Partisan Cities

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Motivation

- **Decentralized** provision of public goods is key aspect of fiscal federalism in U.S.

- **Local governments** uniquely positioned to address city-specific challenges & meet needs of constituencies
  - higher information, competition, accountability [Tiebout 1956; Oates 1972]

- However, municipalities **lack full independence** in decision making
  - Cities derive existence & authority from respective States, according to the Constitution
  - Restricts cities' ability to respond to local needs

- Institutional setting rendered more complex as cities and states governed by elected officials

  - **Politics of fiscal federalism** [Clemens, Veuger 2023]
  - Partisan conflicts manifest in disagreements over budgets, policies, resources allocation (e.g. labor laws, guns, environment, expenditure limits etc)

Research Question

Do **agency frictions**, driven by **partisan interests** between states and local governments, affect the local **provision of public goods**?

- Key area where strategic (partisan) interactions btw cities & states could impact outcomes is **hazard preparedness**
  - Capital improvement projects addressing enviro risks either undertaken independently by city or in partnership with State
  - Degree of State involvement can vary widely
  - No set rule, States have discretion in identifying areas of risk & allocating funds

- We study how partisan alignment between cities and States affects cities':
  - Cost of raising capital
  - Real investments in local adaptation initiatives

Existing Evidence

- Early **legal doctrine:**
  - Dillon Rule
  - Cities are creatures of the state, not independent decision makers, execute and don't decide
  - No room for strategic interactions between State & Local

- **Academic evidence**:
  - Partisanship of cities does not matter for government budgets, spending, crime rates [Ferreira & Gyourko 2009 QJE, Glaser & Ward 2006 QJE]
  - No room for partisanship to affect real investment

- Fails to consider partisan state-city conflicts

In the News

IMPEDING INNOVATION: STATE PREEMPTION OF PROGRESSIVE LOCAL REGULATIONS

*Lauren E. Phillips**

POLITICS

Tennessee's Political Divisions Deepen Between State and Its Cities

Democrats' expulsion by state GOP lawmakers is latest episode of the political polarization playing out in red states with blue cities

By Ginger Adams Otis Follow

Updated April 10, 2023 6:05 pm ET

U.S.

Cities Clash With State Governments Over Social and Environmental Policies

Municipal lawmaking laboratories push boundaries on smoking bans, plastic bags and bathrooms—but states push back

By Valerie Bauerlein Follow *and* Jon Kamp Follow

July 7, 2016 12:30 pm ET

THE WALL STREET JOURNAL.

Record Bankruptcy for Detroit

Motor City 'Is Broke,' Governor Says, as It Seeks to Restructure $18 Billion in Debt

Michigan Governor Rick Snyder (Republican) Detroit Mayor Dave Bing (Democrat)

BUSINESS OF GOVERNMENT SOCIAL ISSUES

Pandemic Provokes City vs. State Conflicts

BY: **ELAINE S. POVICH** - APRIL 14, 2021 12:00 AM

This Paper

- To understand the role of political alignment in city-state relations

  - Hand collect unique dataset with partisan affiliation & election dates of local officials in US
  - Construct a detailed dataset on cities' investment in flood risk adaptation

We find:

1. Partisan Alignment affects cities' Cost of Capital

- Aligned cities (ie. same political party of Governor) have 8bps lower borrowing costs

Mechanism: Preferences; Transfers; State intervention in distress; Governor powers

2. Partisan Alignment affects cities' decision to invest in emergency preparedness

- Cities **increase** investment when **opposite-party** Governor is in power
- Not obvious, partisan alignment should facilitate investment- shared priorities & cheaper funding
- **Moral hazard** incentives dominate
- Aligned local gvt reduce costly resiliency projects, expect positive State intervention

Literature

- Long-standing literature on fiscal federalism [eg. Clemens, Veuger 2023 for review]
- Growing literature on role of partisanship in subnational governments [eg. Carlino et al 2023; de Benedictis-Kessner et al. 2023; Ferreira & Gyourko 2009; Glaser & Ward 2006]
- Determinants of municipal bond spreads [eg. Schwert 2017; Babina et al. 2019; Schultz 2013; Gao et al. 2019; Dagostino 2022; Green 1993; Chalmers 1988; Longstaff 2011; Cornaggia et al. 2018]
- Climate risk and municipal bonds [Lu and Nakhmurina 2023; Painter 2020; Goldsmith-Pinkham et al. 2022]
- We are the first to show that partisan alignment:
  - Is priced in muni bonds
  - Shapes local governments' incentives to invest in emergency preparedness

Data

1. **Partisan Affiliation:**
   - Hand collect name, partisan affiliation & election date of local officials for total 1,048 cities across 45 US states for period 2005-2019
   - Scrape OurCampaign website
   - Scrape current & archived city websites using Wayback Machine (>=10k population)
   - Manually search Wiki, Google, Facebook, voter reg websites for mayors whose party could not identify on city website
   - State Governor election data from Ballotpedia

2. **Bond Vars:** Mergent

3. **Local Gvt Budgets:** Census Annual Survey State & Local Gvt Finances

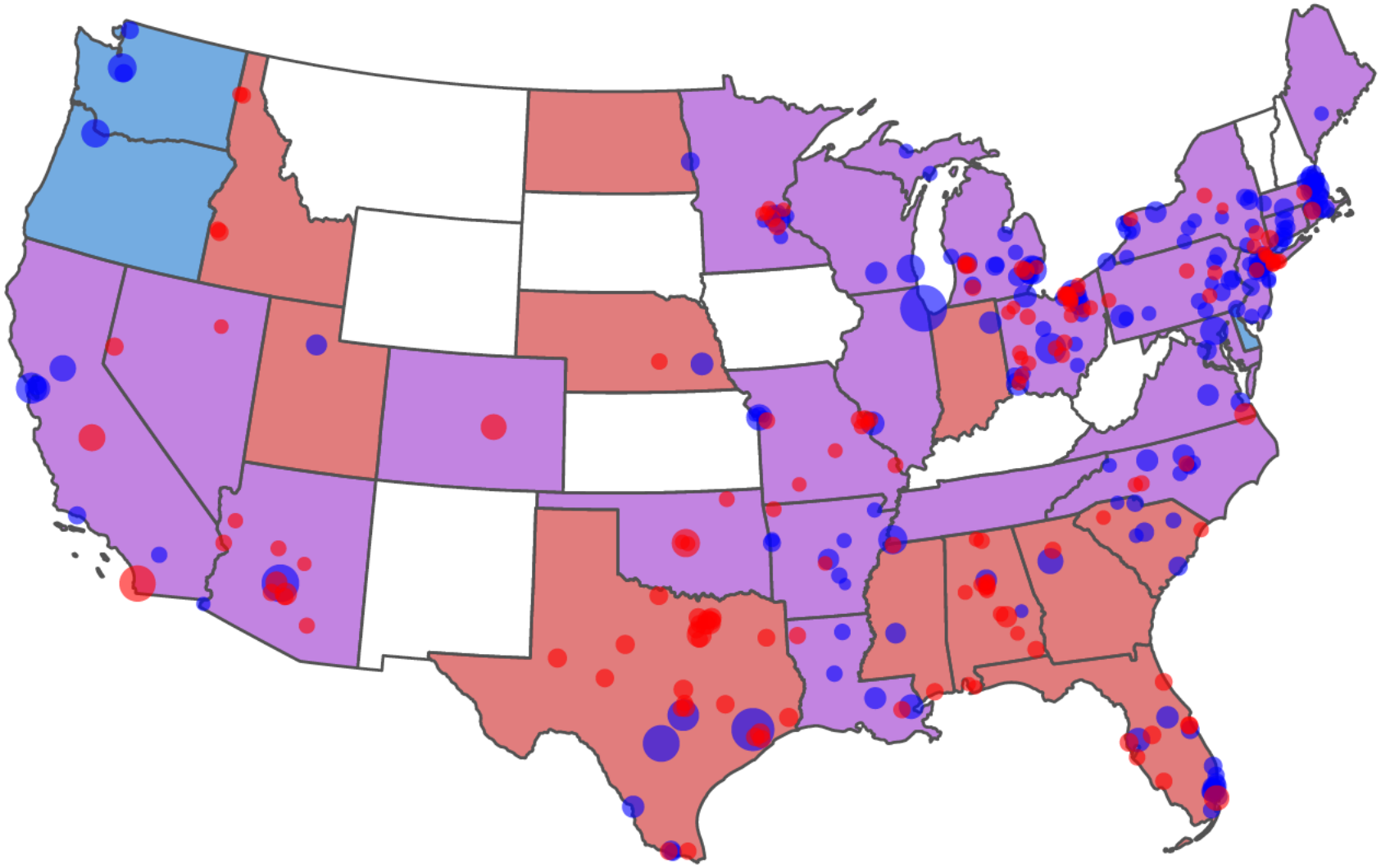
Data

4. Flood Risk Data: 2020 National Flood Risk Assessment (NFRA) by First Street Foundation.

5. Adaptation Data:

- Flood risk adaptation dictionary containing hard, soft & general adaptation measures (no 'cheap talk')
  - built extracting keywords from Carbon Discolure Project, C40 Cities Climate Leadership, IPCC Intergov Panel Climate Change, academic literature, financial disclosure docs
- Scrape bond issuance prospectuses obtained from MSRB EMMA
- Use textual analysis to parse text & identify sentences related to adaptation

Partisanship across the US (2005-2019)



Democratic city

Republican city

State governor switched party during sample period

State governor always Democrat

State governor always Republican

- 24 states switch party
- 36 party-switching elections in sample

Summary Statistics – Bond Characteristics

	Obs.	Mean	St.Dev.	Median
Yield (bps)	23,089	202.8	103.3	190
Spread over MMA (bps)	23,089	35.57	44.85	28.45
Amount ($ million)	23,089	2.301	5.018	0.900
Log(Amount)	23,089	0.839	0.702	0.642
Maturity	23,089	5.594	2.850	5.468
Log(Maturity)	23,089	1.781	0.480	1.867
Insured	23,089	0.201	0.401	0
BQ	23,089	0.154	0.361	0
GO	23,089	0.598	0.490	1
Rating	19,862	14.52	1.956	15

Summary Statistics – City sample

	Obs.	Mean	St.Dev.	Median
Population ($ thousand)	1,813	180.0	326.4	70.87
Log(Population)	1,813	11.34	1.134	11.17
Revenue ($ million)	1,813	553.5	1,202	165.9
Revenue (Per Capita, $ ths)	1,813	2.608	1.640	2.062
Expenditures ($ million)	1,813	566.6	1,224	168.1
Expenditures (Per Capita, $ ths)	1,813	2.673	1.656	2.158
Debt Outstanding ($ million)	1,813	830.3	2,355	139.2
Debt Outstanding (Per Capita, $ ths)	1,813	2.724	2.313	2.089
IG Revenue ($ million)	1,813	120.4	295.5	24.64
IG Revenue (Per Capita, $ ths)	1,813	0.647	0.916	0.296

Empirical Methodology

$$Spread_{i,c,t} = \beta \cdot Aligned\,City_{c,t} + \psi \cdot BondChar_{i,t} + \xi \cdot CityChar_{c,t-1} + \alpha_c + \tau_t + \epsilon_{i,c,t}$$

- Rely on party-switching Governor elections
- Focus on cities never change political affiliation
- Aligned = 1 if mayor & state governor share same partisan affiliation
- Fix a city & track borrowing costs during periods of align and misalign
- City FE removes intrinsic time-invariant differences btw Rep & Dem cities
- Gov Party by year control for Gov party policies & sample concerns
- Year FE control macro conditions, compare align and misalign issuing at same time
- Bond Char: Size, Maturity, GO, BQ, Insured, Ratings FE
- City Char: lagged Revenues p.c. and Debt Outstanding p.c., Population
- Spread is offering yield to maturity minus maturity matched MMA curve

Borrowing Costs

- Partisan gap in local gvt cost of borrowing 6 to 9bp

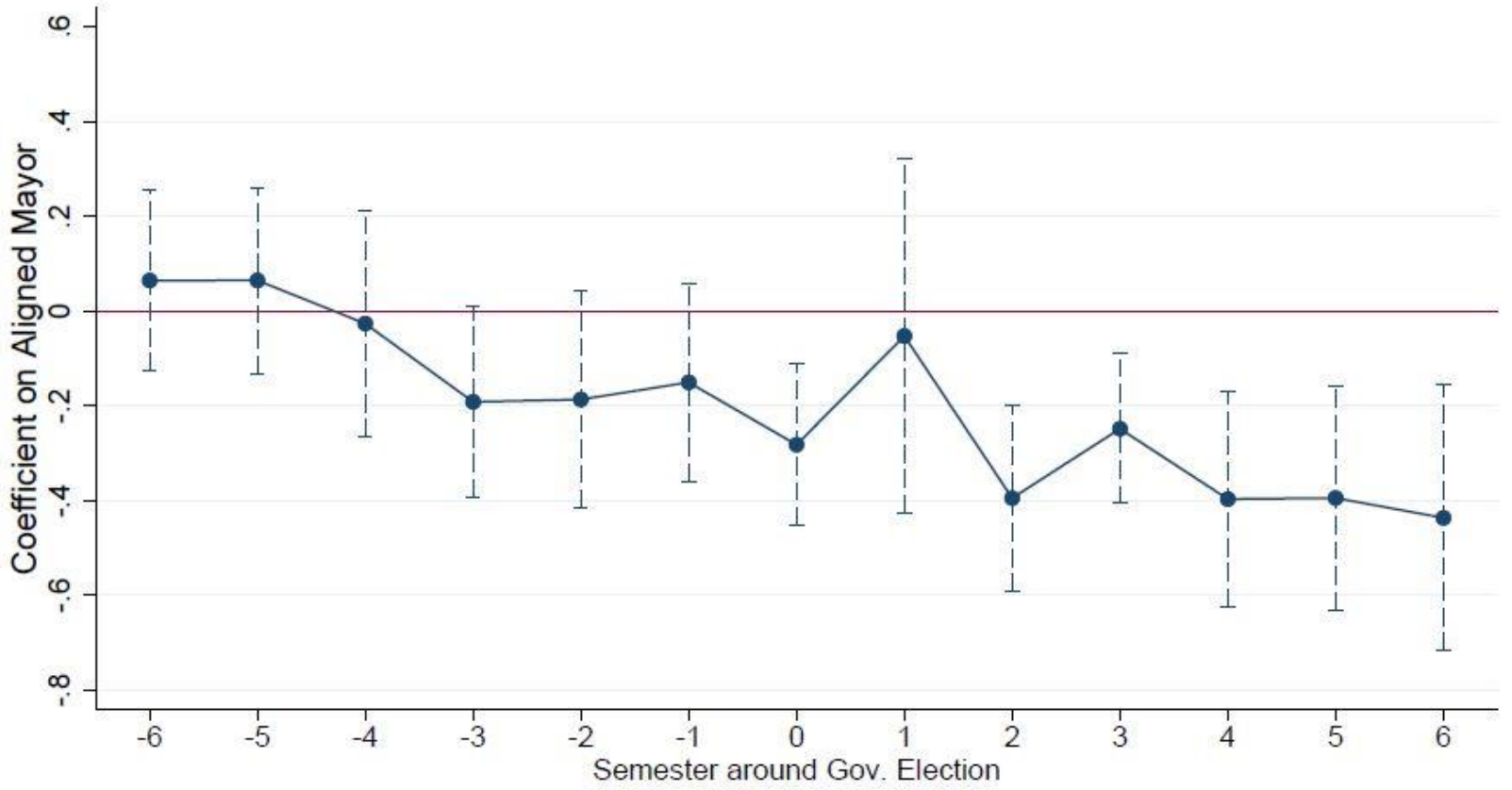
- City FE absorbs party of city
  ⟹ Findings not due to Dem or Rep cities holding partisan preferences over issues having fiscal impact, such as taxes and redistribution.

- Gov Party by Year
  ⟹ Compare Align/Misalign cities under same party Gov during same year

Dep. Var.:	(1) Spread	(2) Spread	(3) Spread	(4) Spread	(5) Spread	(6) Spread
Aligned	-0.080**	-0.082**	-0.089**	-0.092***	-0.093***	-0.062**
	(0.033)	(0.033)	(0.032)	(0.030)	(0.031)	(0.024)
Log(Amount)		0.019	0.019	0.018	0.018	0.017
		(0.020)	(0.018)	(0.019)	(0.019)	(0.019)
Log(Maturity)		0.115***	0.112***	0.112***	0.112***	0.111***
		(0.026)	(0.026)	(0.026)	(0.026)	(0.026)
BQ			-0.064**	-0.062**	-0.063**	-0.062**
			(0.029)	(0.029)	(0.029)	(0.028)
GO			-0.004	-0.003	-0.003	-0.002
			(0.030)	(0.030)	(0.030)	(0.029)
Insured			-0.081*	-0.082*	-0.083*	-0.083*
			(0.045)	(0.045)	(0.045)	(0.045)
Log(Population)				0.225	0.216	0.173
				(0.230)	(0.235)	(0.245)
Revenues$_{t-1}$($p.c.$)					-0.007	-0.010
					(0.019)	(0.017)
Debt Outstanding $_{t-1}$($p.c.$)					0.009	0.010
					(0.016)	(0.015)
Issuer FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Rating Grid FE			Yes	Yes	Yes	Yes
Governor Party by Year FE						Yes
Obs.	23,084	23,084	23,083	23,083	23,083	23,083
Adj. R^2	0.476	0.492	0.539	0.539	0.539	0.547

Borrowing Costs - Dynamics

- Pool data across party-switching elections
- 6 semesters around elections
- T=0 6mo post-elect
- T= -7 base period
- Spread drops as cities become aligned after election
- Effect is persistent



Falsification Tests

- Randomly assign Alignment to cities
- No effect on spreads with random party assignment

	Spread			
	(1)	(2)	(3)	(4)
Random Aligned	-0.002	-0.001	-0.002	-0.002
	(0.004)	(0.004)	(0.004)	(0.003)
Log(Amount)		0.019	0.018	0.018
		(0.020)	(0.019)	(0.019)
Log(Maturity)		0.115***	0.111***	0.111***
		(0.026)	(0.027)	(0.026)
BQ			-0.065**	-0.065**
			(0.029)	(0.030)
GO			-0.005	-0.004
			(0.031)	(0.030)
Insured			-0.080*	-0.081*
			(0.046)	(0.045)
Log(Population)				0.121
				(0.226)
Revenues (p.c.)				-0.003
				(0.020)
Debt Outstanding (p.c.)				0.007
Issuer FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Rating Grid FE			Yes	Yes
Clustering	City & Year	City & Year	City & Year	City & Year
Observations	23,084	23,084	23,083	23,083
Adjusted R-squared	0.473	0.488	0.535	0.535

Decision to Issue

- Higher borrowing costs may discourage misaligned city from borrowing (vs. aligned)
- But may be costly or unfeasible to delay bond issuance
- Mayors re-election pressures
- Delay issuance not guarantee governor party will change
- Overall, no effect of alignment on propensity to issue bonds

Dep. Var.:	(1) Has Issued	(2) Has Issued	(3) Has Issued	(4) Has Issued
Aligned	-0.008	-0.010	-0.006	0.004
	(0.000)	(0.021)	(0.020)	(0.021)
Log(Population)		0.213	0.198	0.183
		(0.126)	(0.129)	(0.128)
Revenues$_{t-1}$($p.c.$)			0.023	0.025
			(0.025)	(0.025)
Debt Outstanding $_{t-1}$($p.c.$)			0.001	-0.000
			(0.007)	(0.007)
Issuer FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Governor Party by Year FE				Yes
Obs.	3,332	3,332	3,129	3,129
Adj. R^2	0.387	0.387	0.383	0.380

Issuance Amount

- May be costly or unfeasible for misaligned city to delay bond issuance
- Mayors re-election pressures
- Delay issuance not guarantee governor party will change

- Could still reduce size of bond issuance

- Look at total issuance amount each year and conditional on having issued
- No evidence of significant reduction

Dep. Var.:	(1) Log(Amount)	(2) Log(Amount)	(3) Log(Amount)	(4) Log(Amount)
Aligned	-0.122	0.051	-0.003	0.001
	(0.323)	(0.323)	(0.060)	(0.099)
Log(Population)	4.202	3.915	1.745***	1.769***
	(2.524)	(2.515)	(0.565)	(0.564)
Revenues$_{t-1}$($p.c.$)	0.412	0.445	0.070	0.078
	(0.416)	(0.407)	(0.067)	(0.069)
Debt Outstanding $_{t-1}$($p.c.$)	-0.015	-0.030	-0.034	-0.035
	(0.129)	(0.128)	(0.033)	(0.034)
Issuer FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Governor Party by Year FE		Yes		Yes
Sample	All	All	If Issued	If Issued
Obs.	3,129	3,129	1,926	1,922
Adj. R^2	0.426	0.423	0.742	0.739

Mechanism - Transfers

- Governors may be more willing to support financially aligned cities
- Healthier budgets, lower cost of capital
- We control for (lagged) city budgets & show that aligned/misaligned cities do not differ on observables
- Test if Aligned cities receive larger transfers – no evidence

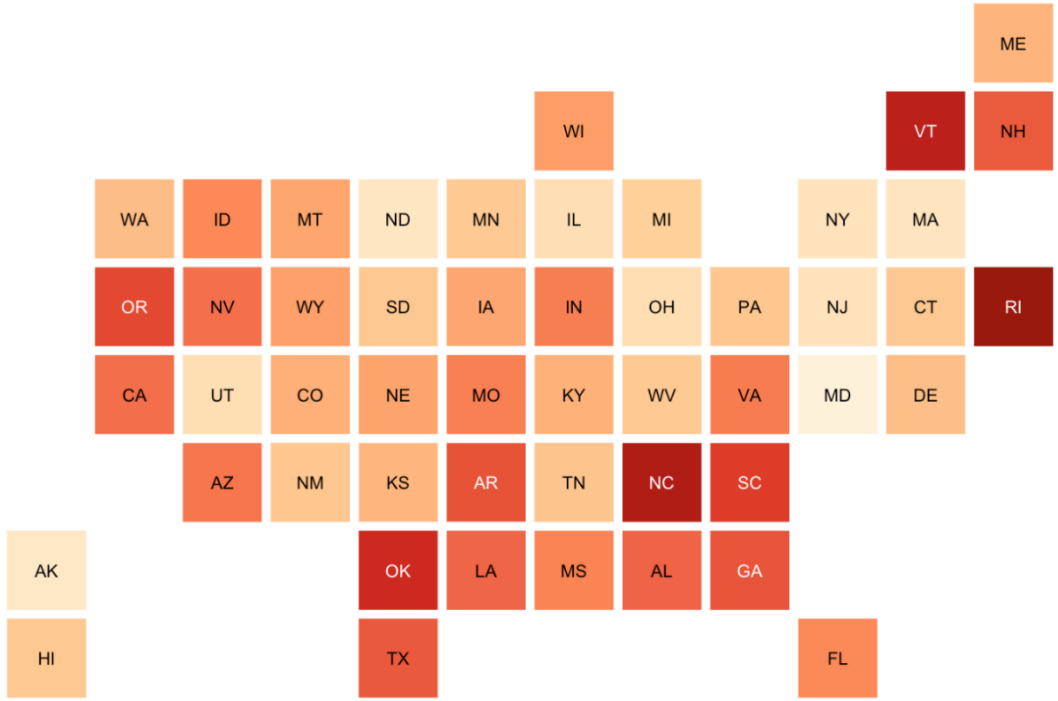
Dep. Var.:	(1) IG Rev. (p.c)	(2) IG Rev. (p.c)	(3) State IG Rev. (p.c)	(4) State IG Rev. (p.c)
Aligned	0.004	0.005	0.001	0.004
	(0.016)	(0.013)	(0.017)	(0.013)
Log(Population)	-0.105	-0.089	-0.094	-0.090
	(0.119)	(0.113)	(0.128)	(0.125)
$\text{Revenues}_{t-1}(p.c.)$	0.073**	0.072**	0.054**	0.053**
	(0.030)	(0.029)	(0.023)	(0.022)
Debt Outstanding $_{t-1}(p.c.)$	-0.002	-0.002	-0.006	-0.006
	(0.006)	(0.006)	(0.005)	(0.005)
Issuer FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Governor Party by Year FE		Yes		Yes
Obs.	3,129	3,129	3,129	3,129
Adj. R^2	0.965	0.965	0.968	0.969

Mechanism: Powers of the Governor

- Gubernatorial powers index:
  - Separately elected state-level officials
  - Tenure potential of governors
  - Governor's appointment power
  - Governor's budget power
  - Governor veto power

- Higher governor discretion, higher prob of state preemption

  → higher uncertainty for local policies/investments



Source: Governors and the Executive Branch by Margaret Ferguson & Thad Beyle

Mechanism: Powers of the Governor

- Partisan gap in cost of capital larger in states with strong Governor powers
- Governor benefits from greater discretion in when & how to intervene in local government affairs
- Discretion benefits aligned, costly for misaligned cities
- Effects stronger for cities governed by mayors rather than city manager

	Spread			
	(1)	(2)	(3)	(4)
Aligned × High Governor Power	-0.078*			
	(0.044)			
High Governor Power	0.031			
	(0.069)			
Aligned × Proactive		-0.090**		
		(0.035)		
Aligned × Fiscal Dependency on State			-0.085*	
			(0.046)	
Fiscal Dependency on State			0.189*	
			(0.092)	
Aligned × Strong Mayor				-0.088**
				(0.036)
Aligned	-0.032	-0.039*	-0.041	-0.032
	(0.024)	(0.021)	(0.036)	(0.032)
City Controls	Yes	Yes	Yes	Yes
Bond Controls	Yes	Yes	Yes	Yes
Issuer fixed effects	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes
Rating fixed effects	Yes	Yes	Yes	Yes
Adjusted R^2	0.550	0.550	0.551	0.550
Observations	23,084	23,084	23,084	23,084

Mechanism: City dependence on the Governor

- **Home Rule** allows cities that adopt such charters to determine their own revenues and expenditures without excessive interference or control from the state government
- Non-home rule cities are more fiscally dependent on States
- Collect charter information for each city
- Effects stronger for non-home rules cities

	Spread			
	(1)	(2)	(3)	(4)
Aligned × High Governor Power	-0.078*			
	(0.044)			
High Governor Power	0.031			
	(0.069)			
Aligned × Proactive		-0.090**		
		(0.035)		
Aligned × Fiscal Dependency on State			-0.085*	
			(0.046)	
Fiscal Dependency on State			0.189*	
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Aligned × Strong Mayor				-0.088**
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Aligned	-0.032	-0.039*	-0.041	-0.032
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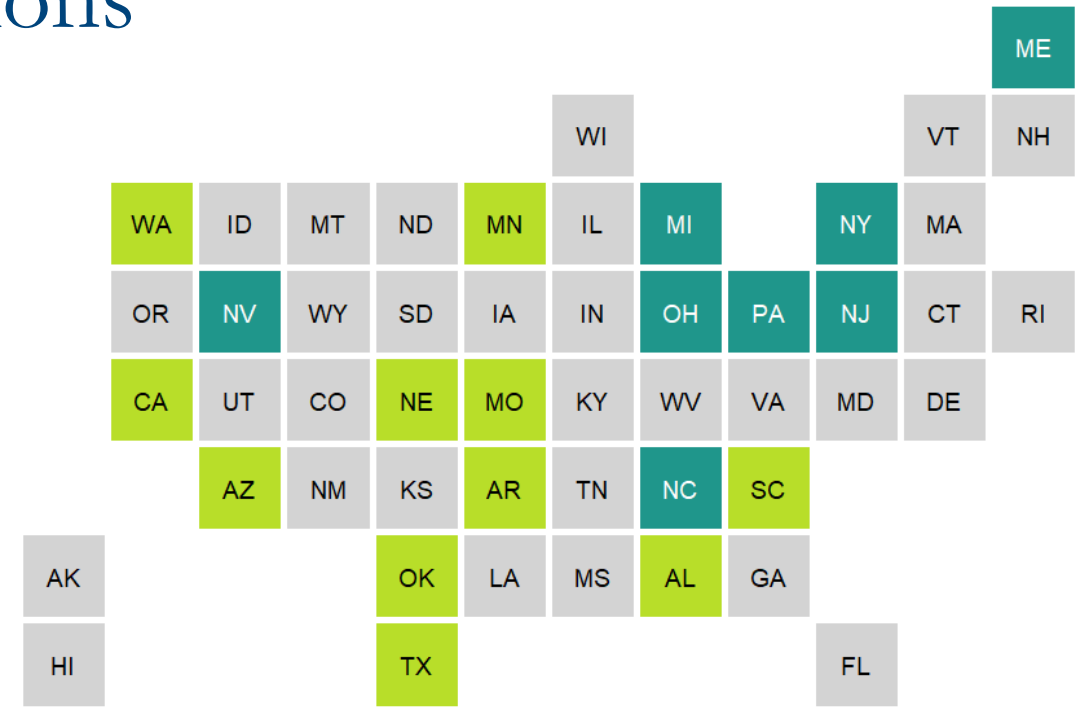
Rating fixed effects	Yes	Yes	Yes	Yes
Adjusted R^2	0.550	0.550	0.551	0.550
Observations	23,084	23,084	23,084	23,084

Mechanism: Role of Expectations

- Variation in extent state can intervene in municipal fiscal matters esp. in distress

- Some States have **Proactive policies,** ie. cities must participate in state-administered assistance programs involving legal procedures and financial reviews

- Some States allow cities to restructure own finances independently and file for **Chapter 9 bankruptcy unconditionally**



Mechanism: Expectations

- Partisan gap in cost of capital larger in states with proactive policies
- Proactive states have discretion in intervention in city finances
- Prob of bailout during distress differs along partisan lines & priced in

	Spread			
	(1)	(2)	(3)	(4)
Aligned × High Governor Power	-0.078*			
	(0.044)			
High Governor Power	0.031			
	(0.069)			
Aligned × Proactive		-0.090**		
		(0.035)		
Aligned × Fiscal Dependency on State			-0.085*	
			(0.046)	
Fiscal Dependency on State			0.189*	
			(0.092)	
Aligned × Strong Mayor				-0.088**
				(0.036)
Aligned	-0.032	-0.039*	-0.041	-0.032
	(0.024)	(0.021)	(0.036)	(0.032)
City Controls	Yes	Yes	Yes	Yes
Bond Controls	Yes	Yes	Yes	Yes
Issuer fixed effects	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes
Rating fixed effects	Yes	Yes	Yes	Yes
Adjusted R^2	0.550	0.550	0.551	0.550
Observations	23,084	23,084	23,084	23,084

Financing Adaptation

- Partisan affiliation of local governments matters, in contrast to early academic evidence
- Partisanship affects municipalities' relationship with the state government
- Aligned cities enjoy lower cost of capital as a result
- Lower borrowing cost should affect real investment decisions
- Focus on type of investment both relevant and co-financed with state: Adaptation
- Does partisanship shape the incentives of cities to invest in hazard mitigation?

Flood Risk Exposure

- Fraction of properties at substantial risk of flooding events (NFRA First Street)
- Flood risk not just coastal phenomenon: pluvial, tidal, storm surges
- Mean fraction of properties at risk in sample 11%
- Florida (27%), Louisiana (22%), South Carolina (16%)

- Natural disasters related to flood risk dominate other weather events in numbers and damage costs (NOAA 2022)

Adaptation dictionary

- Use city-specific dictionary [Lu and Nakhmurina 2023]
  - Start with C40, CDP, IPCC guidance, and academic literature for an initial list of keywords
  - Manually add keywords by reading 16 cities' disclosures over time (FL, MA, DC)

Adaptation dictionary

General	Hard Adaptation		Soft Adaptation
wind mitigation	dyke	stormwater infrastructure	shoreline conservation
wind resistance	dykes	stormwater inlet replacement	shoreline maintenance
wind retrofit	elevated roads	stormwater inspection	shoreline protection
flood preparedness	embankment	stormwater maintenance	shoreline stabilization
	embankments	stormwater master planning	soil retention
	exfiltration system	stormwater operation	tidal flat
	flood wall	stormwater pond	tidal marsh
	floodwall	stormwater project	tidal wetland
	groins	stormwater pump	wet detention basin
	ground water retention	stormwater pump station	wet pond
	groyne	stormwater quality improvement	wetland restoration
	groynes	stormwater retention	
	home elevation	stormwater retrofit	
	hurricane hardening	stormwater services	
	improv stormwater	stormwater system	
	improve drainage	stormwater vault	
	improve road drainage	stormwater vaults	
	inlets	street drainage	
	jetties	surface water maintenance	
	jetty	swale restoration	
	levee	tidal control valve	
	pervious pavement	tidal valves	
	project stormwater	water channel	
	pump system		
	raising streets		
	recharge wells		
	retention basin		
	retention pond		
	retention storage systems		

Estimating Adaptation

- Hard Adaptation:

Infrastructure projects undertaken to reduce flood risk, e.g. seawalls, dykes, flood walls

This project provides for improvements to the Bermuda Boulevard ***seawall***
from 22nd Street to DeSoto Park and abutting City right-of-way. (Tampa, FL, 2018)

- Soft Adaptation:

Nature and sediment-based solutions to reduce flood risk, e.g. beach nourishment, mangrove restoration

Coordinated and permitted ***beach nourishment*** *projects. (Galveston, TX, 2018)*

- **Adaptation**: % sentences in bond prospectus mentioning hard & soft mitigation investment

Validating Adaptation

	Obs.	*Mean*	*St.Dev.*	*Median*	*Diff (s.e.)*
Adaptation (% sentences)	949	0.151	0.256	0.0719	
Republican City	263	0.167	0.165	0.132	0.0219 (1.18)
Democratic City	686	0.145	0.283	0.0606	
Has Hurricane State	363	0.203	0.310	0.136	0.108*** (8.15)
No Hurricane State	586	0.119	0.210	0.0555	
High Properties at Risk	280	0.184	0.345	0.0892	0.0470** (4.27)
Low Properties at Risk	669	0.137	0.207	0.0681	

- Cities with larger fraction of properties at risk talk more of adaptation
- Cities in states with $1bn hurricane occurrence talk more of adaptation

Partisanship in Adaptation Investment

- Unit of obs city-year

- Study how investment in adaptation changes as city goes from misaligned to aligned around party-switching governor elections

- Cities reduce investment in adaptation by 14% -16% when aligned, as measured by fraction of bond issuance dedicated to flood risk mitigation

Dep. Var.:	(1) Adapt	(2) Adapt	(3) Adapt	(4) Is Adapt	(5) Is Adapt	(6) Is Adapt
Aligned	-0.022**	-0.021**	-0.023**	-0.158**	-0.157**	-0.151***
	(0.009)	(0.008)	(0.011)	(0.051)	(0.051)	(0.048)
Log(Population)		-0.269	-0.273		-0.357	-0.533
		(0.248)	(0.259)		(0.614)	(0.824)
Revenues$_{t-1}$($p.c.$)			-0.025			0.052
			(0.031)			(0.035)
Debt Outstanding $_{t-1}$($p.c.$)			0.002			0.015
			(0.008)			(0.013)
Issuer FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Obs.	937	913	905	937	913	905
Adj. R^2	0.508	0.503	0.504	0.602	0.609	0.613

- Limitation: do not capture $ investment
  - Use Dummy *Is Adapt* equal 1 if part of issuance dedicated to flood risk adaptation
  - 15 percentage pts less likely to talk about adaptation, 19% of mean likelihood (0.76)

Conclusion

- Study how city-state partisan conflicts influence risk-sharing, ultimately impacting cities' cost of debt and investment decisions.
- Contrary to early research, we show that partisanship matters at the local level.
- Use a unique hand-collected dataset on political affiliation of U.S. mayors & their investment in hazard mitigation measures.
- We show: partisanship affects local governments' cost of capital, and generates moral hazard implications (↓ borrowing costs, ↓ investment in costly resiliency projects)
- Findings are not due to Dem/Rep cities holding partisan preferences over issues having fiscal impact, such as taxes and redistribution.
- Instead, results consistent with partisan alignment in a multi-tiered government system affecting the probability of State intervention, and agency frictions between state and local governments.