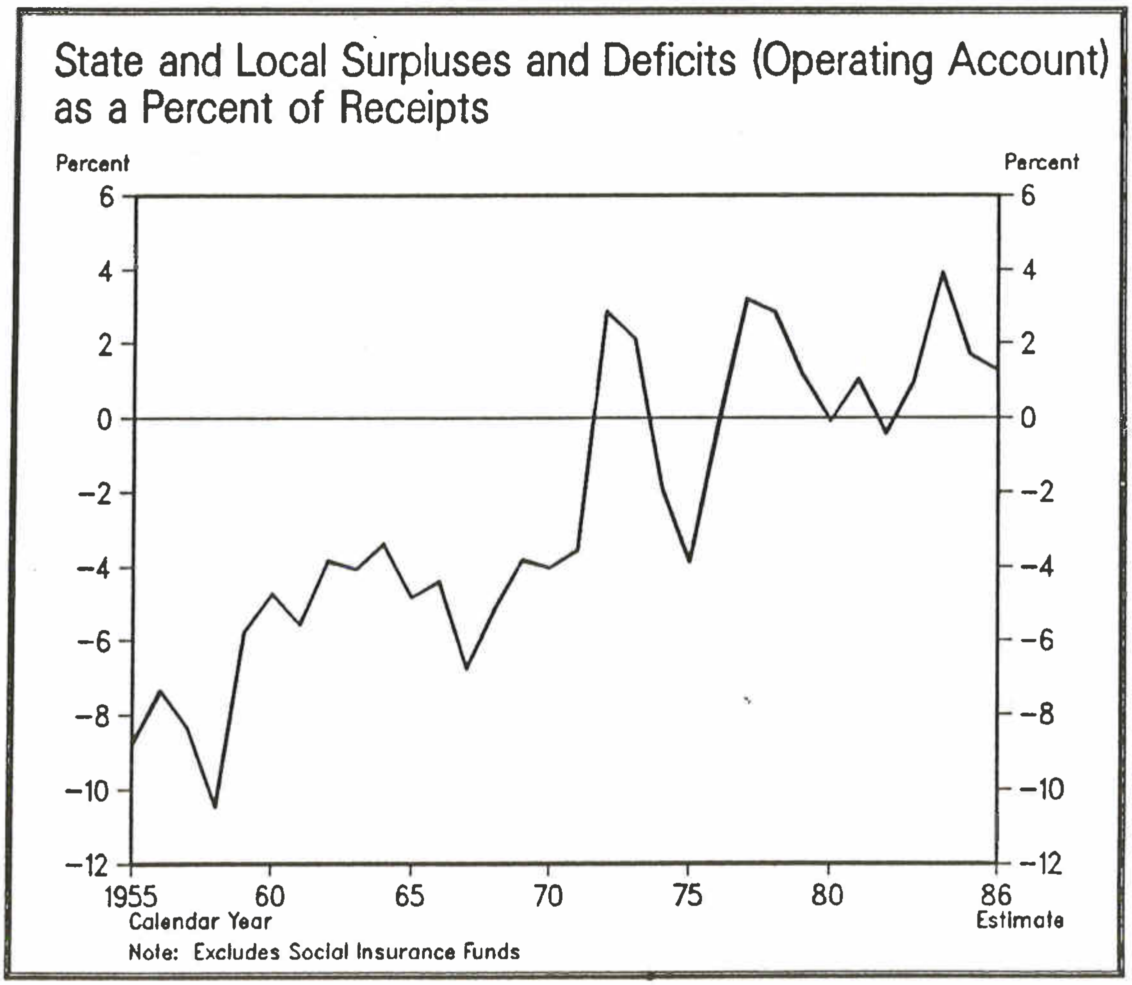
THE HEALTHY FISCAL CONDITION OF AMERICA'S CITIES AND SUBURBS

The urban areas of the United States have rarely been in better economic and fiscal condition than they are today. Not only are suburban cities and counties--which have rarely experienced financial problems because of their solid property tax base--in sound condition, but the central cities also are in excellent shape. For many years, these areas suffered from excessive service spending, economic downturns, tax base erosion, and the hemorrhaging of jobs and population. Now they are experiencing revived economic fortunes, an improvement in governmental and community morale, and greater fiscal capacity to provide services. Moreover, America's state governments, which have shown increased willingness to work with metropolitan areas in this era of revived federalism, also are finding their coffers full. Indeed, in many states and cities, contention these days is over how to use supluses--for tax rebates or increased expenditures.

Underlying Pattern. Precise spending figures for the cities and the states are not easy to determine. Generally these governments are prohibited by law or their constitutions from running deficits, and by political prudence from looking like profit-making jurisdictions. Hence officials and lawmakers try to even out revenues and expenditures each fiscal year by raising or lowering taxes, increasing or cutting expenditures, or giving rebates. So their budgets often obscure rather than reveal the underlying pattern. However, the Treasury Department and the Bureau of the Census do collect aggregate data that can be used to construct a broad picture of the local fiscal conditions.

The data show that since 1970 state and local operating budgets have consistently been in better shape than the national budget. Before 1970, aggregate state and local operating budgets generally were in deficit in some years by as much as 8 percent of their total budgets, according to the national income and product accounts (see Figure 1). But since 1970, operating budgets generally have been solidly in the black.

Figure 1



Source: Special Analysis H, <u>Special Analyses</u>, <u>Budget of the United States, Fiscal Year 1988</u>

Figure 1 shows clearly that the underlying condition of local budgets is greatly improved by periods of national growth. The only deficits in the aggregate state and local budgets since 1970 have occurred in recessions, and the 1980 to 1982 recession caused only a minor shortfall. Given political pressures on local politicians to spend available funds, it is extremely unlikely that they will allow surpluses to exceed 2 or 3 percent of operating budgets, so state and local budgets today probably are close to maximum budget health. Indeed, once bankrupt New York City is now "struggling" with the dire problem of a $600 million surplus, and the state of California wonders what to do with its $1.2 billion surplus.

Businesslike Programs. Most of the surpluses indicated in Figure 1 were generated by local governments.[1] In 1982, for example, while the states ran a deficit of over $7 billion, the localities were over $6 billion in the black. Local governments as a group have not, in fact, run an aggregate deficit since 1975. In addition, these figures do not include the cumulative surplus of over $50 billion built up by state and local governments in pension and social insurance funds.[2] Unlike federal "insurance" programs, which invariably operate with staggering unfunded liabilities, state and local insurance programs tend to be structured on a more businesslike basis.

Census Bureau surveys of cities and major counties result in similar conclusions about the fiscal health of urban areas. Such surveys show city revenues increasing 40 percent between 1980 and 1985, while expenditures rose 34 percent.[3] City surveys by the Bureau show the annual surplus of revenues over expenditures during the period rising from less than $1 billion to over $7.6 billion. Yet at the same time, the revenue received by cities from the federal government declined by 8.8 percent (see Table 1).

Table 1
CITY GOVERNMENT REVENUES AND EXPENDITURES, AND FEDERAL SUPPORT
(in millions of dollars)

	Revenue	Expenditures	Revenue From Federal Government
1980-1	105,451	104,470	11,283
1981-2	115,416	113,039	10,998
1982-3	124,861	120,455	10,666
1983-4	134,376	128,672	10,282
1984-5	147,648	139,997	10,292

Source: Bureau of the Census, *City Government Finances*, October 1986.

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1. Bureau of the Census, *Survey of Current Business*, Washington, D.C., May 1983, October 1984.

2. *Ibid.*

3. Bureau of the Census, *City Government Finances in 1984-5*, Washington, D.C., 1986.

The pattern was similar in the major counties, including the urban counties. From 1982 to 1985, the revenues of these governments increased 19.2 percent, expenditures by 16.7 percent, and the excess of revenues over expenditures widened from $2.7 billion to $11.6 billion, despite the fact that federal assistance to counties remained fairly constant.[4]

The economic base of most metropolitan areas, upon which budget health depends, is also strong and growing stronger. Data on 204 metropolitan areas, computed from Labor Department statistics for the 1986 National Urban Policy Report, showed a net increase of employment in urban areas of 4 percent, more than compensating for the effects of the 1980 to 1982 recession. The figures also indicate that most urban areas have been adjusting successfully to the shift in the economy from manufacturing to financing, insurance, and other services (see Table 2). The continuing strength of America's urban areas is also reflected in the steady decline in the urban unemployment rate since 1984, in areas other than those dependent upon oil (see Table 3).

Table 2

PERCENT CHANGE IN EMPLOYMENT IN 204 METROPOLITAN AREAS, 1979-1984

Region	Total Employment	Manufacturing	F.I.R.E.[a]	Services
New England	7%	-2%	17%	22%
Middle Atlantic	3	-14	13	19
East North Central	-6	-18	7	13
West North Central	1	-9	10	13
South Atlantic	12	1	17	24
East South Central	1	-10	9	15
West South Central	11	-5	23	25
Mountain	13	10	17	26
Pacific	5	-2	9	16
All 204 SMSAs	4	-10	13	19
U.S.	7	-6	14	22

[a]Finance, Insurance, and Real Estate

Source: Computed from tapes produced by the Bureau of Labor Statistics, *President's National Urban Policy Report, 1986.*

4. Bureau of the Census, *Local Government Finances in Major County Areas*, *1984-5*, Washington, D.C., April 1987.

Table 3
UNEMPLOYMENT RATE IN MAJOR METROPOLITAN AREAS
1984-1987

	Average Rate 1984	Rate April 1987
New York*	8.2	4.9
Chicago	8.7	7.4
Los Angeles	7.9	6.4
Detroit	11.1	8.2
Houston	6.7	9.1
Miami	7.5	5.6
Boston	4.1	3.3
Pittsburgh	12.4	6.8
Cleveland	9.1	6.3
Philadelphia	11.1	4.2

*Labor Market Area

Source: Bureau of Labor Statistics, *News*, USDL 87-243, June 16, 1987. *Geographic Profile of Employment and Unemployment, 1984*, Bulletin 2234, May 1985.

While the urban areas have grown stronger financially, the federal government has become weaker. It consistently runs deficits of 15 to 20 percent of its operating budget, and there are unfunded liabilities in such federal insurance programs as Social Security. So the federal government borrows heavily to support the activities of state and local governments that are generally operating in surplus. And not only is the weaker national government borrowing to shift funds to these stronger levels of government, but the funds are provided under restrictive conditions that force local governments to distort their policy decisions and waste money with federal mandates.

HOW FEDERAL "HELP" THREATENS LOCAL INITIATIVE

In the earlier years of suburban growth, many cities had great difficulty obtaining resources and representation from state legislatures, which were dominated by rural interests. Cities increasingly turned to the federal government for succor. Out of this strategy arose the ill-fated urban renewal strategies of the 1960s, such as the Model Cities and community action programs. Federal housing and transportation programs also resulted from this switch in tactics. Contrary to the intentions of city officials, however, many of these programs actually were detrimental to central cities and their residents. Federal transportation and housing programs, for instance, accelerated suburban growth and the exodus of middle-class Americans and industry from the central cities, eroding the tax base. Urban renewal and its successors, including UDAG, tore down inexpensive low-income housing, replacing it with upper-class housing, offices, and hotels, and displacing many inner-city residents. Subsidized housing, on the other hand, reinforced the culture of the ghettos for those who remained.

Complex Relationship. While political reality has meant that 25 to 30 percent of urban funds are diverted to nonmetropolitan areas, roughly in accord with their voting power, the hodge-podge of federal programs still does not address the complex relationship between city and suburb. Central cities and their suburbs have many common interests. They share a regional economy and its transportation needs. Their housing markets overlap, and they share water, sewage, and environmental problems. But they cannot manage these common interests while the federal government interferes and constrains their decisions. Example: one of the greatest urban concerns has been the disparity between suburbs and central cities in income levels, service needs, and tax capacity. Such disparities between cities and their own suburbs tend to be greater than disparities between cities or between metropolitan areas. The consequences of such disparities can only be accommodated through carefully balanced arrangements between local jurisdictions, aided by well-designed state legislation. Yet many federal actions, such as subsidized mass transit and subsidized housing, actually exacerbate many problems and make local solutions more difficult.

In the last six years, however, forced by federalism to work with their states, local governments have begun to realize that state governments can address the common interests of metropolitan areas more effectively than can Washington. At recent conferences of the nation's governors and mayors, participants now brag, deservedly, of their success and superiority to the federal administrations--although not so loudly as to jeopardize any remaining federal largesse.

Overstated Problem. Take the "infrastructure crisis." Only five years ago, it was all the rage. Dire threats abounded of the imminent physical collapse of the nation's transportation, water, and sewage systems. Like most such media-led crises, the problem was overstated, as pointed out by both the U.S. Advisory Commission on Intergovernmental Relations and the U.S. Conference of Mayors.[5] Nevertheless, much of the deterioration resulted from the incentives in federal construction programs, with their generous financial matching, which encouraged cities to seek federal funding for additional facilities, rather than spending funds on maintaining existing infrastructure. So urban areas ended up both with new facilities to maintain, and old ones which had been neglected.

Once the nature of the problem was recognized and the responsible governments began to concentrate funds on the problem, the manageability of the infrastructure requirements became evident. Local governments began to increase their own debt financing for capital needs, innovative methods were developed for infrastructure rehabilitation, and private businesses grew up to satisfy local repair needs.[6] Attention has moved to other concerns. Except in Washington. Congress is still voting to fund unneeded and uneconomic transit systems for localities without regard to the ultimate cost for the cities themselves.

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5. National League of Cities and the United States Conference of Mayors, *Capital Budgeting and Infrastructure in American Cities: An Initial Assessment*, April 1983, cf. p. iv; U.S. Advisory Commission on Intergovernmental Relations, *Public Financing of Physical Infrastructure*, Washington, D.C., 1983, cf. pp. 3-5.

6. U.S. Department of Housing and Urban Development, *The President's National Urban Policy Report, 1986*, p. 50.

Local Incentives. The nation's cities and suburbs have shown a remarkable talent during the economic recovery for making the policy adjustments necessary to invigorate local economies, foster and attract new business, and limit business losses. From New York's emphasis on finance, to Portland, Oregon's growth in high-technology industries, to Indianapolis's focus on medical services, metropolitan areas have shown their alertness to local advantages as the foundation for sustained economic growth. There is no guarantee, of course, that every city will succeed. Some local initiatives, such as financial support for business incubators and venture capital financing, seem likely to prove misguided attempts to mimic the private sector. Yet all are evidence of the newfound drive and inspired innovation of state and local government. The grave danger is that existing and new federal programs and regulatory requirements, incapable of being responsive to local needs, could overwhelm these local actions.

HOW PROGRAMS DISTORT LOCAL DECISIONS

The Community Development Block Grant (CDBG) and the Urban Development Action Grant (UDAG) programs, together with the Economic Development Administration (EDA), are prime examples of federal initiatives that distort or suffocate local initiative. Thanks to federal regulations and rulings by HUD field administrations, for instance, cities have been required to plan and initiate efforts to provide low-income housing in order to receive CDBG funds even though the program originally was created in 1974 to consolidate and simplify a number of urban development programs. Although the Reagan Administration has managed to introduce greater flexibility into the program, Congress is attempting to introduce new requirements for local governments. In addition, CDBG entitlements tend to be extraordinarily wasteful, since all cities of 50,000 or more residents and all urban counties receive these funds regardless of the level of need, or the jurisdiction's own ability to raise revenues. For most cities, the program is just a form of revenue sharing. Given the relative fiscal strengths of the national and local governments, this makes no sense. Placing thresholds on the CDBG entitlement amounts and gradually phasing out funding would give urban governments complete control over community and economic development.

"Free" Money. UDAG and EDA have led to similar problems. Like CDBG, they constitute an effort by the federal government to manage local economic development in directions sanctioned by interest groups. Congress has never allowed these programs to be targeted as originally proposed. Instead, they have become sources of "free" funds for powerful cities and corporations able to invest in effective lobbying efforts. UDAG proponents have never been able to make a solid case for the notion that the marginal help provided by the program actually makes projects possible that would otherwise be impossible--the "but for" condition. In practice, meeting the "but for" condition is a matter of arranging letters and telephone calls from influential politicians and business interests. Success for a city in its application means "free" money from Washington. But it also means that the economic development of the city is attuned to the needs of corporations that are skilled lobbyists, rather than to the most pressing needs of the city.

Greater Flexibility Needed. Economic development and transportation should be left to local determination of market needs and assessments of costs and benefits, not a national agenda. Other urban programs, such as housing and social services, which act in part as payment transfers to individuals, in principle should meet additional standards, since there is a national objective of ensuring that individuals achieve a minimum standard of services, regardless of location. Unfortunately, the programs used to deliver such services almost seem intended to ignore local needs. Even the Reagan Administration, after striving to consolidate as many programs as possible into block grants, recently has helped create categorical programs in rental rehabilitation and rental housing development and has acquiesced in new categorical programs for the homeless. In addition, attempts to consolidate community and social service programs into block grants, as required by the 1981 Omnibus Budget and Reconciliation Act, were never entirely successful, so local communities find themselves with very limited flexibility to meet service needs. The lesson seems to be that, if the federal government desires to provide services to individuals, it should do so directly, through vouchers or other direct grants to families, especially for such services as housing and education. The government should eliminate categorical and pseudo-block grant service programs in favor of vouchers or increased transfer payment programs. Unless this is done, cities will continue under the current combination of low service levels, high administrative costs, and the imposition of burdensome overlapping bureaucracies.

Beyond interfering with the natural working relationships between jurisdictions in urban areas, federal efforts also frequently provide incentives for activities by local government that are not economically efficient or interrupt the operation of an effective private market. Take rent control--usually imposed by politicians who find it expedient to give in to local tenant pressure. Cities that impose rent control only undermine their housing market and then find themselves short of housing. Federal housing programs merely allow such jurisdictions to continue popular but destructive policies courtesy of money from Washington. Self-inflicted wounds are thus perversely rewarded. Similarly, local merchants, hoteliers, or manufacturers can find themselves confronted by fierce competition from well-connected corporations, subsidized by federal UDAG or EDA grants. And small, struggling local businesses, built on their owners' own "sweat equity," are forced to fight for customers with new firms supported by Small Business Administration loans.

RECOMMENDATIONS

Given the economic and political strength of urban and state governments and the heavily surburban character of all of urban America, federal efforts to micromanage urban development clearly are outmoded. Needed instead is a complete rethinking of the urban policy agenda, beginning with a face-to-face confrontation with the true urban financial picture. Several key ingredients are necessary for a federal strategy appropriate to the healthy condition of America's cities. Among them:

◆◆ An announcement that, as a basic principle of urban policy, cities and suburbs will be urged to work together, and their respective state governments, to address policy matters that do not involve federal transfer payments to individuals.

◆◆ The immediate elimination of programs that attempt to foster development in some cities at the expense of others, such as UDAG, EDA, Rental Rehabilitation, and the Housing Development Action Grant programs. Categorical programs aimed at urban development have long outlived whatever usefulness they might once have had.

◆◆ The phasing out of block grant programs, such as CDBG, State Block Grants for Small Cities, and Social Services Block Grants. Since these programs involve direct infusions of money through local governments, time should be allowed for state and local governments to adjust. A three- to five-year elimination schedule, combined with a formula to take into account cities' financial conditions, would allow urban areas with the greatest dependence to adjust more easily and to determine which activities should be continued at local expense and which eliminated as poor value for local taxpayers.

◆◆ New legislation and regulation to prevent federal programs from being used to encourage anti-market activity by local governments. For example, cities suffering from restricted housing markets as the result of stringent rent and development controls should be limited to voucher housing assistance, which would allow renters to seek housing outside of those cities that pursue such damaging housing policies.

◆◆ The replacement of location-specific grants-in-aid providing services to individuals and families by voucher-style assistance or the incorporation of such grants into existing transfer payment programs. This would reduce the administrative burdens on local agencies.

◆◆ The limitation of federal government infrastructure programs to federal properties, such as the interstate highway system, allowing local governments to determine and finance their own local transit needs, as local markets require. In particular, mass transit capital subsidies should be terminated.

CONCLUSION

The cities and suburbs of America have demonstrated that they are capable fiscal and economic managers. They are in a new era of local confidence and growth. Thus it is time for a national urban policy that gives the freest possible hand to local initiative and judgment, minimizing federally induced market distortions and removing federal interference in state and local decision making.

As part of this urban policy for the next decade, the federal government must recognize and accept the inextricable links between cities and suburbs and the need for the primary intergovernmental relationships of these jurisdictions to be with their states. The federal government must cease to interpose itself as the dominant influence in the nation's cities. It has neither the financial capacity nor knowledge of local needs sufficient to play such a role. It must seek instead to reinforce the improved health of the local governments under the federalism policies of recent years by further liberating local urban governments from restrictive federal programs and regulations.

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