MESSAGE FROM THE PRESIDENT GEORGE W. McCARTHY

Strengthening Municipal Fiscal Health

WHEN ONE LOOKS AT FISCALLY DISTRESSED CITIES, it is easy to conclude that insolvency is simply a product of ineffective management, a lack of financial discipline, or the incompetence or corruption of local government. However, several important countervailing facts are worth considering: fiscal insolvency of municipalities today is often the artifact of bad planning decisions made decades ago; many events that led to local fiscal insolvency, including bad planning decisions, were beyond the control of municipalities; and the delicate dance of matching irregular revenues against unpredictable expenditures challenges even the best-run municipalities.

Many planning decisions that catalyzed the decline of Detroit and other Rust Belt cities were made at higher levels of government. For example, construction of federal interstate highways in the 1950s often ran slipshod over local plans and preferences and greased the skids of urban exodus for families, enterprises, and wealth—motivated by the tax advantages of jumping municipal borders. The city of Detroit lost some 60 percent of its population and much of its industry and commerce between 1950 and 2000, while the population of the metropolitan area remained fairly stable. Tax bases and populations of nearby municipalities grew substantially while Detroit's evaporated during that half-century.

Similarly, policies at state and federal levels imposed unpredictable and often unmanageable spending requirements on local governments. Over decades, localities were buffeted by revisions in revenue-sharing formulae of higher-level governments or unfunded mandates. The Clean Water Act, for example, established a much-needed regulatory framework that has cleaned up waterways and protected citizen health since 1972. It also imposed draconian financial demands on local governments, saddling them with the costs of expensive water systems upgrades to meet ever more stringent standards, and the seemingly impossible challenge of separating storm water and wastewater in commingled underground systems built a century ago.

As municipalities internalize the message that poor financial performance is a local problem, they often take remedial actions that inflict more serious damage on their economic and social futures. One of the underreported aspects of the unfolding tragedy in Ferguson, Missouri, is the extent to which the violence and recrimination there is rooted in fiscal challenges. Ferguson, like many jurisdictions in St. Louis County, chose to supplement insufficient local revenues with traffic fines that were harshly enforced. Many similar jurisdictions derived 30 percent or more of their general revenues from enforcement of traffic violations. It is best left to the courts and the Justice Department to determine whether the pattern and practice of enforcement in Ferguson was discriminatory. But there is a separate issue involving the conflation of public safety and revenue generation, which can lead to perverse outcomes.

St. Louis County is not unique in its creative use of local courts as a revenue generator; it is pattern and practice in municipalities across the United States and other continents. In a 2006 study of North Carolina counties by the St. Louis Federal Reserve Bank, humorously named *Red Ink in the Rear View*, the authors found that a 10 percent decrease in annual revenues led to a 6.4 percent increase in traffic citations. Interestingly, there was no reversion to fewer citations when revenues rose. In one astounding case, the town of Waldo, Florida, derived half of its general revenues from traffic fines. New York City netted $624 million in general revenues in 2008 using aggressively priced and enforced parking violations. On the international front, the BBC and *The Guardian* accused London's Hammersmith and Fulham Council of using traffic courts as a major revenue source in 2013.

Another dangerous way that municipalities shore up finances is through the sale of tax liens to investors. Although this practice attracts needed revenue, conveying powerful tax liens leads to unintended consequences that are difficult to manage. The dominance of tax liens over all other liens gives extraordinary power to those exercising foreclosure. Savvy investors who pay a small share of outstanding arrearages to purchase liens can acquire properties at pennies on the dollar of actual value. These new owners manage their holdings to maximize return, which often runs counter to public interest when it promotes naked speculation on vacated properties or accelerated neighborhood decline through widespread absentee ownership.

Municipalities make desperate choices like these to improve fiscal status in part because of popular opposition to property taxes, the dominant source of local revenue. Any municipality that considers raising property taxes to cover obligations faces the prospect of local tax revolts or increased pressure to relieve residents and businesses of tax burdens. In this issue, Adam Langley analyzes the property tax credits and homestead exemptions that provide individual relief from this unpopular tax, but further constrict local public budgets (p. 24). Constraints imposed by property tax limitations often lead to more reckless measures to make ends meet.

Perhaps there are other approaches available to municipalities to restore fiscal health. In Detroit, an unprecedented partnership among the public, private, and civic sectors supported a participatory planning exercise called *Detroit Future City*. More than 100,000 residents contributed to the design of this extraordinary land use and economic redevelopment strategy. John Gallagher reports on early implementation of projects that are intended to bring this community vision to reality in the Motor City and turn around decades of decline (p. 14).

Municipalities in developing countries confront a different set of fiscal challenges. In many countries, as national governments devolve responsibility for supplying public goods and services to localities, municipalities must invent new local public finance systems; most see property taxation as a promising revenue option. However, effective property tax systems are built on foundations such as land registries and value assessment tools. The difficulty of building these systems is magnified in cities with expansive informal settlements, where residents and their homesteads are not officially registered or recognized. Ryan Dubé reports on some of the challenges of establishing and maintaining a property registration system in Lima, Peru, where an upgraded system has not delivered on hypothetical benefits proposed by theorists (p. 6).

The challenges of attaining and sustaining municipal fiscal health are manifold and complex but not insuperable. During the 1960s and 1970s, today's hottest American urban economies also struggled with population flight, urban blight, and insurmountable fiscal challenges: the cities in or near bankruptcy then were Boston; New York; Washington, DC; Seattle; and San Francisco. Their renaissance might have had less to do with their intrinsic greatness than the work of larger forces at higher levels of geography. This is not to cast aspersions on our great coastal cities; it is simply to make the larger point that municipal insolvency is a structural problem, not necessarily a product of any particular deficiency in local leadership.

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Sound planning and effective public management lay at the heart of municipal fiscal health. A sound fiscal stance is required to finance public investment in projects that build a prosperous and sustainable local economy. A robust local economy grows a tax base that throws off revenues, which local governments need to pay for the public goods and services that support a good quality of life. But chronic and unpredictable variability of both local revenues and expenditures requires effective planning to survive inevitable bumps in the road.

In October, I named redevelopment—the effective reuse of previously developed land—a millennial challenge. Managing and sustaining the fiscal health of local governments is another such challenge. We need a better understanding of the theory and practice of planning, taxation, and valuation that can guide municipalities' efforts to pursue this elusive goal. The Lincoln Institute of Land Policy is uniquely poised to inform such efforts. In this issue, we've touched on a few topics that relate to municipal fiscal health; this millennial challenge will remain a major focus of our work here at the Institute. L