NATIONAL LEAGUE OF CITIES

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Municipal Finance and Infrastructure over the Last Century

This brief, part of a series to commemorate the 100th anniversary of the National League of Cities, explores municipal budgetary trends and investments in infrastructure over the last century.

Introduction

Municipal budgets are an essential component of local governance in the United States. They reflect the choices and trade-offs that city leaders make to provide public services and infrastructure to their residents and businesses. Municipal budgets also respond to changing economic and social conditions, and national and global events often shape the trajectory of their revenues and expenditures.

One of the main trends in municipal budgets over the last 100 years has been the expansion of both revenues and expenditures. Cities have increased their revenues through a combination of strategies: Diversifying their tax bases (property, sales, income), accessing intergovernmental transfers (federal or state), and/or generating fees or charges for services.[1] Concurrently, cities have increased their expenditures by expanding their functions, in areas such as education, infrastructure, public space management, and health and human services, among others (see our centennial brief on municipal workforce & service provision).

This expansion, however, has been neither smooth nor linear. Rather, it has been punctuated by periods of economic contractions that affected the fiscal capacity and stability of cities. These periods are defined by events such as the Great Depression (1929-1939), stagflation in the 1970s, or more recently the collapse of the dot-com bubble (2000), the Great Recession (2007-2009), and the COVID-19 pandemic (2020-2023). Each posed significant challenges for municipal budgets in terms of revenue shortfalls, expenditure pressures or debt burdens.

This brief is divided into three sections. First, using data from 1932 to 1971, we review year-to-year changes in both revenues and expenditure of cities and put a spotlight on the effects of the Great Depression and World War II. Next, we examine general fund revenues and expenditures during the 1986-2023 period, giving particular attention to the impacts of the Great Recession and COVID-19. Finally, we present an overview of city infrastructure efforts over the past century.

REVENUES AND EXPENDITURES PRE-1971:

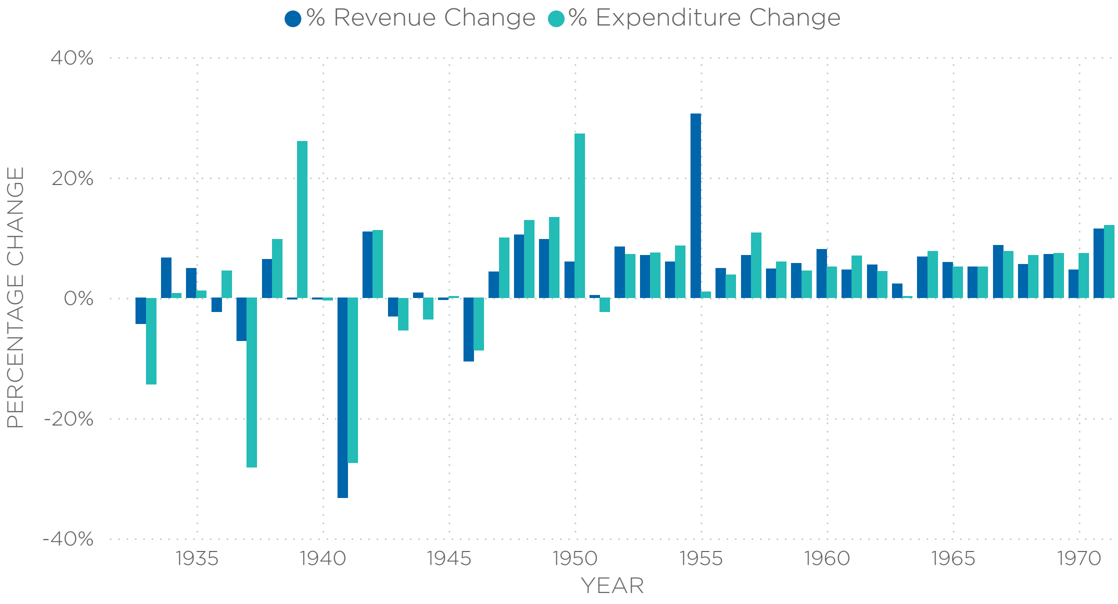
The Impacts of the Great Depression and World War II

Governments experienced significant budgetary turbulence in the 1930s and 1940s before embarking on a long period of mostly stable growth after 1952, characterized by consistent increases in both revenue and expenditure levels. Figure 1 details the overall trends for average municipal budget revenues and expenditures, based on data from 94 municipal governments with an estimated population of over 100,000 between 1932-1971.

FIGURE 1

City Budgets Expanded for Most Years Prior to 1971

ANNUAL PERCENTAGE CHANGES IN MUNICIPAL BUDGET REVENUES AND EXPENDITURES 1932-1971



Source: United States. Bureau of the Census. City finances for the years 1932-1971.
Figure notes: All figures are adjusted for inflation in 2023-dollar values. Sample of the 94 cities with an estimate population of over 100,000 during 1932-1971.

In the 1930s, the Great Depression caused widespread unemployment, poverty, deflation and social unrest, taking a toll on millions of people around the world. It also affected municipal revenues and expenditures, as many municipalities faced reduced tax revenues, increased demand for public services, and difficulties in borrowing money. Some municipalities had to cut spending, raise taxes or default on their debts. Others received federal or state aid to help cope with the crisis. The variations in municipal responses and outcomes led to significant fluctuations in their revenues and expenditures over the decade.[2] President Herbert Hoover signed the Reconstruction Finance Corporation Act on January 22, 1932, creating the Reconstruction Finance Corporation, which provided emergency financing facilities for financial institutions to help finance agriculture, commerce and industry.[3]

As part of the Roosevelt administration's New Deal, agencies such as the Works Progress Administration (WPA) and the Civilian Conservation Corps (CCC) were established to help with short-term governmental aid and to provide temporary jobs and employment on construction projects. WPA helped to create 8.5 million jobs and to construct 650,000 miles of roads, 125,000 public buildings, 75,000 bridges and 8,000 parks. The CCC put unemployed, unskilled young men to work on rural and park improvements.[4]

The fluctuations in the 1940s, on the other hand, were associated with World War II, which severely impacted both global and national economies. The war reduced the tax base of many local governments in the United States, as industries shifted to war production and workers moved to other areas. In addition, the federal government-imposed restrictions on municipal borrowing and spending, limiting local governments' ability to raise revenues from bonds or grants. Furthermore, the war increased the demand for public services, such as civil defense, health care and welfare, putting more pressure on municipal budgets.[5]

Inflation was another contributing factor in the 1940s. The US experienced a sharp rise in inflation during the war years, reaching a peak of 14.6 percent in 1942 and, according to Friedman and Schwartz (1963), it reduced the real purchasing power of municipal revenues by an estimated 25 percent between 1940 and 1945.[6] At the same time, inflation increased the cost of municipal operations, in categories such as wages, materials and utilities.

Revenues and Expenditures in Recent Decades

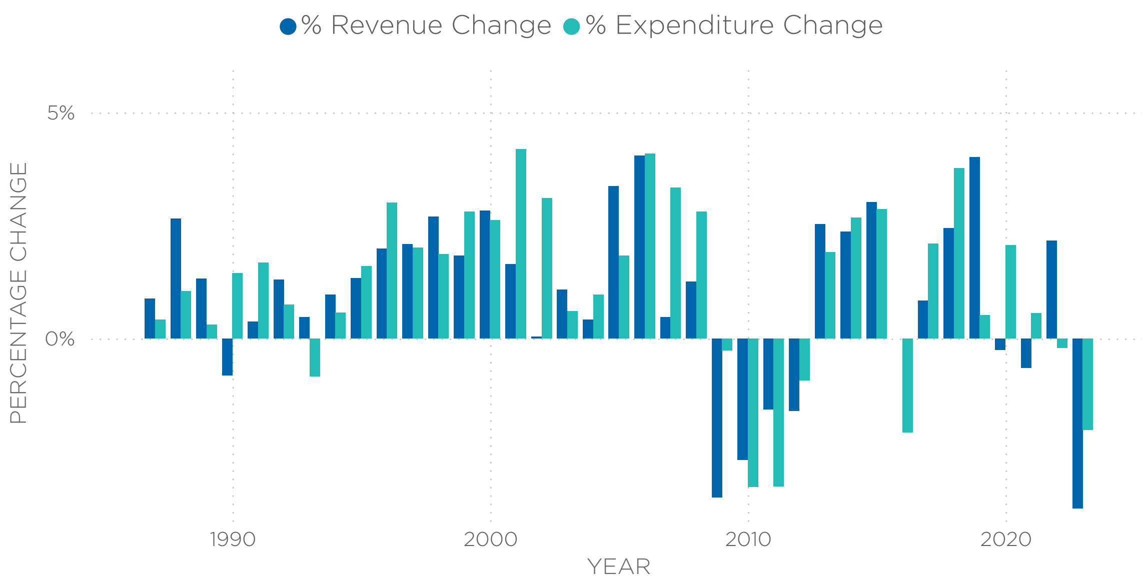
The Great Recession

Municipal revenues and expenditures experienced healthy growth, for the most part, from 1976 until 2007, when the global economy started to undergo a deep recession. The Great Recession, which began in December 2007 and ended in June 2009, had a significant negative effect on the fiscal positions of local governments, especially in advanced economies.[7] Local governments faced challenges in accessing credit markets, reducing their ability to finance their spending needs. Furthermore, the crisis reduced the tax base and increased the demand for social services, creating fiscal imbalances and pressures for local governments.

FIGURE 2

Over The Last Four Decades, The Great Recession and Covid-19 Put The Most Downward Pressure On City Budgets

ANNUAL PERCENTAGE CHANGES IN MUNICIPAL BUDGET REVENUES AND EXPENDITURES 1986-2023



Source: National League of Cities Annual City Fiscal Conditions report.
Figure Notes: All figures are adjusted for inflation in 2023-dollar values. Data for fiscal years 1986-2022 collected from municipal Annual Comprehensive Financial Reports (ACFR). Data for fiscal year 2023 collected from municipal budgets.

Local governments in the US did not fare any better. It took municipal governments nearly a decade of effort and responsible budgeting to work their way out of the negative effects of the Great Recession. By 2019, most governments throughout the nation enjoyed a healthy fiscal outlook and many had built up their rainy-day funds to weather future downturns. However, the COVID-19 pandemic, which came sooner than many local governments expected another economic downturn to occur, brought a new set of strains to municipal governments, their budgets and their capacity to meet service needs.

Covid-19

The COVID-19 pandemic affected the economic activity, public health and social welfare of many cities around the world. According to a report by the World Bank, the pandemic reduced municipal revenues from taxes, fees and transfers, while increasing municipal expenditures on health care, social protection and emergency response. The report also found that the fiscal impact of the pandemic varied across regions and income levels, depending on the severity of the outbreak, the policy responses and the pre-existing fiscal conditions.[8]

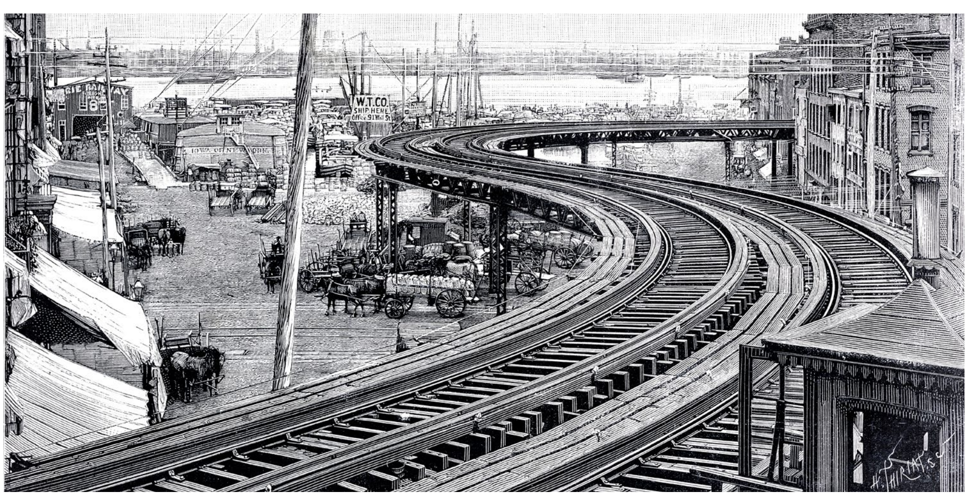
By 2023, three years after the pandemic outbreak, US cities were back on their feet, but the 2023 City Fiscal Conditions report found that many cities were not fully confident about their near-term fiscal future. In 2023, even with increased reserves, survey analysis found that cities remained cautious in their budgeting and planning, as they anticipated potential risks and uncertainties in the post-COVID era. Still, there are bright spots: according to the report, the average city experienced more than a 6 percent increase in general fund revenues (measured in nominal terms). This trend can be attributed to a healthy 2021 housing market (which increased property tax receipts), an overall economic rebound following the lifting of COVID-19 public health precautions and a significant influx of federal funds through the American Rescue Plan Act (ARPA).

Municipal Infrastructure over the Last Century

Infrastructure development and maintenance represent one of the largest categories of expenses for cities. Infrastructure is a driver of growth and economic development, and a lack of sound infrastructure threatens the competitiveness and productivity of cities. In this section, we focus on how municipal infrastructure projects have been funded since the 1930s.[9]

Before the early 1900s, infrastructure was primarily financed by the private sector.[10] In the early 1900s, as infrastructure needs evolved both in scope and complexity, cities started to invest in infrastructure as a matter of public health, focusing on sanitation and clean water. Early in the 20th century (specifically late 19th and early 20th centuries), local taxes (such as property tax) provided the majority of funding cities used for infrastructure purposes.

After World War II, cities regained their workforce and the federal government started sending an extraordinary amount of federal financial aid to cities. Massive infrastructure expansions occurred across the nation following passage of the Federal Aid Highway Act of 1944 and later, the Federal Aid Highway Act of 1956.[11] These infrastructure investments led to the expansion of suburbs, as cheap land around beltways drew residents and businesses away from urban centers.[12]



Post World War II

For the latter half of the 20th century, continuing through contemporary times, taxes have ceased to be the primary source of funding for local infrastructure. There are several reasons for this change. Very few cities collect income taxes, property taxes do not immediately respond to the economic cycle and sales taxes no longer represent economic activity as consumer behavior has changed dramatically (i.e., a shift toward online shopping where still most cities cannot fully capture such sales taxes). Moreover, most cities are not able to raise taxes unilaterally due to state-imposed tax and revenue expenditure limits (TELs).[13] In addition to the lack of capacity to adjust their tax rates, the burden of expenses for municipalities has increased.

Cities have found solutions to expand resources for infrastructure. Reliance on municipal bonds has increased during the last hundred years, and today they are an essential source of capital for infrastructure projects.[14] With increasing awareness about climate change, cities have also implemented stormwater utility fees.

Most notably, federal and state support has played a significant role in how cities can meet the infrastructure needs of their communities. The ARPA State and Local Fiscal Recovery Funds program (SLFRF) is a recent illustrative example. The SLFRF program's flexibility enabled municipalities to develop new or improve existing infrastructure to ensure continued access to government services and economic opportunities throughout the height of the pandemic.[15, 16] The Bipartisan Infrastructure Law (BIL), signed into law in November 2021, has already directed nearly $400 billion in funding to over 40,000 specific projects and awards, across over 4,500 communities in all 50 states, the District of Columbia, US territories, and Tribal communities. Among the sectors benefiting from BIL funding are transportation (including support for electric vehicles), clean water and high-speed Internet.[17]

Infrastructure financing methods have changed over the past century, evolving from private financing to public financing that relies upon a combination of tax and fee revenues, borrowing from the market, and federal and state support.

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