

Testimony Prepared for the Pennsylvania Senate

Local Government Committee Urban Affairs and Housing Committee

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I appreciate the opportunity to testify before your committees. My testimony draws from both analysis of data collected by the Department of Community and Economic Development as well as my first-hand experience working with struggling municipalities. My recommendations for legislative action include changes that affect municipal revenues and expenditures and how local governments in Pennsylvania offer services.

The fiscal health of communities in the Pittsburgh Region has been a major concern for the past 30 years, but much of our understanding of the problem is based on intuition, sensational stories of fiscal catastrophes, and filings for Act 47 Distressed Community status. A more informed discussion of local government financial health requires a thorough analysis of the available data to identify the scope of the problems. PittsburghToday.org and the University of Pittsburgh's Graduate School of Public and International Affairs have teamed up to provide the data necessary for improved public dialogue. The data used in this analysis will soon be available under the government indicators section of that website. What follows is the first of several reviews meant to gauge the fiscal health of municipalities in Southwest Pennsylvania.

Annual Deficits

The most basic measure of municipal fiscal health concerns the annual results of municipal revenue collections and expenditures. Healthy communities run a small annual surplus that allows them to build a rainy day fund and budget for long-term capital and infrastructure needs. Even healthy municipalities face the occasional shortfall due to unexpected events. Governments that run regular deficits, commonly defined as two or more annual deficits in a 5-6 year period, show significant signs of fiscal distress.

Using data from the Pennsylvania Department of Community and Economic Development surveys of municipal governments (cities, townships, boroughs) over a six year period from 2000 to 2005, Table 1 shows that 63.4 percent of municipalities in the ten county Pittsburgh Region experienced two or more annual deficits. A full 88.5% of our local governments experienced at least one deficit during the period, with only 59 of 513 (11.5 percent) cities, townships, or boroughs able to avoid deficits during the period. This is an astounding finding and represents widespread financial problems beyond expectations.

Table 1: Number of Annual Deficits (2000 – 2005)¹

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Six Deficits	9	1.6	1.8	1.8
	Five Deficits	29	5.3	5.7	7.4
	Four Deficits	57	10.3	11.1	18.5
	Three Deficits	81	14.7	15.8	34.3
	Two Deficits	149	27.0	29.0	63.4
	One Deficit	129	23.4	25.1	88.5
	No Deficits	59	10.7	11.5	100.0
	Total	513	92.9	100.0	
Missing	Data	39	7.1		
Total		552	100.0		

¹ A handful of municipalities experienced substantial surpluses in the late 1990s and consciously chose to reduce revenues, thus resulting in multiple annual deficits. This is a short-term strategy and will be evidenced in the data in future years.

Structural Deficits

Because annual surpluses and deficits simply give us a snapshot of governments' finances, a better measure of fiscal health compares growth in revenues and growth in expenditures over a period of time. One would expect struggling municipalities to increase revenues and/or reduce expenditures in response to poor financial performance, but there are substantial impediments to doing so. On the revenue side, elected officials face state imposed limits on tax rates, citizen sentiments strongly opposed to increased tax burdens, and placing their town at a competitive disadvantage if rates are raised higher than surrounding communities. Expenditure cuts are limited by statutory requirements to provide specific services, labor contracts, and citizen demands for services. After all, someone needs to police our neighborhoods, respond to fires and car crashes, and plow our roads.

Table 2 shows that 51.1 percent of municipalities in the region experienced a structural deficit from 2000 to 2005. This means that expenditures grew at a faster pace than revenues. A closer look at the data shows that 31.2 percent of our local governments faced severe structural deficits where expenditure growth was more than 3 percent larger than revenue growth. Cities, townships, and boroughs in the severe category will quickly run out of rainy day funds and face increasing annual deficits. Once again we find that more than half of municipalities in the Pittsburgh Region face fiscal distress.

**Table 2: Municipalities Experiencing Structural Deficits
(Revenue Growth less than Expenditure Growth, 2000 – 2005)**

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No Structural Deficit	255	46.2	48.9	48.9
	Structural Deficit	266	48.2	51.1	100.0
	Total	521	94.4	100.0	
Missing	Data	31	5.6		
Total		552	100.0		

Factoring in Inflation

One important factor that we have yet to address is the effect of inflation on municipal finances. Inflation has the awful effect of reducing the value of money raised as revenues and decreasing the level of services we receive for a given level of expenditures. It may be the case that even those municipalities that have not experienced annual or structural deficits are providing lower levels of service due solely to the corrosive effects of inflation. While 60.1 percent of municipalities experienced revenue growth from 2000 to 2005, Table 3 shows that a little more than half (53 percent) of local governments were able to increase revenues at or above the rate of inflation. On the expenditure side, 56.6% of local governments saw expenditure growth in real dollars. Table 4 indicates that 51.6 percent experienced expenditure growth at or above the rate of inflation. In both cases, almost half of our cities, townships, and boroughs lost buying power by not keeping up with inflation.

Table 3: Revenue Growth Relative to Inflation (3.5% inflation estimate)

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Revenue Growth < Inflation	245	44.4	47.0	47.0
	Revenue Growth > = Inflation	276	50.0	53.0	100.0
	Total	521	94.4	100.0	
Missing	Data	31	5.6		
Total		552	100.0		

Table 4: Expenditure Growth Relative to Inflation (3.5% inflation estimate)

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Expenditure Growth < Inflation	252	45.7	48.4	48.4
	Expenditure Growth > = Inflation	269	48.7	51.6	100.0
	Total	521	94.4	100.0	
Missing	Data	31	5.6		
Total		552	100.0		

The purpose of presenting this information is to improve the quality of dialogue on an extremely important topic. The findings presented here do not constitute a thorough review of municipal fiscal health in the region, but they review a handful of the most important measures analysts should use. *It is shocking that every one of the measures above suggests that almost half of our local governments are facing financial crises.*

While the size of the problem is greater than I ever expected, I am quite familiar with these issues. I have had the opportunity to leave the ivory tower often in recent years, having worked on a team that has completed Early Intervention Program projects in 10 municipalities and 2 counties. I have met with mayors, council members, managers, finance directors, and department heads to discuss their concerns and, as required by the Early Intervention Program, done a thorough review of their finances. What I have found is a consistent set of problems on both the revenue and expenditure sides of the financial equation. It is on these experiences that I base my recommendations for legislative action.

Revenue Recommendations

1. Mandate regular property assessment by counties
 - a. Our current system places municipalities in an untenable situation. They face hard millage caps instituted by the Commonwealth, but are dependent on the counties to reassess. A substantial number of counties have not reassessed in twenty or more years. Many communities that slowly increased taxes at or near the rate of inflation now face these hard caps, even after receiving court approval.
 - b. If counties are not required by statute to provide regular reassessments, *the legislature should remove the maximum millage rates on municipal governments or index them at the rate of inflation.*
2. Provide more flexibility in local tax structures
 - a. The current local government tax structure limits local governments by taking away their ability to reinstate some taxes after they have been repealed. This is particularly true for taxes on businesses. *Removing these limitations will allow local governments to adjust their tax structure to the changing demographic and economic conditions they face.*
 - b. The Local Services Tax is the first new revenue source provided by the Commonwealth in almost 20 years. Like the Per Capita and Residence taxes, the current \$52 fee will erode quickly due to inflation. *It is recommended that these maximum charges be indexed to inflation.*
3. Allow local governments to assess fees on large tax-exempt organizations
 - a. Many of these large corporations pay only a small fraction of the cost of local service provision and some refuse to pay at all. The currently proposed legislation is a good first step, but *the maximum rate should be tied to cost of services and indexed to inflation.*

Expenditure Recommendation

1. Act 111 Reform

- a. Labor organizations in Police and Fire deserve the protections necessary to assure a safe working environment and a reasonable wage. However, the current arbitration provisions in Act 111 do not require arbitration panels to consider a municipality's ability to pay for the awards given. In cases where the issue is raised, revenue sources from restricted funds outside of the general fund are often cited as available to pay for emergency services. This is not only inaccurate, it has caused some municipalities to make drastic, unplanned cuts in administration, code enforcement, public works, and recreation to cover the subsequent costs of public safety awards. *The Act 111 arbitration provisions should be amended to require that arbitration awards be based on a municipality's ability to pay from the general fund.*

Multi-Municipal and Shared Services Recommendations

Multi-municipal and shared services are important mechanisms to achieve economies of scale at the local government level. In some cases, citizens are likely to receive higher levels of service at a lower cost than if each municipality provided the service separately. The fragmented nature of local government in Pennsylvania makes it politically difficult to force shared services on municipalities. A recent study conducted by the Local Government Academy (2006) identified local service provision with selected multi-municipal cooperation as the most beneficial form of service delivery among municipal administrators (Local Government Academy, 2006). For that reason, it is recommended that Pennsylvania build on its successes in the area of multi-municipal planning by providing *incentives* for shared service provision throughout the Commonwealth.

1. Provide state incentives for shared services

- a. The level of police services provided across the Commonwealth varies widely from no service at all to large, professional police forces with 24-7 coverage. *The state legislature should provide financial incentives for municipalities with no or part-time police services to negotiate for shared services with full-time departments.*
- b. Pennsylvania is heavily dependent on Volunteer Fire Departments for fire protection. Many of these departments are excellent organizations, but some are suffering from aging volunteers and fewer new recruits. Paid fire departments have become difficult to maintain in cities due to increasing costs and the prevalence of the four platoon system. In a handful of cases, tensions between competing volunteer companies or between paid and volunteer forces affect public safety. *The state legislature should provide financial incentives for joint training and greater coordination among paid and volunteer fire companies. In cases where volunteer companies are no longer meeting community needs, counties and municipalities should be required to negotiate alternative service agreements.*
- c. *The Commonwealth should provide incentives for municipalities to negotiate greater shared services in the areas of Public Works, Parks and Recreation, and Code Enforcement. In many cases, this will include working through existing Councils of Government and/or direct negotiations between municipalities.*

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