

CHAPTER 1

INTRODUCTION

For several decades governments have operated on the assumption that economic growth and expansion of urban centers would result in revenues larger than the increased costs of services. Yet these same decades have been marked by recurrent bouts of "fiscal crisis." The explosion of public debt in the 1980s and the persistent shortage of revenue to meet needs have brought into question the validity of assumptions about growth, revenue, and costs of government. Taxpayers have resisted the imposition of new taxes and, through efforts such as the passage of Proposition 13 in 1978, have limited the growth of old ones. Governments have increasingly turned to development fees to finance new infrastructure, linking the costs of development directly to assessments on the developer. Unable to convince voters to endorse new general obligation bonds, governments have turned to the creation of new financing mechanisms to raise funds. In the scramble to balance budgets, old, established relationships between levels of government are overturned: the federal government cuts back on transfers to states and localities; the state is accused of "stealing" local government revenues.

Despite the recurrence of fiscal crises, most government officials remain convinced the fiscal health of the community depends on growth, but increasingly they seek growth of a particular kind. Governments (and often citizens) resist the development of affordable housing, while encouraging the proliferation of shopping

centers, auto malls, and luxury hotels. One effect of Proposition 13--which capped property tax rates at 1% of assessed value and limited the increase in assessed value to 2% per year until the property is sold--was a greater reliance on the retail sales tax. Since this tax is assessed at the point of sale, i.e., the retail store, cities have come to favor retail uses over all others. The cult of retail has gone so far that some cities have changed their zoning to require downtown buildings to remain vacant, rather than be used for nonretail businesses (Redwood City 1992). Retail developers are increasingly demanding, and getting, subsidies from local governments to locate within their boundaries (Wolfe 1993).

This process of selecting land uses according to the perceived benefits to the city's budget has been called the fiscalization of land use. Increasingly, the examination of fiscal impacts is written into city general plans and included in environmental impact reports. The measurement of fiscal effects is treated as an exact science; through the techniques of fiscal impact analysis, the process can even be reduced to a computer program. Yet, there is accumulating evidence that this fiscalization process is not working. Far from eliminating the fiscal crisis, increased attention to fiscal impacts has been accompanied by fears of growing public deficits. Could it be that we are drawing incorrect conclusions about land use, based on faulty data or methodologies? Do the results of empirical analysis provide a firm basis for making conclusions about the fiscal effects of different types of land use?

The fiscalization of land use is based on a variant of the outmoded concept of geographical determinism: in this case, the belief that the type of land use (e.g., retail, residential, industrial) "determines" the revenues to be derived from, and the costs to service, an area of the city. Many factors other than development, how-

ever, play a role in determining the level of government revenues and expenditures. History, culture, institutions, politics, and personalities all ultimately shape our landscapes and our government budgets. This thesis, therefore, will not attempt to "prove" that a particular type of development "causes" certain expenditures and "produces" certain revenues. Rather, by examining the relationship of geographical factors to local government expenditures, I intend to look critically at the evidence on which fiscal impact analysis is based and show some of the problems in drawing conclusions from these relationships. Attention will be given to the political and institutional factors that influence the impacts of development on government budgets. To do so will require a careful examination of the following questions.

1. What are the patterns of municipal expenditures and revenues for the cities of San Mateo County? The amounts expended and collected in the 20 cities vary greatly, despite a similar location in the larger world. These patterns will be the basis for this study.

2. What is the relationship between this pattern of finances and the economic, demographic, and land use patterns of these cities? Although all of the cities are technically suburbs of San Francisco, they vary greatly in age, wealth, density, degree of economic development, and types of land use. Using data from the U.S. Census of Population and Housing, the Economic Censuses, and the ABAG Land Use Policy Survey Database, I will attempt to develop correlations between revenues and expenses and these underlying variables.

3. What is the actual relationship between development in the 1980s and the revenues and expenditures of the cities in the county? Using census data on building permits by place of issue, I will attempt to determine if the level and type

of development are statistically associated with changes in government revenue between 1980 and 1990.

4. What are the institutional factors that affect the spatial distribution of government revenues and expenditures? How much development "pays" is greatly affected by the organization of our tax system, i.e., its methods of collection and distribution. How might changes in this structure affect the perceived "fiscal impact" of development?

The Theoretical Basis of the Study

The idea that land use and particular types of development have a fiscal effect, i.e., that developing land in a particular way will "provide" a certain level of revenue while "requiring" a certain expenditure for services, is the unexamined theoretical premise at the heart of the fiscalization of land use. Forgetting that correlation does not imply causation, the temptation is to see a deterministic effect of development: a shopping center development requires a widening of roads; an increase in the number of poor people causes an increase in spending on police protection. Ignored in this deterministic view is the process of decision making and the potential for differing opinions on what should be spent. The owners of older downtown stores may not want traffic improvements that make it easier for their customers to drive to competitors' new stores; poor people may prefer that money be spent on housing and job training rather than on more police.

Economists (and others) have developed a number of theories to explain the role of government in the economy (society) and the level of spending on government's various "services." Neoclassical economics assumes that, most of the time, production by private firms in a competitive market efficiently satisfies

the demand for goods and services: the welfare of "society" is maximized by the interaction of supply and demand. The market, however, may not always be efficient: costs and benefits may be external to the accounting systems of individuals or firms. The sum of private costs and benefits may not equal the total costs and benefits to the society: each individual may choose to purchase less education than is actually needed by the society as a whole; the pollution caused by a manufacturing plant may not show up as a cost on the books of the owner, but it is a cost to society. To deal with these externalities, society creates government--an entity for political, rather than market, decision making. This government may make rules to force producers to account for external costs, subsidize the production of goods that society wants its members to consume more of, or redistribute resources if the market distribution is perceived as being unfair.

The neoclassical theory assumes that the end result of government action reflects the desires of society as a whole: there are two mechanisms for determining what level of goods and services are produced by government--voting and mobility. Through voting, the consumers (voters) are presented with alternative choices of levels of spending on services, and, by their votes for candidates or referenda, they choose how much they want to spend (and perhaps also the level of taxation to pay for those services). The end result is that actual expenditures reflect the desires of the median voter. Alternatively, through mobility, consumers "vote with their feet," moving to those areas that have the mix of government-provided goods and services they prefer (Fisher 1988; Sullivan 1990).

The success of voting in determining an optimal level of output for government services depends on a number of shaky assumptions: (1) The members of a society disagree only about the level of government services, not fundamentally

about whether such services should be provided at all. If half the voters want a new stadium and half do not, what is the median position? (2) Information presented to the voters is accurate; there is no place in the theory for distorted television advertising campaigns or last minute "hit" pieces. (3) Voting results reflect the interests of the whole society and not just the small number of people who vote in local elections.

Similarly, producing the optimal level of government services through mobility depends on an unrealistic assumption: the absence of segregation--racial or economic. The residents of East Palo Alto may prefer the level of services provided in Atherton, but they are unable to move there. Can we conclude that the cities with the largest populations were providing the level of services desired by the greatest number of people, or are they simply providing the most affordable housing?

Despite the shortcomings of these assumptions, the median voter and mobility hypotheses do have the strength of emphasizing human decision making. The level of government expenditure is a product of political action and competition between alternatives, not a predestined result of a certain kind of development or land use. Neoclassical theory, however, assumes a social harmony that may not exist.

James O'Connor, on the other hand, recognizes that there may be a direct contradiction between the desires of different groups in society and that the desires of one group may predominate. For O'Connor, government in a capitalist society functions as the representative of the capitalist class, and government expenditures are aimed at meeting the needs of that class. The government provides the public capital necessary to maintain the profitability of private capital

(highways, airports, the military) and the expenditures needed to maintain social harmony (welfare, parks, housing subsidies). The tendency is for these expenditures to grow faster than revenues, as the crisis of capitalism is reflected in the fiscal crisis of the state (O'Connor 1973).

O'Connor's theory has been criticized for trying to explain a fiscal crisis on the basis of a theory of expenditures, without adequate analysis of revenues. Why, critics ask, is a class sufficiently conscious of its own interests to undertake massive expenditures, unwilling to collect enough revenue to pay for those services (Mosley 1978)? There is, in fact, some evidence that businessmen are willing to increase taxes when they perceive the level of services as inadequate for continued growth and profitability (Fisher 1988, 299). The theory as put forth by O'Connor also lacks an appreciation of countervailing forces: what about the opposition of workers, small businesses, and others to the desire of large corporations for a government subservient to their limited interests? (O'Connor's theory was developed before the environmental movement was of much significance, but here is, in fact, an organized movement affecting government expenditures in ways that may adversely affect the profitability of capital.)

Theorists from outside the world of economics seem less inclined to view public decision making as a neatly logical outcome of initial conditions. Sociologists, political scientists, and historians give greater emphasis to the actions of individuals or groups motivated by ideology as well as self-interest. The conflict and cooperation between these forces may or may not reflect the interests of larger groups in the society. In the extreme view, individual politicians are just out for themselves, and the resulting patterns of expenditure reflect individual interests, rather than any larger public good (McDonald and Ward 1984). This type of

analysis does not lead to a grand theory capable of explaining expenditures of all governments in all places, but focuses instead on the particular conditions, individuals, and groups involved in local political action. It is much better than either of the other theories at explaining the proliferation of "pork barrel" projects in the federal budget, projects that seem to benefit only a small group in one particular congressional district. Indeed, we can often see in the criticism of government, and Congress in particular, a complaint that expenditure decisions do not represent the interests of "society" or of "business," but are catering to the whims of "special interests."

All of these theories together, however, do not provide any basis for a "geographic determinist" explanation of government expenditures. Regardless of how land use is organized, regardless of the spatial patterns of urban development, there are still decisions to be made about public expenditures. It is not the dispersed settlement patterns of postwar suburbia that create a high level of highway expenditures, it is the need of business to move workers efficiently to work and consumers to shopping, the desire of suburban residents for mobility, the desire of local construction companies for government contracts, and the political organization and skills of these individuals and groups that decide how, when, and where, government will expend public funds.

The Strange Case of the Entry Features

A recent public expenditure decision in Redwood City, California illustrates the explanatory role of each of these theories. The city's Historic Resources Advisory Committee had proposed the re-creation of an arch sign with the slogan "Climate Best by Government Test" that had once adorned downtown Redwood

City. The City Council decided to combine this suggestion with plans to improve downtown, which like the downtown areas of many similar cities had declined as a shopping destination with the rise of suburban shopping malls. At this point we have an idea introduced by a small group of people for personal, nostalgic reasons, combined with an effort to improve profitability (of downtown stores) through public investment. There was no evidence that this expenditure was desired by a median voter or a majority of the population.

The City next hired an urban design consultant who developed a "theory" to justify the expansion of this project into a \$1.3 million "Downtown Entry Features Program." The theory emphasized the public investment to support profitability aspect: downtown businesses were suffering because people couldn't find downtown Redwood City. By creating a series of entry features (concrete pillars, banners, and two replicas of the old arch sign) potential customers were to be shown the way to downtown, and once they found their way there, they would shop in the stores and the downtown's prosperity would return (Ghori 1993).

At public meetings held to discuss the proposals, it was generally agreed the theory was true: people couldn't find downtown, and entry features were the solution. At no time was any evidence presented to support either proposition; there was no public opinion survey that indicated an inability to find downtown, and no hard evidence of improved profitability of businesses in cities that had undertaken similar programs. Opponents of the project pointed out that within weeks of the first workshop on the entry features, 150,000 people (nearly one-fourth of the county's population) had lined the streets of Redwood City for the annual Fourth of July parade. Far from being difficult to find, downtown Redwood City was, for at least one day of the year, able to attract a larger audience than any other event in

the county. Opponents also pointed out that the level of increased retail sales necessary to recoup the public expenditure (\$130 million at 1% of retail sales returned to the city as sales tax) was extraordinarily unlikely, especially since Redwood City as a whole was already capturing more than its proportionate share of total county retail sales. (Some businesses located in the hard to find downtown had been successful for years.)

The proponents made no effort to refute the arguments that this expenditure would not enhance profitability (the O'Connor theory) or provide a public benefit greater than the public cost (neoclassical theory). In the end, the "people can't find downtown" theory was abandoned; at the final meeting approving the project, the consultant and city planning director denied the project was intended to attract people downtown (see Redwood City 1993). The project was ultimately approved on the same basis it had begun: the overwhelming support of a small group of influential, long-time Redwood City residents who wanted to re-create the Redwood City of their youth and leave behind a monument to themselves. (One downtown Redwood City businessman believes the primary reason for government construction projects is the desire of council members to get their names on the plaques that are always found at the entrances or cornerstones of public buildings.) The story of this particular project shows the importance of individuals with noneconomic motives in determining public expenditures.