DEMOGRAPHIA

Policy Analysis:
The Pennsylvania Distressed Municipalities Program (Act 47)

A recurring theme in Pennsylvania is that its system of small local democracies is driving municipalities into financial distress. In fact, however, a review of municipalities that have entered formal financial distress under Act 47 reveals higher spending has often been the driving factor.

A 2007 Brookings report refers to an "epidemic of distress" among Pennsylvania municipalities.[1] This perspective is echoed in a Pennsylvania Economy League[2] report, which contended that distressed municipalities do not have sufficient taxing capacity. This perspective, however, ignores the other side of the municipal operating statement --- expenditures. Insufficient revenues are not the only potential cause of municipal financial distress. As noted above, distress can also be caused by excessive spending. Generally, it is likely that distress in a municipality with significantly lower than average revenues per capita is the result of insufficient revenues. On the other hand, it is likely that distress in a municipality with significantly higher than average per capita revenues is the result of insufficient cost control. In such cases, focusing on tax capacity misses the point completely.

In fact, financial distress among Pennsylvania municipalities is skewed toward higher expenditures rather than lower revenues. The distressed municipalities generally tax at higher levels than municipalities that are not in distress. On average, distressed municipalities collected $322 in local taxation per capita in 2004, 80 percent more than the $178 among non-distressed municipalities (Figure 1).

- Fourteen of the 17 distressed municipalities for which 2004 data is available had higher than average per capita local taxes.

- Nine of the distressed municipalities have per capita local taxation levels more than 50 percent above average.

- The largest distressed municipality, Pittsburgh, has by far the highest variation from average of any distressed municipality, collecting nearly *five times* as much local taxation per capita as the average Pennsylvania municipality.

- The distressed cities of Scranton and Chester collect more than 2.5 times as much local taxation per capita as the non-distressed average.

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[1] Brookings Institution (2007), *Committing to Prosperity.*
[2] Pennsylvania Economy League (2007), *Structuring Healthy Communities, Part 1: Revenue Generation and Fiscal Health*.

Moreover, even the distressed municipalities indicate that "bigger is not better" with respect to municipal governments. The largest distressed municipalities generally have higher local taxes per capita than the smaller distressed municipalities. In addition, they averaged approximately 20 percent more in federal and state aid per capita than the statewide average.

At least to some extent, financial distress in Pennsylvania is driven by higher expenditures rather than insufficient revenues, since many distressed municipalities have comparatively healthy tax revenues.

Distress in the Largest Municipalities: Both Philadelphia and Pittsburgh, the state's largest municipalities, have represented a particular problems with respect to municipal distress. By the early 1990s, the largest municipality, Philadelphia had become seriously distressed. Present Governor Ed Rendell had been elected Mayor on a promise to remedy the situation and led an effort to restore the city to financial health. He noted that labor and management costs in the city were "out of line"[3] and proceeded to implement a cost reduction program that that yielded what can only be called spectacular results in just a few years.

More recently, Pittsburgh has also become financially distressed and, unlike Philadelphia under Mayor Rendell, has formally entered the Act 47 program. There have been a various proposals to alleviate Pittsburgh's financial distress through city-county consolidation,[4] generally based upon an assumption that the problem was a lack of revenues.

In fact, however, Pittsburgh has enjoyed comparatively healthy revenues. Pittsburgh's local taxation per capita is nearly five times the state municipal average. The more than 125 other municipalities in Allegheny County collect local tax revenues that are less than one-half the Pittsburgh rate (Figure 2). In additional Pittsburgh receives considerably more state and federal revenue than the other jurisdictions in Allegheny County (Figure 3).

In an environment where spending, rather than funding is the problem, there could be no more inappropriate strategy than consolidation, service sharing or tax sharing. Such approaches could simply lead to more widespread financial distress. Spending interests would have an even larger tax base from which to seek additional funds and taxpayers in the balance of Allegheny County would be likely to face considerably higher taxation in the future, and less responsive government. Under consolidation, taxpayers of the more efficient municipalities would be forced to participate in financing Pittsburgh's excessive expenditures, despite not having had the electoral opportunity to keep them under control (as the governance system had allowed them do in their own municipalities). Tax sharing would create the same problem because it allows higher spending jurisdictions to impose higher taxes on people who cannot participate in their elections. Milton Friedman once said that people are more careful with their own money than other people's money. The same dynamic operates in government, as the experience of Pennsylvania's distressed municipalities program indicates.

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[3]Edward G. Rendell (1992), *The City of Philadelphia Five-Year Financial Plan*, City of Philadelphia.

[4] Consolidation of all municipal governments in the county and the county government.

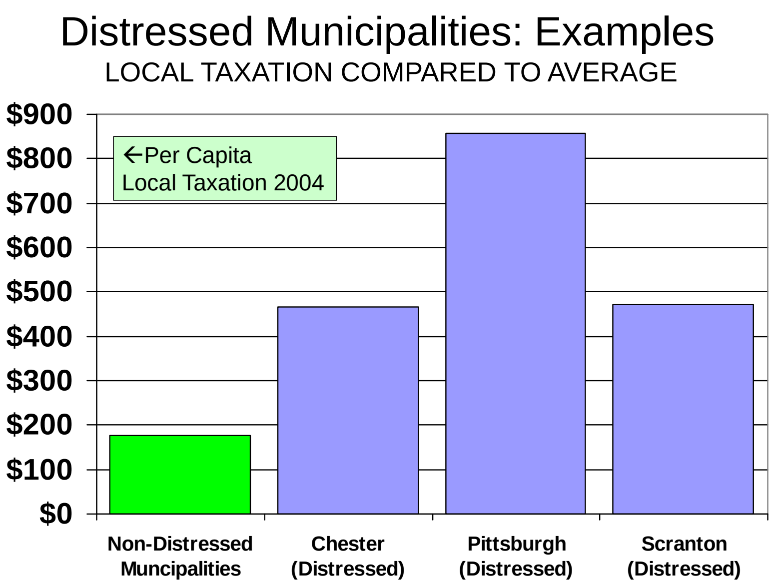
Distressed Municipalities: Examples
LOCAL TAXATION COMPARED TO AVERAGE
$900
$800
$700
$600
$500
$400
$300
$200
$100
$0
←Per Capita
Local Taxation 2004
Non-Distressed Muncipalities
Chester (Distressed)
Pittsburgh (Distressed)
Scranton (Distressed)

Figure 1

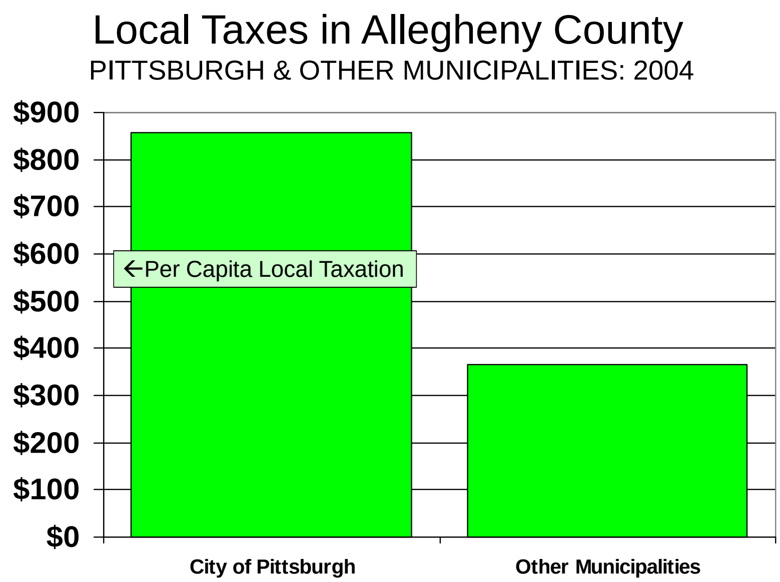
Local Taxes in Allegheny County
PITTSBURGH & OTHER MUNICIPALITIES: 2004
$900
$800
$700
$600
$500
$400
$300
$200
$100
$0
←Per Capita Local Taxation
City of Pittsburgh
Other Municipalities

Figure 2

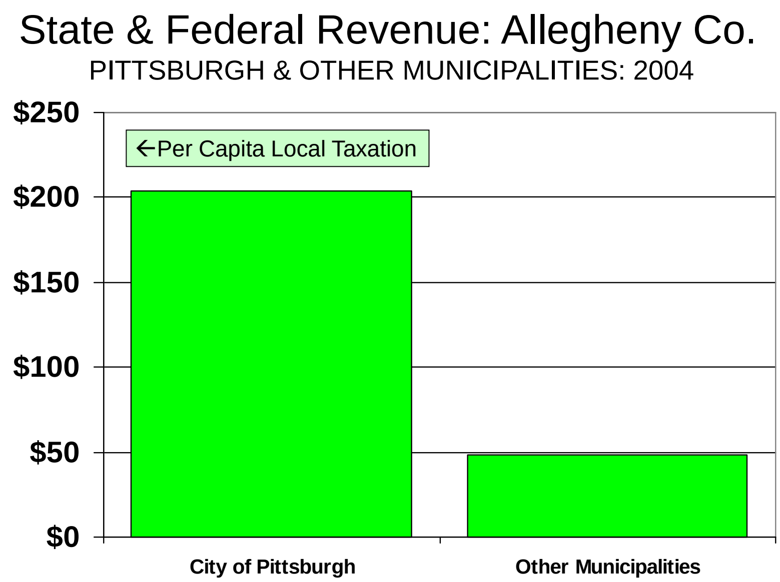
State & Federal Revenue: Allegheny Co.
PITTSBURGH & OTHER MUNICIPALITIES: 2004
$250
$200
$150
$100
$50
$0
←Per Capita Local Taxation
City of Pittsburgh
Other Municipalities

Figure 3