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Six Profiles of the Changing Face of Fiscal Federalism: An Overview

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Overview

A truly remarkable sea change has occurred in how we finance the public enterprise, yet this change has gone largely unnoticed by the general public. Policy makers at the federal, state, and local levels of government have had to respond to this change. Individuals who have suffered its consequences have had to adjust to a new economic environment. It is only now, however, that experts in the field of government finance have begun to chart its future course. The causes of the change, future policy directions, and the eventual impact on society of this change is the subject of this book. Six of the nation's most influential economists, political scientists, and sociologists have been asked to comment on this change. Their views are found on the pages that follow.

What is this change that is of such concern to these experts? In simple terms, it is the reshaping of the system of providing basic government services, and who will pay the bill. In the past ten years, we have reversed policies that were established by federal lawmakers over the previous thirty years. What had been a clear and forthright policy to reduce vertical and horizontal fiscal imbalances among federal, state, and local governments has given way to the establishment of a new "competitive federalism" where governments are expected to finance their own activities. That is, our old system which was characterized by the federal government taking active steps to level up those governments that did not have the wherewithal to provide basic government services has been replaced by what John Shannon calls "fend for yourself federalism"—if a service cannot be paid for at the level where provided, then do without it.

The implications of operating in a competitive environment are, of course, the same for governments as they are for individual business firms. Revenues are revenues, whether raised through taxes or raised through the sale of products. In order to maximize its share of the pie, each governmental unit is required to measure its competition and to implement strategies that lead to survival and, hopefully, to establishing a cushion for future growth. The competitive upside of this policy is a public sector equivalent of Joseph Schumpeter's concept of "creative destruction"—the threat of bankruptcy will force a business enterprise (government) to operate efficiently. They will provide only those goods and services that their constituencies demand and they will provide these goods and services in the most cost-effective manner. Cities, towns, and even states that cannot compete, are simply left behind. Thus the structure of the public sector, like its private sector counterparts, will continually evolve. Those communities that are successful will not only attract new residents and businesses; they will attract imitators who will try to replicate their success. Those that fail will lose population and their economic base. Over time, these communities will simply disappear or learn the harsh lessons of the market and adapt.

The competitive downside is equally clear. When a city, town, or state fails, its elected officials and public workers face the prospect of unemployment, and those residents who are unable to flee must ultimately pay the price for this lack of market efficiency. Government services must be reduced. Taxes must be raised. And the community must brace for its eventual demise, since there is little chance for success under these circumstances. Reduced service levels coupled with higher taxes are certainly not conducive to attracting newcomers or retaining the existing population—particularly if the services that are cut and the taxes that are raised are those affecting the relatively affluent. The question then becomes: who can move and who is forced to stay behind in this competitive environment? Can the less affluent move to the flourishing communities? Can the mom and pop grocery stores leave their neighborhoods? Can the aged be uprooted and moved to new cities and towns? Probably not, since the poor do not have the financial resources to move, the small business units are often dependent upon a local market, and the aged are reluctant to start again in a new and strange place. Thus, when a city, town, or state dies, it traps within it those who cannot move. It traps those who are least able to compete. It traps the poor. It traps the small inefficient firms. It traps the aged.

In these circumstances, it can be argued that the true losers are the citizens who by historic accident happen to reside in less successful jurisdictions. These citizens must now weigh the net benefits of hanging on or of moving on to greener pastures. Critics question whether such a process when applied to the governmental sector is *creative destruction* or merely *destruction*. If it is the latter, it runs counter to the classical notion of *public* service.