Made by History

The Fed could undo decades of damage to cities. Here’s how.

The bond market has fueled vast inequities between cities and suburbs — especially in smaller locales.

If a new Federal Reserve initiative is done correctly, it could impact almost every single American and eradicate a lending market that has long undermined economic opportunity for African Americans in particular. (Andrew Harrer/Bloomberg News)

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On April 9, the Federal Reserve announced a plan to ease the burdens of cities crippled by the unexpected and widening budget shortfalls created by the coronavirus pandemic. The new Municipal Liquidity Facility

initiative essentially allows the Fed to purchase an eligible city's short-term debts. As currently proposed, it will only apply to cities with populations exceeding 1 million.

To be sure, black Americans in large cities like Chicago, New York City and Philadelphia might indirectly benefit through Fed funds channeled into preventive operations. But as others have noted, the population threshold threatens to exclude smaller cities with majority black populations, many of which already suffer from a chronic underinvestment in local infrastructure. Coupled with the disproportionate toll covid-19, the disease caused by the coronavirus, is taking on African Americans across the United States, such a policy that privileges larger municipalities while trying to alleviate economic hardship seems to once again reinforce racial inequality.

As outlined, the plan creates a two-track system that provides direct federal relief to eligible large municipalities but leaves smaller municipalities subject to the terms of the private market. But, if done correctly, this plan could impact almost every single American and eradicate a lending market that has long undermined economic opportunity for African Americans in particular.

A seldom-told story is that municipal debt is the primary way cities fund infrastructure. In good times and bad, amid economic growth and budgetary shortfalls, cities regularly issue bonds to finance water and sewage systems, schools and parks.

It works like this. Cities issue bonds through the private bond market — a network of banks, investors, credit rating analysts and sellers of information who stake their fortunes on the infrastructural needs of everyday Americans. Just as Ford's Detroit automobile plants gave rise to manufacturers supplying ancillary machinery and parts, the sale of a bond affords real estate developers, pipe manufacturers, concrete suppliers and glassmakers the opportunity to profit through the conversion of borrowed funds into basic infrastructure. In exchange for lending, bondholders collect principal and tax-exempt interest income backed by layers of guarantees. Although yields are relatively low, municipal debt is one of the safest assets and bondholders hold all the advantages.

America's cities became increasingly dependent on the bond market after World War II. The municipal bond market was hardly race neutral. A billion dollar industry, it was powered by an ideology and politics that, similar to federal housing policy, gave preference to white middle-class consumption and the social mobility of white Americans more generally.

Federally guaranteed mortgages "pulled" eligible white Americans from the city to the suburbs. The partnership between federal housing officials, mortgage bankers and real estate agents triggered the divestment of mortgage capital from the city and increased demands for debt-financed schools, parks and playgrounds in suburban areas. The flight of white Americans who still worked or shopped in the downtowns of urban America mandated not only new highways, but also parking facilities, new streets and roads. Bond financiers profited from white flight and the desperate pursuit of cities to attract white middle-class Americans as workers and consumers. They could have their cake and eat it, too.

In the 20 years after World War II, a period of relatively low interest rates, local governments borrowed billions through the bond market. And yet, black children in cities around the country continued to attend underfunded schools. Streets went unpaved, and adequate parks and recreational facilities in black neighborhoods were hard to come by. This was in part the result of credit analysts seeing suburban bonds as more appealing.

By the late 1960s the will to address these inequities clashed with rising interest rates, outright racism, tax revolts and the power of credit rating analysts. New York City, Detroit, Boston, Baltimore and Cincinnati saw their bonds downgraded during the decade. Some thought the urban uprisings in these cities triggered a downgrade. Others stressed such long-term trends as white middle-class suburbanization and the urban concentration of low-income minorities.

The riots and concurrent migrations, in other words, seemed to threaten the "proper" ratio of revenue to expenditures, and threatened the stability of the city itself. Credit analysts treated city revenue and expenditures as mere reflections of objective conditions. But, despite the technocratic discourse, credit analysts themselves were not immune from imagining the city as a blighted space dragged down by poor black people.

Municipal officials acknowledged the complexity of interest rates, but agreed that a downgrade affected the cost to borrow. Higher interest rates meant fewer hospitals and classrooms, reduced water and sewer lines and a greater chunk of expenditures tied to interest payments. And over the long run, the inability to improve these facilities snapped back onto the city's credit profile making them that much harder to improve. Here was a feedback loop of penalties rooted in dependence on the bond market.

As Rep. Wright Patman (D-Tex.) put it back then, instead of being "based on a genuine sound analysis of finance," rating agencies "just reach up out of thin air and pull down these triple A and double A ratings." If only a slight exaggeration, Patman and others nevertheless observed something unjust: Bond raters effectively penalized cities for decades of federal support for America's suburbs. It could be said that these cities were downgraded for the nation's history of interlocking forms of racial discrimination.

The number of people living in American cities cannot be treated as a function of abstract processes, individual choice or moral tales of black pathology or white backlash. As a metric, "population size" is itself the product of historic forces, some of which were shaped at the local level, but most of which fell outside of local control. Indeed, the size of a city is the reflection of migrations to and from it, and the attendant rationales — be it climate breakdown, racial terrorism or otherwise; the push of taxation and the pull of subsidies; the rise and fall of industries; segregated labor markets and racist housing policies.

The structural dependence of cities on a racially inflected market is what makes the Fed proposal a potential watershed. It decouples infrastructure and social services from the whims of the market, and offers a blueprint for jurisdictions, large or small, rich or poor, majority black or not, to seek an infusion of funds. But only if the Municipal Liquidity Facility broadens its criteria to include not only small cities and counties, but other political jurisdictions, too.

Consider how this might affect Milwaukee, a city of roughly 600,000 and one of the most racially segregated cities in America that is in desperate need of support to handle the alarming covid-related deaths of its black residents. Or how it might impact a commonwealth like Puerto Rico, decimated by an anemic federal response following a series of hurricanes that weakened its protective infrastructure, from housing to health care.

Eliminating population thresholds entirely and instead prioritizing cities that are majority black, territories with preexisting debts and municipalities already suffering from hospital closures, overcrowded living facilities, homeless shelters and county jails would lesson the racial and spatial inequalities that have reigned for decades. Why? Because it would enable municipalities to avoid the punitive credit ratings that devalue certain regions or populations over others.