

Actions by Local Government Leaders for Economic Recovery
Intelligent public investment can reap rewards.

City and county managers have the responsibility to promote organizational adaptability and steer through the fiscal crisis successfully. A larger question is whether local government leaders can contribute to economic recovery and avoid making matters worse or dampening recovery efforts.

With a large number of employees paid regularly and substantial purchases of goods and services, local governments are important economic agents. In a fiscal crisis, what, if anything, can local government leaders do to stimulate their economies? Justin Marlowe points out that the answer, according to public finance theorists, is local governments can accomplish little on their own. The actions they take, however, could exacerbate problems if they make cuts in ways that accelerate rather than counter the shrinkage of the local economy.

Leaders can mildly stimulate their local economies with several strategies: 1) increasing revenues or drawing down financial reserves to maintain or increase local government expenditures; and 2) expanding or accelerating local capital projects. In the current crisis as in previous situations, many cities are maintaining expenditure levels primarily by increasing charges, but also by adjusting taxes and other revenues when possible. (See figure 5). Furthermore, many local governments have accumulated financial reserves, ranging from 30-50 percent of their annual expenditures. Research shows that it is helpful to use reserves to prop up spending when revenues decline and make local government fiscal decisions less counterproductive to economic stimulation. The positive effect of public spending is especially strong for public facilities and services that have a direct relationship to business and industry, including roads, bridges, storm water treatment, and other basic infrastructure. Present circumstances resemble the ideal conditions for local economic stimulus through capital improvements, and the federal stimulus package may provide the funding that is not available at the local level.

A third possible strategy would be for local leaders to emulate Congress by reducing local tax rates to encourage spending. Realistically, stimulus works differently at the local level. Reducing taxes has less impact on local consumer spending than maintaining programs and expenditure levels. The evidence suggests local consumer spending does not get a boost so much as savings, which enters a large pool distributed globally rather than locally.

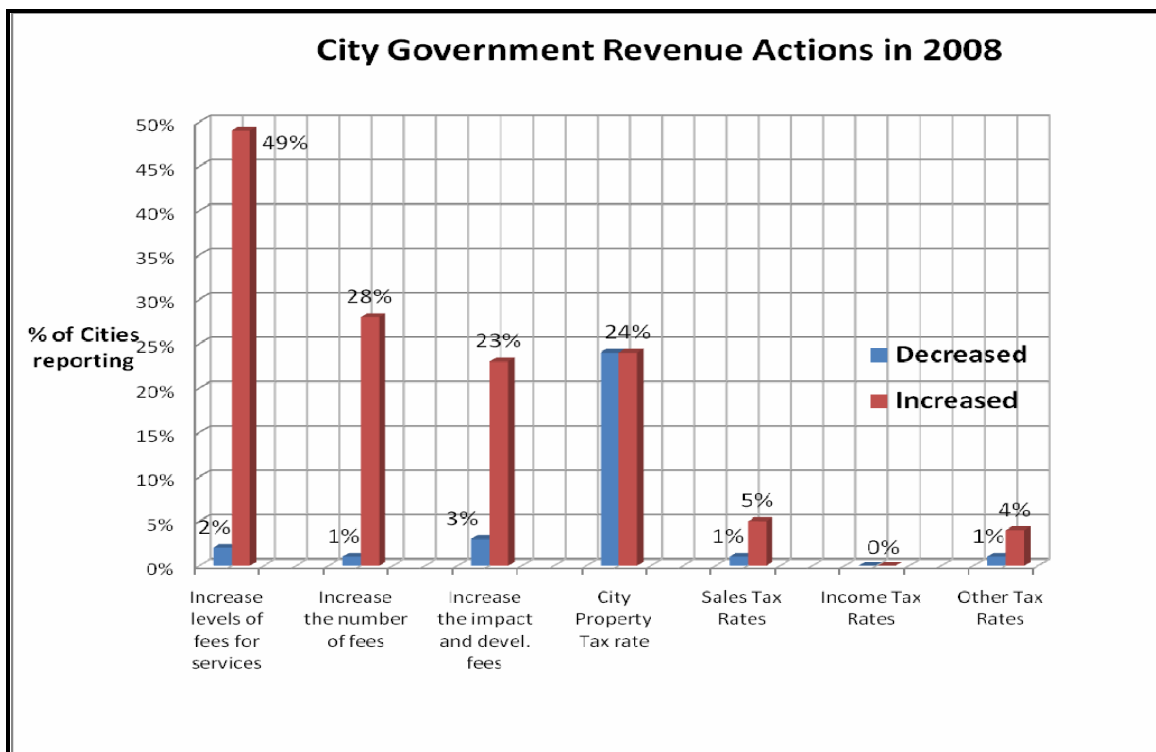
Marlowe concludes that, ironically, the best option for local governments asked to do something to stimulate their local economies is to maintain current expenditure levels and expand capital improvements if local revenues, reserves, interest rates, and federal grant funds make it possible. This course of action, Jeff Chapman notes, is not typical. Commonly, he says, the state and local response to a change in economic activity tends to make downturns and upturns more extreme. However, nearly all of the economics literature estimates that cutting expenditures hurts the local economic recovery more than raising taxes.

Economic development efforts can generate jobs and tax revenues during a recession. While fiscal economic development incentives do not work all that well, according to research estimates, to attract investment to a particular state, these incentives do become

powerful at the local level after a developer has decided to move to a particular region. In particular, they may be more important during a recession; the private sector firm might be more sensitive to the impacts of the incentives because its profit margins may be smaller. The incentives, however, do not have to be solely in cash. Factors besides fiscal incentives do matter in economic development, and some may have a bigger impact than tax gifts. For example, local community assets including infrastructure, a skilled workforce, and educational institutions matter to private sector firms in location and expansion decisions, as do factors with less direct impact, from the process of getting project approvals to the local government's credit worthiness in the municipal bond market. A period of resource scarcity is an appropriate time for jurisdictions in a region to share incentives and benefits instead of pursuing new development as a zero-sum game.

Chapman contrasts fiscal stimulus with economic development. Developing the economic base must be considered more of a long-run play, involving careful planning, multiple analyses of many variables, and minimal expectations of quick payoff. State and local fiscal stimulus differs due to its emphasis on immediate effects.

Figure 5. City Revenue Actions



Source: Michael A. Pagano and Christopher W. Hoene, "City Fiscal Conditions in 2008," *National League of Cities*