

The Changing Pattern of Local Finance

By MABEL L. WALKER

THE MUNICIPAL FINANCE PICTURE has changed greatly since the days (1906-1917) when New York City was fortunate enough to have Mr. Lawson Purdy as president of the Department of Taxes and Assessments. It has changed throughout the country as well as in New York City. Moreover, the process of change in this field has gained tremendous impetus since the Second World War, so that developments within the past three years appear more momentous than in the entire four decades beginning with 1906.

To some observers the current situation presents itself only as an intensification of long-felt problems, and they look to standard remedies to ease the situation. I cannot share that attitude. I believe that profound changes are taking place with respect to the American city and that as a result there is definitely emerging a new pattern of city finance.

Current developments in local finance are both more revolutionary and more spectacular than concurrent developments in either federal or state finance. Things have been happening locally because the pressure of developments in the urban field was so great that action became inevitable.

The old pattern of city finance meant primary and overwhelming emphasis on property taxes. During a transitional period, when it first began to be evident that property taxes could no longer keep pace with local revenue needs, such taxes were supplemented by ever-increasing state aid. Why has the prewar fashion become thus outmoded?

First, because the property tax, that old gray mare of the revenue system, definitely is not what it used to be. For almost a century and a half American cities grew rapidly. Therefore, the cities could meet the costs of growing pains and live more or less affluently on property tax collections. In more recent decades, property tax yields did not increase rapidly enough to keep pace with increasing urban needs, and we began to enter the heyday of state aid. In the period since World War II, it has become evident that property taxes are even less adequate to finance the mushrooming costs of city government. Moreover, a sour attitude concerning ever-increasing state aid has definitely made itself felt.

These are the basic reasons for the shift from the old to the new pattern in city taxes that is definitely getting under way.

What is the Pattern?

THE MOST IMPORTANT ASPECT of the "new look" in municipal finance is the turn to new local tax sources. The cities are demanding, and the legislatures are granting, ever-increasing tax privileges. The wisdom of some of these privileges is questionable, but additional taxing powers for the local governments appear inevitable.

Almost half the states (twenty or more) have granted some additional taxing powers to local governments since the last war and this movement continues apace.

The states that have gone furthest in allowing tax leeway to the localities are Pennsylvania and New York. Pennsylvania, in its now famous Act 481, enacted in 1947, gave local units unprecedented freedom of taxation. Local governments were given power to tax anything not taxed by the state. This power applied not only to cities, both large and small, but also to boroughs, townships, and even school districts. These broad taxing powers were granted to 3,600 local units, including 49 cities, 937 boroughs, 60 first-class townships, and 2,542 school districts.

New York State also conferred broad taxing powers upon its local units. Its approach to the problem was more selective, however, since it specified definitely what taxes could be levied by particular units. Whereas Pennsylvania granted local governments the power to tax any sources not being utilized by the state, New York permitted localities to adopt some taxes which were also being imposed by the state.

Local Sales Taxes

THE MOST STRIKING DEVELOPMENTS in the new local legislation have been in the sales and income tax fields. These are the two most productive forms of levies after the property tax. The sales tax has had a more phenomenal spread, but in some respects the spread of the local income tax is of more far-reaching significance.

New York City and New Orleans initiated local sales taxes in the middle thirties. These are still the two most outstanding examples of city sales taxes in this country, but local sales tax developments in California during the last three years have been more spectacular.

There has been a state sales tax in California since 1933. In order to simplify procedure, the California cities adopted the state law at their own rates. In this way they could avail themselves of the state audit. There are now over 100 California cities imposing sales taxes at 1 per cent or at $\frac{1}{2}$ of 1 per cent. In no other state has there been anything comparable to this local sales tax development.

Despite the 1947 enabling legislation, New York cities and counties have been in no great haste to impose sales taxes, although such taxes have become effective in some of the largest cities. In 1947 Syracuse imposed a 2 per cent tax, and Erie County, in which Buffalo is located, levied a 1 per cent tax. The Syracuse tax was decreased to 1 per cent in 1948. In 1948 Monroe County, in which Rochester is located, imposed a temporary gross receipts tax of $\frac{3}{5}$ of 1 per cent on financial and $\frac{3}{10}$ of 1 per cent on other businesses. Poughkeepsie has imposed a 2 per cent sales and use tax.

Retail sales taxes and gross receipts taxes have been imposed by local governments of a number of other states. Denver adopted a 1 per cent sales tax in 1948.

Local Income Taxes

THE LOCAL INCOME TAX is even more of an innovation than the local sales tax. There was perhaps a certain inevitability in the adoption of city income taxes, and in the form which these taxes have taken.

Canadian cities have experimented with city income taxes for more than a hundred years, but they are a relatively new development in this country.

In an historic experiment, Philadelphia imposed a $1\frac{1}{2}$ per cent tax on wages and business profits of residents and nonresidents in November, 1938. The State Supreme Court upheld the tax but threw out all exemptions provided in the ordinance. This court decision thus made the tax a flat rate tax. The court further "assumed that regulations will be promulgated" to have the tax collected "at the source." The 1938 law was repealed and a new $1\frac{1}{2}$ per cent municipal income tax law was enacted in December, 1939. The tax, which followed the implied suggestions made in the court decision on the earlier tax, was upheld by the Supreme Court.

Prior to the Philadelphia experiment, income taxes had not been considered administratively feasible for local governments. Apparently the development of a form of income tax adapted to local use was not the outcome of logical analysis, but was stumbled upon as the result of a court decision delineating the vagaries of the Pennsylvania constitution. The Philadelphia tax has served as a model for later local income taxes.

The Philadelphia tax proved so extraordinarily productive that the rate was reduced to 1 per cent, effective Jan. 1, 1943. For some years, Philadelphia was the only city to impose a city income tax, excepting of course the District of Columbia tax applying in Washington.

In 1946 Toledo adopted a 1 per cent tax. In 1947 the first local income tax law resulting from the new Pennsylvania enabling legislation was adopted by the Coraopolis School District of that state at a rate of 1 per cent.

The city income tax movement gained definite momentum in 1948. The Ohio cities of Columbus, Springfield, and Youngstown all adopted income taxes. Louisville adopted a 1 per cent income tax, and St. Louis a $\frac{1}{2}$ of 1 per cent tax. A Minneapolis income tax proposal was defeated. Saginaw, Michigan, approved an income-profits tax, subject to referendum.

It is in Pennsylvania, however, that the local income tax movement has made its most startling development. According to the Pennsylvania Chamber of Commerce, 133 local governments in Pennsylvania have adopted income taxes under the 1947 enabling law. Many, if not most, of these taxes have been imposed by school districts.

Admissions Taxes

MANY PERSONS see in admissions taxes a "natural" for city governments. The widespread popularity which local sales taxes attain in California and which local income taxes are gaining in Pennsylvania, is accorded to admissions taxes in Ohio, Pennsylvania, and Washington. Every Ohio city over 25,000 population except Toledo and Norwood has adopted an admissions tax since Ohio authorized such taxes in 1947. There had previously been a state tax on admissions. This was dropped in 1947 and municipalities were allowed to impose local admissions taxes.

One hundred and sixty-six Pennsylvania communities have imposed admissions taxes.

At least 63 Washington cities impose admissions taxes.

Other Local Taxes

CONSIDERABLE SPACE could be used in enumerating other types of local levies that are being imposed. Some of the most important are gross receipts taxes (actually such taxes are a form of sales tax), taxes on utility services, and liquor, gasoline and tobacco taxes. Some of the newer forms of taxes are those on hotel rooms and on auto use. A reversion to the past is seen in the spread of local poll taxes in Pennsylvania. Under the delicate designation of "per capita" taxes, 220 Pennsylvania communities have imposed this tax.

Severance taxes are also being widely adopted under the blanket authority granted in Pennsylvania. Taxes have been imposed on processing and transporting coal, on dumping mine refuse, on mine props, and other mining operations. Different types of taxes have been imposed by adjoining boroughs and school districts with the result that the same ton of coal may be taxed several times.

In summarizing the Pennsylvania experience under Act 481 for a pamphlet¹ recently published by the Tax Institute, Mr. Welles A. Gray of the Pennsylvania Economy League stated that 692 local governments had been reported as levying 919 different taxes under this enabling legislation. Nevertheless, Mr. Gray concludes:

One unexpected, but very constructive, result of the new Pennsylvania law has been a heightening of the interest of local citizen groups in the fiscal problems of their communities . . . With the threat of new taxes to be imposed under Act 481 there was a substantial upsurge of interest in local fiscal affairs . . . When they have the direct responsibility of paying for the services performed by their local governments, citizens become interested in whether those services are rendered efficiently and whether the proposed new taxes actually are needed, rather than in how much more money they can get from state sources.

One of the newest notes in the local revenue picture has recently been sounded by Mayor James M. Curley of Boston. In a New Year message he asked the City Council for a city tax on industrial profits at the rate of 15 per cent. Another up-to-the-minute proposal emanates from other cities where plans are being made to tax television in bars.

Effect of Urban Decentralization

BEFORE CONCLUDING this brief summary, it seems appropriate to add a few evaluative comments to this recital. First, why have these things happened, and why have they happened at this particular time?

Notwithstanding the customary interpretation of urban population statistics, there appear on every hand indisputable evidences that the population push of today is away from, and not toward, the large city.

Retailers know that urban decentralization is taking place and they are locating their stores accordingly. Industrial executives know that industries are decentralizing. They are writing books and making speeches and conducting surveys on the subject—as well as locating their branch plants in small cities and rural communities. The building industry knows that decentralization is taking place. Read the real estate section of any Sunday newspaper and see the week-by-week record of what is happening. Transportation agencies are painfully aware of the exodus to the suburbs and beyond. Many other groups, representing diverse fields of interest, are aware of decentralization as a result of observing developments in their fields.

But in precisely those places where it is most important that this phenomenon be correctly analyzed and interpreted in order that appropriate

¹ "More State Aid or More Local Taxes?" Forum Pamphlet Four, December, 1948.

adaptation can be made to what seems to be an inevitable development, we hear continued talk of the urban trend.

Recognized or unrecognized, however, decentralization is the undertow that is rapidly changing the pattern of local government finance in America.

The current practise of throwing ever-larger loops around the so-called metropolitan districts and then considering such areas as a whole is fraught with serious consequences, because some of the most significant current population movements are within these metropolitan areas.

The general lack of awareness of population developments affecting the city appears to stem from several causes, among which are the following: the census definitions of urban and rural places; the current emphasis on featuring population statistics by metropolitan areas, with too little attention to population shifts within these areas; the lack of statistical data concerning daily and weekend commuting; absorption with temporary phenomena resulting from wartime developments; general lack of qualitative and quantitative analysis and correlation of data concerning developments in industry, retailing, construction, and other fields; and an even greater lack of understanding of the basic desires of human beings.

Under the existing set of definitions and classifications, as the city disintegrates into the surrounding countryside, the outgoing population flows into small outlying communities which immediately become classified as urban, thus making it appear that the population shift is from country to city, rather than from city to country.

It has already been indicated that the property tax revenues, which for such a long period expanded sufficiently to keep pace with local financial needs, are no longer sufficient for that purpose. Moreover, to an increasing number of persons, ever-expanding state aid, which seemed such a happy solution of the difficulty a decade or so ago, does not appear to be the appropriate answer.

With sharply limited revenues on the one hand, cities are faced on the other hand with rapidly rising expenditures due to an inflationary situation, postwar needs, and the long-term trend to ever-growing governmental functions.

These are the factors that are changing the pattern of local finance. Coupled with the search for new taxes is a desire to obtain some tax revenue from those citizens who profit from the city, but as nonresidents contribute little to its expenses. This desire is frequently emphasized in the agitation for local income taxes. Such taxes fall upon the commuter as well as the resident. Admissions taxes, hotel taxes, and parking meters hit the transient.

Concurrently, we see under way a tendency to charge suburban fringes for municipal services rendered, or even to annex such territory.

Looking to the Future

TWO THINGS SEEM INEVITABLE: first, increased taxing powers for local governments; second, utilization of those powers in a way that will make the commuting and contact population of a city help support it. These goals can be achieved without too great difficulty. Some more or less faltering steps have already been made along these lines, as has been indicated in this paper.

But the problem is enormously complicated by the pattern of local governmental units. We cannot define our cities satisfactorily as political entities. We are on even less tenable ground in trying to define them as economic entities. And now, before we have solved even these basic problems, we find the cities in the process of disintegrating all over the surrounding countryside, with the entire urban-suburban-rural set of relationships in a state of great confusion.

I believe the city planners, the fiscal planners, and the governmental researchers would all be well advised to keep in touch with each other and to examine jointly economic and sociological factors affecting the city. Moreover, the time is overripe for a reworking of the definitions of such terms as city, country, urban, rural, suburban, etc., and for a recasting of the mold in which census data are being fashioned.

Tax planners are not the villains in the plot. They are merely hardworking, groping souls who are trying to muddle along as best they can and meet the problem as they see it.

Over in another corner, city planners are dreaming up beautiful cities as they would like to have them. Elsewhere traffic engineers are fretting over their particular difficulties, while on still another plane political scientists chew on their particular cud. The urban redevelopers and public housers work on other tangents.

No wonder the American city is developing a widely splitting personality.

The city is disintegrating, but it gives no signs of disappearing. Instead it is in the immediately unhappy process of changing its form and functions. The basic economic and social data on which orderly transitional plans can be formulated are presently lacking. Hence mutually contradictory solutions are being simultaneously urged. At best urban problems in the coming years will be difficult; at worst they will be chaotic.