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Revenue Systems, Governance Structures and Fiscal Health: A Critical Review of U.S. Municipal Finance in Large Cities

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Abstract

This review critically examines the complex interplay between revenue systems, governance structures, and fiscal health in large U.S. cities. It addresses two primary research questions: (1) Does a diversified mixture of revenue streams in large cities enhance fiscal conditions and improve service delivery? The review explores whether cities that rely on a broader array of revenue sources—such as taxes, fees, and transfers—are better equipped to manage economic shocks, maintain budgetary balance, and fund essential public services equitably. It further considers how revenue diversity may affect long-term fiscal stability and reduce dependence on volatile or regressive funding mechanisms. (2) Do cities with a council-manager form of government exhibit better fiscal health compared to other governance structures? This question probes the influence of professionalized administration, separation of powers, and managerial accountability on budgetary outcomes. It evaluates whether such governance arrangements are more likely to implement sound fiscal practices, avoid deficits, and ensure transparency in financial decision-making.

By synthesizing existing literature and empirical evidence, the review aims to elucidate the relationships between revenue generation strategies, institutional governance models, and fiscal outcomes. It explores how cities rely on property taxes, sales taxes, user fees, and intergovernmental transfers, and how these are influenced by political, economic, and institutional factors. The analysis further interrogates the impact of governance frameworks—particularly the distinctions between council-manager and mayor-council systems—on fiscal performance. The findings contribute to a nuanced understanding of municipal fiscal health and provide insights to inform policy discussions on sustainable and effective urban financial management.

Keywords: Revenue diversification, municipal finance, council-manager governance, fiscal health, urban economics, U.S. cities, local governments, service delivery, governance structures.

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Introduction

In the evolving landscape of urban governance, the fiscal health of large U.S. cities has become a focal point of scholarly inquiry. Fiscal health, defined as a city's ability to generate sufficient revenue to meet its expenditure obligations while maintaining service quality and financial stability, is influenced by various factors, including revenue structures and governance models (Chernick & Reschovsky, 2017). This review examines how variations in revenue systems and governance structures affect the fiscal health of large U.S. cities.

Revenue diversification refers to the strategy of broadening the sources of municipal income beyond traditional means such as property taxes. By incorporating alternative revenue streams like sales taxes, service fees, and intergovernmental transfers, cities aim to reduce fiscal vulnerability and enhance financial resilience (Carroll, 2009). Empirical studies suggest that a diversified revenue portfolio can mitigate the impact of economic downturns and stabilize

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municipal budgets (Hendrick, 2006). However, the effectiveness of diversification strategies may vary based on local economic conditions and administrative capacities.

Governance structures also play a critical role in fiscal management. The council-manager form of government, characterized by a professional administrator appointed by an elected council, is posited to promote efficient and effective fiscal practices. This model contrasts with the mayor-council system, where an elected mayor holds executive authority. Research indicates that council-manager cities often exhibit better fiscal performance, attributed to professional management and reduced political interference in administrative decisions (Carr & Karuppusamy, 2009). Nevertheless, the relationship between governance structure and fiscal health is complex and may be influenced by factors such as political culture and institutional arrangements.

This review addresses two primary research questions: (1) Does a diversified mixture of revenue streams in large cities enhance fiscal conditions and improve service delivery? (2) Do cities with a council-manager form of government exhibit better fiscal health compared to other governance structures? By synthesizing existing literature and empirical evidence, the review aims to elucidate the interplay between revenue systems, governance models, and fiscal outcomes in large U.S. cities. The findings will contribute to a nuanced understanding of municipal fiscal health and inform policy discussions on effective urban financial management.

Theoretical Framework

Fiscal federalism and revenue diversification

Fiscal federalism theory provides a framework for understanding the allocation of fiscal responsibilities and resources among different levels of government. At its core, the theory posits that decentralized governments are better positioned to tailor revenue mechanisms to local preferences, potentially leading to more efficient and responsive public service delivery (Oates, 1999). This decentralization allows subnational governments to design and implement fiscal policies that align with the specific needs and preferences of their constituencies.

Revenue diversification, within this context, refers to the strategy of broadening the sources of municipal income beyond traditional means such as property taxes. By incorporating alternative revenue streams like sales taxes, service fees, and intergovernmental transfers, cities aim to reduce fiscal vulnerability and enhance financial resilience (Carroll, 2009). Empirical studies suggest that a diversified revenue portfolio can mitigate the impact of economic downturns and stabilize municipal budgets (Hendrick, 2006). For instance, a study by Jimenez and Afonso (2022) found that diversifying to non-tax sources improves budgetary solvency, as indicated by higher government-wide operating ratios and reserves.

However, the application of fiscal federalism theory to revenue diversification is not without challenges. Krane, Ebdon, and Bartle (2004) argue that the recent diversification of municipal revenue sources in response to devolutionary forces does not always align with the expectations of fiscal federalism theories. Their analysis suggests that the use of an institutional approach to the study of fiscal federalism would help to reduce the mismatch between theory and reality. This indicates that while fiscal federalism provides a useful framework, it may not fully capture the complexities and nuances of municipal revenue diversification in practice.

Moreover, the effectiveness of revenue diversification strategies may vary based on local economic conditions and administrative capacities. For example, Hendrick (2019) notes that revenue diversification is more productive in rural areas with higher incomes or in rural areas which serve as regional marketing or tourist centers than in rural areas without these characteristics. This suggests that the benefits of revenue diversification are not uniformly distributed and depend on specific contextual factors.

Institutional theory and municipal fiscal health

Institutional theory offers a framework for understanding how formal structures, norms, and routines shape organizational behavior and outcomes. In the context of municipal governance, this theory posits that cities adopt certain administrative practices and structures not solely based on efficiency but also to gain legitimacy and align with established norms (Scott, 2008). This perspective is particularly relevant when examining the fiscal health of cities, as institutional arrangements can significantly influence financial decision-making processes.

One application of institutional theory in municipal governance is the adoption of the council-manager form of government. This structure, characterized by a professional manager appointed by an elected council, is often perceived as a means to enhance administrative efficiency and reduce political interference in fiscal matters (Carr & Karuppusamy, 2009). The professionalization of city management aligns with institutional norms that value expertise and rational decision-making, thereby promoting fiscal stability.

Empirical studies support the notion that institutional structures impact fiscal outcomes. For instance, Freeland (2024) analyzed California municipalities and found that cities with certain institutional arrangements, such as contracting out public safety services, exhibited stronger fiscal health. This suggests that institutional choices, influenced by prevailing norms and practices, can lead to more sustainable financial management.

However, institutional theory also acknowledges that organizations may adopt certain structures to conform to external expectations, even if these do not lead to improved efficiency—a concept known as institutional isomorphism (DiMaggio & Powell, 1983). This implies that while adopting the council-manager model may signal a commitment to good governance, it does not automatically guarantee better fiscal health. Other factors, such as local economic conditions and administrative capacity, also play critical roles.

Empirical Evidence on Revenue Diversification

Empirical research underscores the significance of revenue diversification in enhancing the fiscal health of large U.S. cities. Diversification, defined as the expansion of municipal revenue sources beyond traditional property taxes, aims to stabilize income streams, mitigate fiscal stress, and improve service delivery. However, the effectiveness of diversification strategies varies based on local contexts and governance structures.

Hendrick (2006) analyzed 260 suburban municipalities in the Chicago metropolitan area, revealing that communities with more diversified revenue structures exhibited lower tax effort, suggesting improved fiscal capacity. This effect was more pronounced in home rule municipalities, which possess greater autonomy in revenue generation. The study indicates that revenue diversification can reduce reliance on property taxes, thereby enhancing fiscal flexibility.researchgate.net

Jimenez and Afonso (2022) conducted a comprehensive study of over 500 midsized and large U.S. cities from 2006 to 2012, finding that diversification into non-tax sources, such as service charges and fees, positively impacted budgetary solvency. Conversely, diversification within the tax structure, like increasing sales taxes, did not yield similar benefits and, in some cases, negatively affected fiscal health. This distinction emphasizes the importance of the types of revenue sources in diversification strategies.

Case studies further illustrate the implications of revenue structures. Boston, for instance, relies heavily on property taxes, which constituted 71.1% of its operating revenue in FY25, up from 55.9% in FY06 (Boston Municipal Research Bureau, 2024). This heavy dependence limits fiscal flexibility and exposes the city to risks associated with property market fluctuations. In contrast, cities like El Paso and Las Vegas benefit from overlapping governmental units, such as county governments and independent school districts, which share the responsibility of providing public services. In these cities, municipal governments account for less than a quarter of total local public service expenditures, with the remainder managed by other entities (Chernick et al., 2014). This structure allows for a more diversified revenue base and shared fiscal responsibility.

However, revenue diversification is not without challenges. Hendrick (2019) notes that while diversification can enhance fiscal health, its effectiveness is contingent upon factors such as local economic conditions and administrative capacity. Moreover, the presence of overlapping jurisdictions can complicate fiscal management and accountability.

Governance Structures and Fiscal Outcomes

Empirical research on municipal governance structures in the United States has consistently examined the fiscal implications of the council-manager and mayor-council forms of government. The council-manager model, characterized by a professionally appointed city manager overseeing administrative operations, is often contrasted with the mayor-council model, where an elected mayor holds executive powers. These structural differences have been linked to variations in fiscal performance and political dynamics within municipalities.

Carr (2015) conducted a comprehensive review of studies comparing these governance forms and found that council-manager governments tend to exhibit more professional management practices, leading to improved fiscal outcomes. The professionalization inherent in the council-manager model is associated with more strategic budgeting and long-term financial planning, which can enhance fiscal stability. Conversely, mayor-council governments, particularly those with strong mayor systems, may experience fiscal challenges due to the concentration of executive power and potential for politicized decision-making.

Coate and Knight (2009) developed a theoretical framework suggesting that mayor-council governments might lead to lower public spending due to the checks and balances between the mayor and council. However, their empirical analysis revealed that cities transitioning to a mayor-council form experienced a 9% reduction in per capita spending, indicating that this structure might constrain fiscal expansion. While reduced spending can be beneficial in controlling budgets, it may also limit the capacity to invest in essential public services.

Further empirical evidence by McDonald (2018) indicates that the presence of a professional city manager correlates with better fiscal health indicators, such as higher fund balances and lower debt levels. This suggests that the administrative expertise in council-manager governments contributes to more prudent fiscal management. In contrast, mayor-council governments may be more susceptible to fiscal stress due to political considerations influencing budgetary decisions.

However, it's important to note that the relationship between governance structure and fiscal outcomes is not solely deterministic. Factors such as local economic conditions, demographic characteristics, and state-level policies also play significant roles. For instance, cities with robust economic bases may maintain fiscal health regardless of governance form, while those facing economic decline may struggle despite professional management.

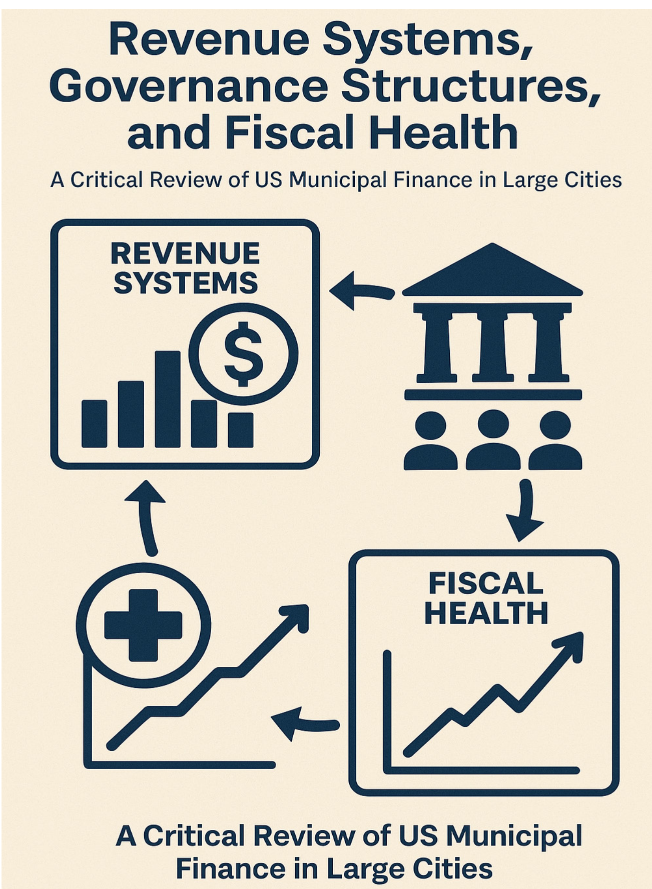

Figure 1: Revenue System, Governance Structure and fiscal Health

Interplay Between Revenue Diversification and Governance

The interplay between revenue diversification and municipal governance structures significantly influences the fiscal health of large U.S. cities. Empirical studies suggest that the effectiveness of revenue diversification strategies is contingent upon the governance model in place, particularly highlighting the advantages of the council-manager form over the mayor-council system.

In the council-manager model, professional city managers are appointed to oversee administrative operations, promoting a focus on efficiency and long-term planning. This professional management structure facilitates the strategic implementation of diversified revenue streams, such as service charges and fees, which are less volatile than traditional tax revenues. Jimenez and Afonso (2022) found that diversification into non-tax sources positively impacts budgetary solvency, indicating that professional management can effectively leverage these revenue types to enhance fiscal stability.

Conversely, the mayor-council model, characterized by an elected mayor with executive powers, may introduce political considerations into fiscal decision-making. This structure can lead to prioritization of short-term political gains over long-term fiscal health, potentially undermining the benefits of revenue diversification. Hendrick (2019) observed that in such politically driven environments, the implementation of diversified revenue strategies might not yield the intended fiscal stability due to inconsistent policy application and potential misalignment with long-term financial planning.

Moreover, the presence of overlapping governmental units, such as independent school districts and county governments, can influence the effectiveness of revenue diversification. Cities like El Paso and Las Vegas, which benefit from such overlapping structures, have demonstrated more stable fiscal conditions, suggesting that the broader governance context plays a role in the success of diversification strategies (Chernick & Reschovsky, 2017).

Policy implications of these findings emphasize the need for municipalities to consider their governance structures when designing and implementing revenue diversification strategies. Adopting a council-manager model may provide the professional management necessary to effectively utilize diversified revenue streams, thereby enhancing fiscal health and service delivery. Additionally, fostering intergovernmental collaboration can further support the stability and efficiency of municipal finances.

Conclusion

In conclusion, this review has demonstrated that both revenue diversification and the council-manager form of governance play significant roles in strengthening the fiscal health of large cities in the United States. Municipalities that adopt a diversified mix of revenue sources—extending beyond reliance on property taxes to include fees, service charges, and intergovernmental transfers—appear more resilient in the face of economic fluctuations and better equipped to maintain service delivery. Similarly, cities that operate under the council-manager model often show superior fiscal performance, largely due to the professionalized management and long-term financial planning that such systems promote.

However, the evidence reviewed also reveals that neither revenue diversification nor governance structure functions in isolation. The effectiveness of revenue strategies is influenced by the institutional context in which they are implemented. Professional city managers in council-manager systems are typically more capable of aligning revenue policies with long-term goals, whereas mayor-council systems may be more vulnerable to political pressures that compromise fiscal sustainability. Furthermore, overlapping governmental responsibilities and state-level mandates can complicate the relationship between local policy and fiscal outcomes, suggesting that broader governance ecosystems must be considered in any analysis.

These findings align with key tenets of institutional theory, which suggests that organizational structures and norms, such as professional city management, shape financial behaviors and outcomes (Scott, 2008). The professionalization inherent in the council-manager system reflects institutional isomorphism, where municipalities adopt widely accepted governance models not only for efficiency but also to legitimize their practices (DiMaggio & Powell, 1983). This theoretical perspective helps explain why some cities implement fiscal strategies that mirror best practices, even when local contexts differ.

Furthermore, the review supports insights from fiscal federalism theory (Oates, 1999), which emphasizes the role of decentralized governance in aligning revenue and expenditure decisions with local needs. The evidence suggests that revenue diversification is most effective when matched with local administrative capacity and governance structures that prioritize long-term stability over short-term political gains.

Nonetheless, revenue strategies and governance models do not operate in isolation. Their success depends on contextual factors such as economic conditions, overlapping governmental jurisdictions, and civic engagement. The complexity of these interrelationships underscores the importance of integrated policy frameworks that consider both institutional arrangements and fiscal strategy.

Despite the insights gained, several questions remain. Much of the current literature is cross-sectional and unable to establish causal relationships. Longitudinal studies are needed to determine how changes in governance or revenue structure over time affect fiscal health. In addition, greater attention should be paid to the role of local political cultures, voter preferences, and civic engagement in shaping fiscal choices. Future research should also explore the interaction between local and state fiscal policies, the distributional effects of revenue diversification, and the potential of hybrid governance models that combine elements of both major forms.

Ultimately, a deeper understanding of these dynamics will be essential for crafting fiscal policies that are both equitable and sustainable in an era of urban financial uncertainty.

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