Infrastructure Spending After the Great Recession

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How is state and local government spending on infrastructure (capital) faring more than six years after the Great Recession ended formally? The short (and depressing) answer is that on average the state and local government sector is not investing to the degree in the past. Of course, governments in some states are doing much better than in others, with the differences quite dramatic. If permanent, the Great Recession may become an important factor in continuing the decline in the quality of state and local government capital facilities (roads, bridges, schools, water and sewer systems, and so on). In addition to reframing the role of state and local governments in the U.S. economy, this trend has implications for environmental quality, safety, and economic growth.

That the financial market crisis and subsequent Great Recession had a historically substantial impact on the state and local government sector is well known. The Great Recession began officially in December 2007, during fiscal year 2008 for most state and local governments, and ended in June 2009, at the end of fiscal year 2009. Revenue declined substantially, initially for state governments and later for local governments, requiring adjustments in spending, employment, and services. The federal government response to the Recession included additional resources and financial options for state and local governments, which partially mitigated the fiscal effects for a limited period. However, those effects were temporary.

Infrastructure Investment

State and local government spending on infrastructure has declined substantially in the last several years and is now less than before the Great Recession, as shown in Figure 1. State and local governments spent a nominal amount of about $325 billion on capital expenditure in 2007, rising to $357 billion in 2009 as a result of the federal government stimulus, and then falling to $323 billion in 2013. However, these nominal amounts mask real declines in value. State-local capital spending was 2.3 percent of GDP in 2007 but only 1.9 percent in 2013. Adjusting for changes in population and prices, real per capita state-local capital spending declined from $1,162 in 2007 to $952 in 2013.

Moreover, state and local governments together were spending more than 12 percent of their budgets on capital investment in 2007 but only about 10 percent in 2013. So, public capital investment has declined not only because state and local governments are spending less overall, but also because capital investment has become relatively less important. Obviously, this trend has serious potential implications for the quality of public infrastructure in the future.

Aggregate Spending Levels

State and local governments are spending less than before the Great Recession. Real per capita spending (in 2010 dollars) in fiscal year 2013 ($9,269) remained below the level of spending in fiscal year 2007 ($9,363), just before the Great Recession. Per capita spending increased substantially in 2009 and 2010 as a result of the federal government stimulus, a pattern similar to employment, but has been decreasing since. Similarly, total state-local government spending amounted to 23.7 percent of personal income in fiscal year 2007, but only 22.8 percent in fiscal year 2013.

Revenue

One reason for the decline in capital spending is that revenue changes between 2007 and 2013 (before the Great Recession compared to the most recent Census data year) have been less than the growth of population and prices and the growth of income. Total real general revenue of state and local governments in 2013 is about the same as in 2007. However, both real general revenue per capita ($7,783 in 2013 vs. $8,180 in 2007) and general revenue as a percentage of personal income (19.1 percent in 2013 vs. 20.7 percent in 2007) are lower in 2013 than 2007. Of course, revenue growth is the result of a combination of changes in economic conditions and political choices.

Expenditure Mix

And as noted previously, the share of spending going to capital investment decreased by two percentage points. There have been few major changes in the other categories of spending. The importance of public welfare has increased, consistent with growing health care costs and expansion of Medicaid. The importance of education spending decreased a bit (34.4 percent vs. 33.2 percent), consistent with evidence that local governments decreased the number of education employees substantially.

Fiscal Balances

Not surprisingly given the rest of the fiscal picture, state governments have not been able to return fully to the reserves before the Great Recession. NASBO (Fiscal Survey of the States, Spring 2015) reports "Budget reserves reached a low in fiscal 2010 due to the severe decline in revenues and rise in expenditure demands tied to the recession. Since that time, states have made progress in rebuilding budget reserves. In fiscal 2014, total balances amounted to … 9.9 percent of general fund expenditures." This compares to state government fiscal balances of 11.5 percent of general fund expenditures in 2006 and 10.1 percent in 2007. NASBO also notes that

reserves vary substantially among the states, and that "… a majority of states project total balance levels of 5.0 percent or more in 2016 …" implying that a number of states are expecting substantially lower balances.

State Differences

As is common in state-local finance, the status of individual states often differs from the "average" or aggregate position of the overall state-local sector, which is true in this instance. Governments in some states have returned to the fiscal status that prevailed before the Great Recession much more so than others. The differences can be substantial. For example, real aggregate per capita spending in North Dakota *increased* by more than $2,400 from 2007 to 2013, whereas real per capita expenditure *decreased* by more than $1,200 in Florida over that time. Other states with large decreases include Arizona, Georgia, and Nevada, whereas Alaska is another state where real spending per person increased substantially.

Similar differences exist for state and local government capital spending. As noted, the national pattern is that per capita state-local capital spending increased in 2008 and 2009, during and immediately after the Great Recession, and capital spending then declined for 2010 and subsequent years. The pattern among New England states is quite different. With the exception of Connecticut and Rhode Island, per capita capital spending did not increase during 2008 and 2009. On the other hand, in contrast to the national trend, capital spending has increased in both Connecticut and Massachusetts since (with relatively large increases in 2011 and 2012) whereas spending initially increased in 2011 in the other four states but fell back in 2012.

Although the picture is clear, the ultimate reasons are not. Although income and employment have returned to pre-recession levels, state-local government revenue has not. This may partly reflect the continuing lag in "catch-up" of property taxes, but it also may imply that state and local government political bodies have not been willing to increase revenue sufficiently. Attitudes of both public officials and citizens may have changed – temporarily or permanently – leading to a smaller subnational government sector overall. Finally, concerns about debt, perhaps affected by outstanding state-local pension liabilities, may have influenced state and local governments to borrow less, which is a primary mechanism for funding capital investment. In any case, a continual decline in state and local government capital investment seems inconsistent with the evidence about declining quality of transportation facilities, increasing traffic congestion, and signs of potentially dangerous changes in water and sewer systems.

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Figure 1