Corona crisis hits municipalities: revenues collapse, investments are at risk

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The coronavirus crisis is placing a heavy strain on municipalities. More than 90% of the treasurers who responded to a supplementary survey to the KfW Municipal Panel 2020 anticipate declining revenues, while some 60% expect rising expenditures. The crisis thus threatens to deal a significant blow to the budgets of many municipalities. It would bring the previous years' positive trend of increasing municipal investment to a standstill.

Given the backlog of municipal investment, which the KfW Municipal Panel 2020 estimates to be some EUR 147 billion, and the major societal challenges of the coming years, the time has come to secure municipalities' investment capacity and make municipal infrastructure fit for the future despite the current crisis – or precisely because of it.

Coronavirus crisis has shattered all plans

The coronavirus pandemic has upended personal and business life in Germany. Even if only a vague prediction can as yet be made of the economic impact, one thing is already clear: it is massive. Germany will experience a historic recession and the only uncertain thing about it is its severity and duration.

The crisis has also hit municipalities hard. While expectations had already clouded over in autumn of 2019 in the KfW Municipal Panel 2020 survey, sentiment deteriorated dramatically once again in the past months. A supplementary survey among the participants of the KfW Municipal Panel 2020 showed that more than 42% anticipate massive decreases in overall revenues for the year 2020, particularly as a result of falling tax revenues. In total, about 95% of the municipalities expect decreasing revenues, only 4% expect no change. At the same time, more than 60% of respondents predict rising expenditures.

Medium-term expectations are also alarming. Almost 90% of respondents continue to expect lower revenues for the years from 2021 onwards, even if 'only' just under 30% now predict sharply declining revenues. At the same time, most expect increases in almost all major expenditure categories – social expenditure, material expenditure and human resources. Capital expenditure is the exception, where 30% expect a decline.

This illustrates the well-known dilemma: when governments have less financial leeway, they mainly reduce what they perceive to be disposable expenses. This affects investment expenditure in particular, which is reflected in the fact that treasurers expect not just the level of investment to fall in the coming years but also its share of the budget. The crisis has thus again pushed investment down on the list of priorities.

This move may be understandable from a budget policy perspective but it is alarming for municipal infrastructure. After all, during the regular survey from autumn of 2019 for the KfW Municipal Panel 2020 it already became apparent that municipal investment needs were still high. At the same time, municipalities were facing challenges that hampered a (reasonable) capital expenditure increase. The main reasons given for holding back on capital expenditure were capacity constraints in the construction sector and the resulting fruitless tenders (45%), as well as building authorities‘ staff shortages (25%). Rising construction costs are another problem. Although they were rarely the reason for deferring expenditures, the high costs led to rising investment expenditure without creating any additional infrastructure.

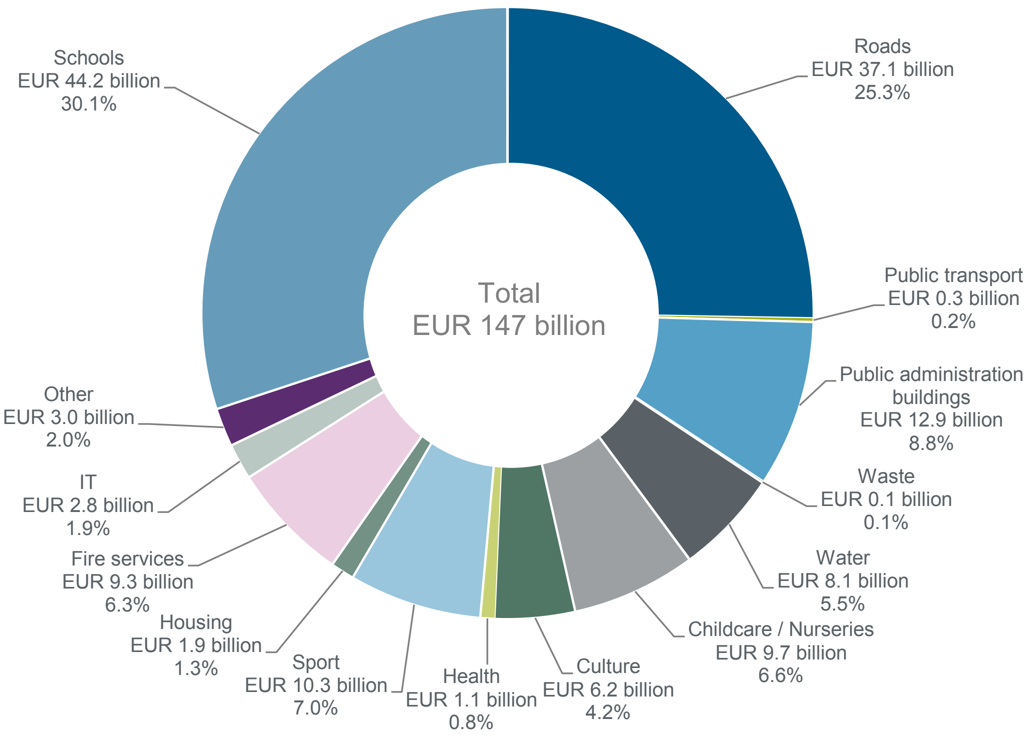
Risk of declining investment hampers reduction of backlog

With growing demands for quality municipal infrastructure and amid increasing difficulties in realising investment projects, it is not surprising that perceived investment backlogs identified in the KfW Municipal Panel 2020 are growing even as gross capital expenditure is rising. The estimate of around EUR 147 billion for 2019 is 6% higher than for the previous year. As in the prior years, a large portion of the investment backlog has grown in areas under the control of nearly all municipalities: schools (30%), roads (25%) and public administration buildings (9%).

In autumn of 2019, almost all municipalities still regarded the financing conditions for investment as adequate. Self-funding (38%) and promotional funds (28%) were the main sources. Municipal loans had a share of 19% of investment finance. Also thanks to the favourable financing conditions, around 75% of municipalities were still predicting that the investment backlog would decrease overall or at least remain steady. For schools and child daycare services, more than half of the treasurers even expected a decline. However, whether they will maintain this view in light of the crisis is open to question.

Note: This paper contains the opinion of the authors and does not necessarily represent the position of KfW.

Municipalities' perceived investment backlog (2019)



Source: KfW Municipal Panel 2020

Municipalities need modern infrastructure

In addition to their immediate task of managing the crisis, municipalities also have to perform their 'regular functions‘. In recent years, the KfW Municipal Panel already revealed problems in maintaining existing infrastructure, taking very little account yet of additional investment needs resulting from new megatrends. The crisis highlighted some of the challenges, such as the potentials and pent-up needs in the area of digitalisation. There is a risk that others, such as adapting to demographic change, may fade into the background as a result of the crisis. However, the increase in the perceived investment backlog in the KfW Municipal Panel shows that these challenges have not gone away. On the contrary, they must be vigorously addressed in the coming years!

In order to tackle these challenges, municipalities need efficient infrastructure. The only way to create it is with the right investment – in the right volume and the right priorities. Municipalities also need sufficient scope to be able to put in place the investment strategy that is right for them. But the crisis has diminished this scope considerably for many. The supplementary survey has shown that municipalities therefore want certainty about the financial consequences more than anything. That is hardly surprising because lack of funds (48%) and staff shortages (19%) were already the main drivers of the investment backlog in the survey of autumn of 2019. If the successes gained in increasing municipal investment over the past years are not to be jeopardised, the municipalities' capacity to invest must be maintained during and after the crisis as well.

Thus, the findings of the KfW Municipal Panel illustrate yet again that municipalities require, above all, budgetary planning certainty with a long-term perspective if they are to fulfil their important role for public investment. Right now, giving municipalities this certainty is a core task of policymakers. After all, the investment expenditure secured in this way would ultimately not just help foster growth during the coronavirus crisis but also contribute sustainably to securing our country's long-term prosperity.

About the supplementary survey

Under the supplementary survey, in April 2020 more than 400 participants of the KfW Municipal Panel were asked by the German Institute of Urban Affairs (Difu) for their assessment of the current situation.

You can find a more detailed evaluation of the findings at www.kfw.de/research-kommunen. (Available in German only)

The KfW Municipal Panel

The KfW Municipal Panel is based on an annual survey of treasuries of cities and municipalities with more than 2,000 inhabitants and of all regional districts. The survey is conducted by the German Institute for Urban Affairs (Difu) and supported by the leading municipal associations. The panel advisory board includes municipal representatives and researchers.

The complete KfW Municipal Panel can be accessed at www.kfw.de/kommunalpanel. (Available in German only)

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