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American Paradox: It's Never Been Cheaper for Cities and States to Borrow Money…And They Refuse to Do It.

Plunging global interest rates have made borrowing cheap, but many are struggling with sluggish revenue growth and higher expenses

Wall Street is urging governments to invest in big-ticket infrastructure projects. Voters and public officials have a different message: not so fast.

Plunging global interest rates have made borrowing cheaper than ever. But instead of spending on aging roads, bridges and buildings, many state and local governments are scaling back.

New government-bond issues have dropped to levels not seen in the past 20 years. Municipal borrowers issued about $140 billion in bonds for new projects last year. Adjusted for inflation, that is 53% lower than in 2006 and 21% lower than in 1996. So far this year, municipalities have borrowed $95.1 billion, about $10 billion more than at this time last year.

Seven years after the recession ended, voters and government officials remain scarred by the deep budget cuts they endured at the height of the financial crisis and the sluggish revenue growth that has constrained spending since then.

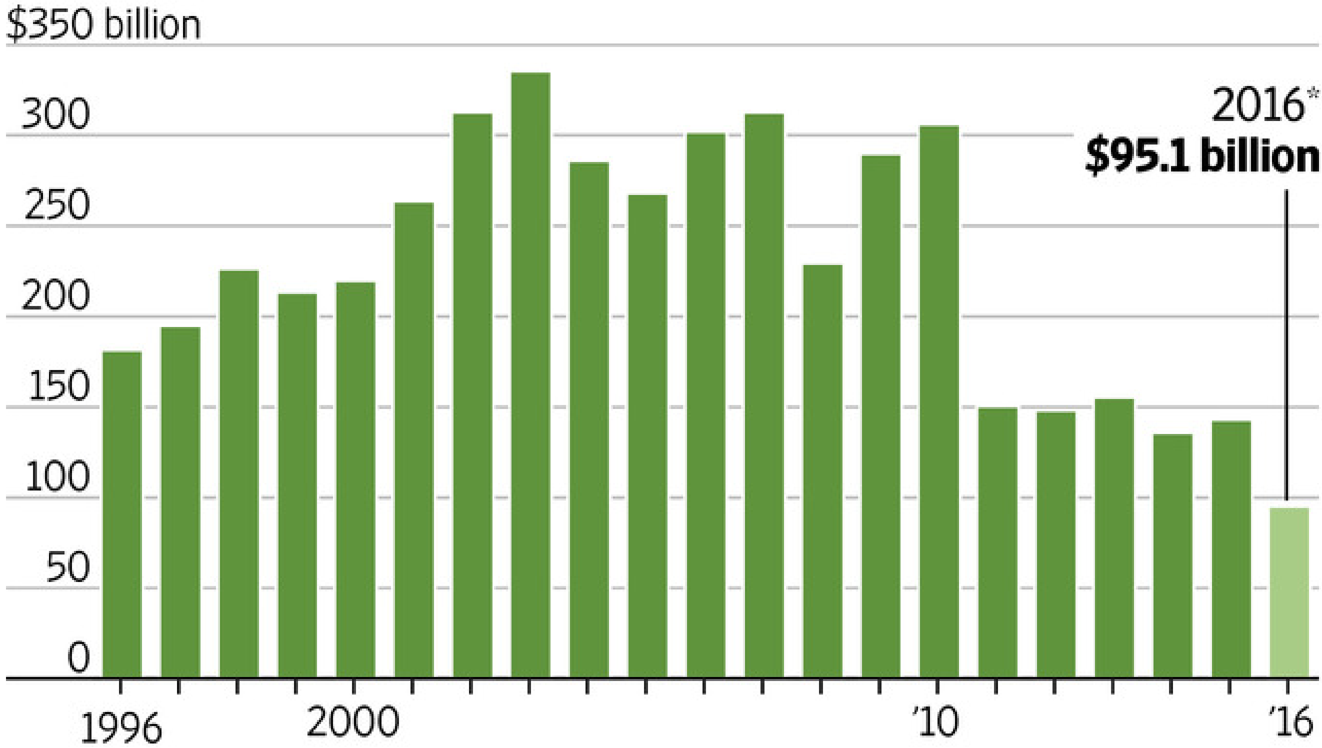
“The collapse in interest rates corresponded with the recession and with a political trend toward antitax sentiment,” said Dan Seymour, an analyst with Moody's Investors Service. ”Even as state and local governments are looking at lower bond yields, they are facing a public that is reluctant to pay more taxes.”

As a share of the economy, state and local governments are investing less in capital projects than they have since the early 1980s, according to Commerce Department data.

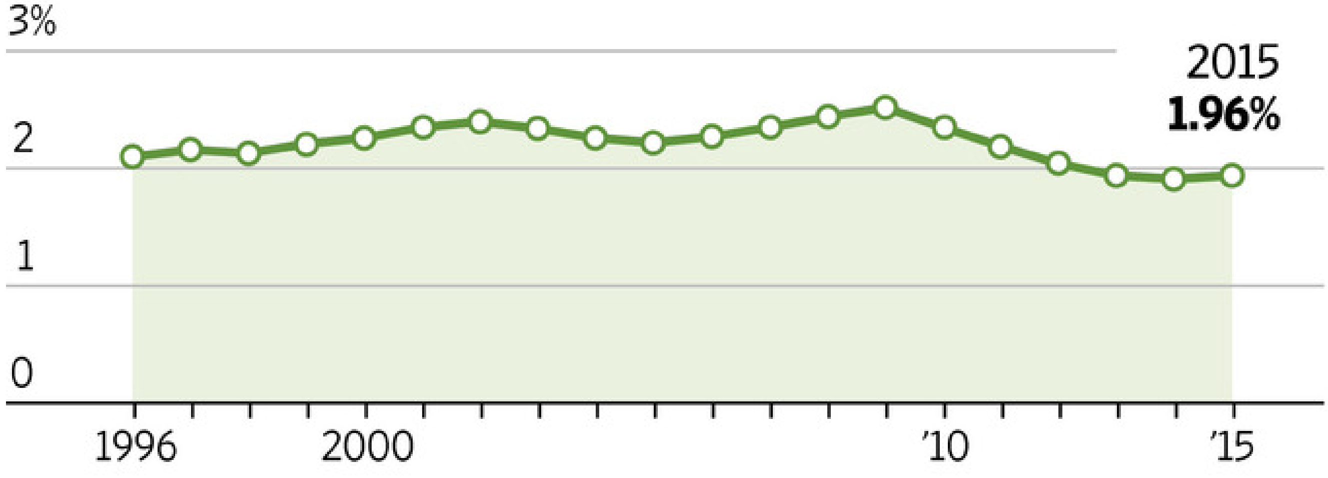
Scaling Back

Government borrowing for new projects has fallen to the lowest level in more than two decades, while state and local investment as a share of the economy has declined.

U.S. municipal borrowing for new projects in 2016 dollars.



State and local investment in capital projects as a percentage of GDP



*2016 figure is through Aug. 3.

Sources: Thomson Reuters (issuance); Department of Commerce (investment)

THE WALL STREET JOURNAL.

Last week, Hawaii became the latest state to pare new highway construction after legislators turned down a gas-tax increase.

In May, California transportation officials announced a 28% cut to construction plans between now and 2021. New public-sector borrowing in the state last year dropped almost 40% from 2009.

Florida officials went five years without approving any new borrowing by the state's main construction program for public schools and universities despite a long list of projects. When the legislature and governor finally signed off on new borrowing again in March, they limited the new debt to $275 million, down from $1.4 billion in fiscal 2007.

"Our governor is a debt hawk," said Ben Watkins, Florida's director of bond finance.

Governments have reported significant drops in borrowing costs while their ratings have remained unchanged. Barclays PLC's municipal-bond index, which is a gauge of municipal-debt yields, this summer reached a 20-year low of 1.6%, compared with about 4.2% in summer 2006.

Wall Street executives are calling for investments in infrastructure. J.P. Morgan Chase & Co. CEO James Dimon cited a "need for good, long-term infrastructure plans" in a letter to shareholders this year, echoing economists' sentiments.

Asset managers that invest in municipal bonds too would like to see increased issuance, because the additional supply could force governments to pay more to entice purchasers, driving up yields.

State and local governments are carrying about the same amount of debt as they were when they emerged from the recession, in part because tax revenue has been slow to rebound.

S&P Global Ratings analyst John Sugden said that in many places, the hesitation "reflects good budget management" by governments whose revenue projections leave no room for additional debt payments or upkeep costs for newly constructed projects.

On the other hand, he said, forgoing timely repairs to existing structures could drive up costs in the long run.

A McKinsey Global Institute study released in June found the U.S. should boost infrastructure spending by 0.7% of its gross domestic product between now and 2030 to meet transportation, water, power and telecommunications infrastructure needs. Doing so this year would mean roughly $129 billion in new spending.

Many struggling legislatures and city halls are instead focusing on underfunded employee pensions and rising Medicaid costs. Some cash-strapped areas, such as Puerto Rico and the city of Chicago, face high annual debt payments.

Federal grants to state and local governments for capital investment are expected to total less than $68 billion in 2016, according to data from the Office of Management and Budget. They hovered around $80 billion in the early part of the last decade and surpassed $90 billion in the aftermath of the recession. Estimates are in 2009 dollars.

State tax revenue, meanwhile, isn't expected to bounce back soon. The National Association of State Budget Officers estimates state spending will rise 2.5% in fiscal 2017, down from 5.5% in 2016 and 4.2% in 2015.

"There aren't a lot of additional dollars to go around to spend on infrastructure, transportation and other areas of the budget," said Brian Sigritz, director of state fiscal studies for the association.

Many states require a voter referendum before taking out new loans. That means political considerations often matter more than interest rates when governments consider a new round of borrowing.

Voters in Wisconsin school districts have rejected 40% of ballot questions seeking to issue debt over the past 10 years, according to the Department of Public Instruction.

The 1,300-student Dodgeville School District, about 45 miles outside Madison, scrapped plans to build a $34 million high school in 2014 after voters roundly rejected a $48 million borrowing referendum. This April, the district gained approval for a roughly $20 million proposal to expand the existing high school.

Among the improvements the district decided to forgo was a second gym. "We need that, but it was perceived to be a want, rather than a need," said District Administrator Jeff Jacobson.

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