Foreword

The theme of *Tools for State and Local Fiscal Management* is as clear as it is important. The job of the fiscal analyst is to act as an honest broker in identifying and evaluating, in a fact-based and non-ideological manner, how governments address questions of allocating money for different sets of services and how to pay for those services to achieve the economist’s objectives of efficiency and equity. Further, when necessary, the fiscal analyst must balance sometimes-conflicting efficiency versus equity outcomes by recognizing that there is a system of central/state/local government roles to address this matter at the most appropriate scale.

Drawing on these themes, this volume offers content that ranges from how some states have successfully adopted the techniques of dynamic revenue analysis and designed and implemented alternative methods to fund public goods and services, to that of addressing the questions of intergovernmental fiscal cooperation and making transparent to citizens how their government functions. Moreover, the case study approach allows the authors to demonstrate that, to accomplish the intended objectives of efficiency and equity, the fiscal analyst must go beyond looking at what at first glance simply makes “policy sense” by further addressing the intersection between public finance policy and public financial management.

This is a timely book. Over the past two decades, far-reaching global and domestic marketplace developments have taken place that have not only led to the revisiting of the overarching question of the economic, social, and political role of governments, but also to what can be done to make day-to-day public service delivery work for people. These developments affect all types of government—central, state, and local. The respective natures of these far-reaching developments are briefly summarized below. Before they can be addressed, however, a first question arises: Why does the primary task of addressing these developments fall on the state and local sector?

There are two reasons for this targeting. The first is the dominant role of state and local governments in the US intergovernmental system. Entering the 2000s, state and local spending accounted for more than one and a half times that of total federal spending, including defense spending (BEA, 2021a). The same is true today. When taking the perspective of “which government” does the nation’s non-defense spending, the numbers are even more dramatic; the state and local sector role has been four to five times that of federal non-defense spending. To give this state versus federal dominance further context, state and local governments now account for three out of every four public sector employees, provide the bulk of all basic public services consumed by individuals and businesses, and own 93 percent of the nation’s infrastructure (Hill, 2020; BEA, 2016; Grundy, 2020; OPM, 2020). The 50 states and over 90,000 local governments also act as agents for the federal government in managing and passing through billions of federal dollars to supplement state/local maintenance of the health care and income safety net (US Census, 2019).
The second reason that state and local governments have grown in prominence is that the federal sector is on an unsustainable financial path. The US entered the 21st century with the nation’s then-longest record (120 months) of steady growth (NBER, 2020). The federal budget was in surplus for the first time since 1960 (1999, 2000, and 2021) (Tax Policy Center, 2021). Although the annual federal budget would be in deficit for the next seven years, the size of that deficit came in as percentages of gross domestic product (GDP) that were comparable to, and had been managed throughout, the 1980s and 1990s. Then came the economic shocks of the Great Recession and the COVID-19 coronavirus pandemic. During the Great Recession (2007–09) and its multiyear aftermath, federal receipts registered historic lows, averaging less than 15 percent of GDP compared to the 1990s’ average of about 18 percent. There was another history-setting recovery (128 months) before the economics of the pandemic arrived (Tax Policy Center, 2021).

These low receipts exacerbated the problem of federal debt. In 2011, the Congressional Budget Office (CBO) projected that, under current law, federal debt was on track to exceed 70 percent of GDP—the highest level since shortly after World War II (CBO, 2011). Then came the trilogy of large deficit financing: The Great Recession, the Tax Cuts and Jobs Act tax cuts (in 2017), and a series of pandemic relief and stimulus bills during 2020 and 2021. The CBO now projects that, under current law, the federal debt will be 107 percent of GDP by 2031 (CBO, 2021). Absent dramatic adjustments on both the spending (for example, growth in entitlements as the nation ages, income inequality and its implications for the health care safety net, and the growth of hard-to-tax worldwide business income) and revenue sides of the federal budget (for example, a national consumption tax and carbon tax), the federal government fiscal space is constrained by debt and its mandatory entitlements. “Washington” is not the go-to government for responding to fiscal change.

However, state and local governments have their own fiscal developments to adjust to, and here is where understanding the tools of state/local fiscal analysis become key to making government work for its citizens. There are three topics to consider, each of which presents challenges as well as opportunities for a new era of state and local public finance. The first sets the context for state/local budget policy while the next two topics look at both sides of the budget equation:

- **Growing vulnerability of the sector to recessions.** There is a growing vulnerability of the state and local sector to changes of the “regular order” of the business cycle. The impact of the recession of 2001–02 was nearly four times as great as that of the recession of 1991–92 when measuring state budget shortfalls as a percentage of GDP. Noting this vulnerability, some alerts were sounded in the early 2000s regarding the growing fiscal obsolescence of a state and local fiscal system that, as the research showed, was characterized by overreliance on federal aid, a lack of diversity in own source revenues, and a general unreadiness to respond to an economy that was shifting from goods to services along with the rapid emergence of e-commerce. However, with the recovery of the early 2000s and the urgency of new wars to fund in Afghanistan and Iraq, the matter of fiscal obsolescence was put on the “problems to be addressed” agenda. Then came the Great Recession (2007–09) that led to shortfalls twice that of those in 2001–02.
At the time of writing, the nation is still in the midst of the coronavirus pandemic, which has led to an estimated 3.5 percent decrease in real GDP for 2020 (BEA, 2021b). As a whole, the states started out in good fiscal shape at the start of the pandemic. The National Association of Budget Officers reports (NASBO, 2020) that the states ended their pre-pandemic fiscal years with budget reserves (“rainy day funds”) at 7.6 percent of their general operating funds, compared to 4.7 percent ahead of the Great Recession. However, with the emergence of the novel coronavirus, COVID-19, the situation deteriorated very rapidly, especially for municipalities, which saw receipts falling by nearly a fifth and expenses rising by about same relative magnitude. Although there will be a recovery, how all this will play out in the next few years is a matter to be left to the researchers in this book and their fiscal analysis colleagues.

- **Rising expenditures.** Not only is the government sector more vulnerable to recessions than previously, but it is also undergoing increased demand for spending. On the expenditure side of the budget, the education sector is the largest component of state/local spending. Here policy meets management, as not only do new modes of teaching become part of the service delivery mix but leaders must also address the challenge to adjust for the uneven pandemic impacts on students and households across the empirically testable variables of race, income, and wealth. Other key matters for the fiscal analyst to address include questions of (1) which type of government (for example, dependent versus independent school districts) best fits a population; (2) how to account for an aging population’s demands for other services including public welfare and health care; (3) the private/public financing of affordable housing; and (4) what state and local government’s role is in addressing the widely acknowledged gaps of their residents’ income and wealth across various characteristics.

- **Fiscal obsolescence of the “big three” revenue sources.** Finally, revenue sources are also changing. A good indicator of how the revenue side of state/local budgets is changing is to look at the numbers on the composition of revenue. Twenty years ago, current charges related to funding the flow of services accounted for 17.7 percent of US state and local general revenue from own sources. That put it well behind the importance of both sales and gross receipts (24.8 percent) and the property tax (22.5 percent), and nearly the same as the sum of individual and corporate income taxes (17.8 percent). Since pre-pandemic 2018, there is a different story: Current charges account for 21.1 percent of state/local own source general revenues, eclipsing the income taxes (18.6 percent), making user fees nearly on par with the property tax (21.2 percent), and quickly closing in on the sales and gross receipts category (23.6 percent) (US Census 1998, 2018).

There are two key factors that assist in explaining the smaller role of the “big three” state/local taxes. As just shown, the first is that the alternative of non-tax current charges are attractive from both a political and revenue management perspective. As citizens have become resistant to higher taxes, politicians have become more permissive to the slow but steady enactment of different types of local fees and charges. User charge pricing also satisfies the efficiency and equity tests, since it matches who-benefits with who-pays. The policy and management case for increased charging is that the technology for targeting and then collecting from...
those who benefit from many (not all) types of state/local services is dramatically improving.

Just how much growth there is in charging is an uncertainty, since the bulk of current charges are now derived from education (including higher education) and hospitals. On the other side of these matters, the states and the federal government are coming under increasing pressure to control the costs of, as well as pay for, “Big Ed” and “Big Med,” the ever-expanding education and health care sectors. How governments manage these competing demands fairly and efficiently has major implications for the tools of budget analysis, including those profiled in this volume.

The second matter, and one far more important than the user charge explanation, is that the former “big three” of revenues, as well as the former system of and expectations for expenditures, are not now appropriately structured to adapt to the rapidly changing fiscal architecture of the “new world” of commerce. As noted, in the past—even the recent past—these changes were largely approached as “problems to be addressed” at another time. Now, however, that “other time” is arriving at a rapid pace. Consider the effects of the following paradigm shifts on the fiscal landscape of the 2020s and 2030s, as summarized by the Connecticut Tax Panel (2016):

- Production economy → Service economy
- Salaried or wage-earner employees → Contingent and contract workforce
- Office workers in state “A” → Remote workers in state “B”
- People and places → Robots and cloud infrastructure
- Geographic boundaries → Cyberspace production
- Brick-and-mortar on-site sales → e-Commerce sales
- Physical presence → Economic presence
- Place and cost of performance → Market-based sourcing
- “C” corporations → Pass-through entities

Although the long-agreed-to universal goals of efficiency and equity will continue to frame the work of the fiscal analyst, the questions will change as the applications change. Many of the old tools will continue to matter, but new ways of thinking and tools will matter as well. This is where this volume fits in. It is a not a book that you are likely to pick up and read through chapter by chapter. Rather, its collection of chapters serves as a knowledge source that fiscal analysts, policymakers, educators, and anyone interested in the tools of public finance can take off the shelf, time and time again, as a reference of examples at the cutting edge of research where public finance intersects with public management.

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NOTES

1. As Hill notes, determining public workforce numbers is highly nuanced. Numbers cited for the ratio of state to local government employment vary as how to define total employment: For example, military versus civilian and, within military, active duty versus reserve forces and whether contractors, who may be full or part time, are also to be counted. If we take an expansive view of “federal employment,” including US Postal Services (USPS) workers, then the numbers work out as reported in the text, with a share of 76 percent (Grundy, 2020). If, however, we exclude both components of the military and the USPS, then the state and local sector to federal sector ratio share jumps to about 0.9 (though the precise number is constantly in flux). This is consistent with the 0.93 share derived by the way the US Office of Personnel Management (OPM) counts civilian employees (full and part time) “on the federal payroll” (OPM, 2020).

2. Tribal governments are recognized as sovereign nations under the auspices of the federal government, and therefore do not meet the definition of a state or local government. The 16 territories, which are partially self-governing, that exist under the authority of the US government are also excluded from the definition of a state or local government. The District of Columbia is counted as a municipal government in Census Bureau statistics on governments (US Census, 2019).


REFERENCES


