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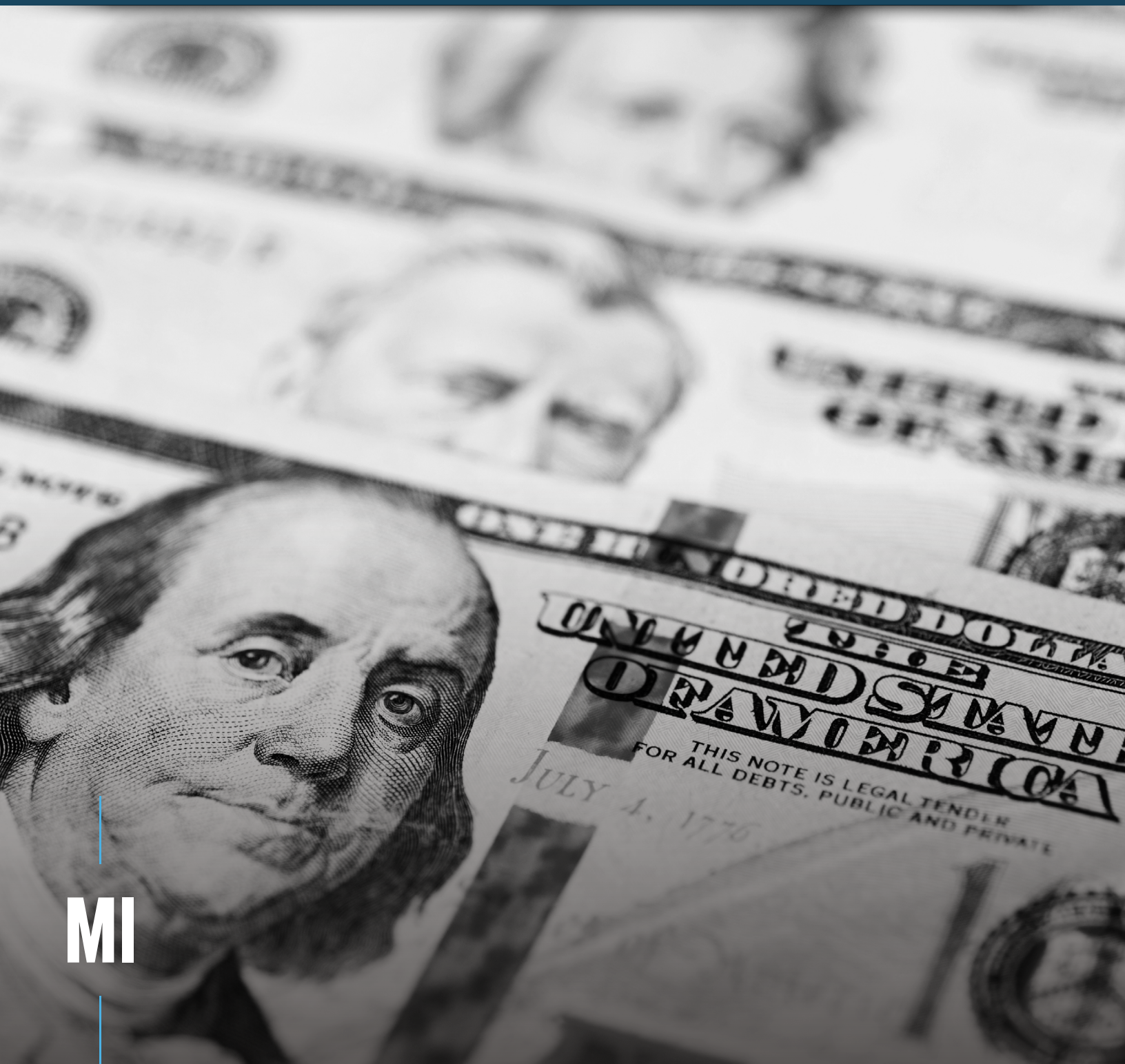
WHEN CITIES ARE AT THE FINANCIAL BRINK

The Case for "Intervention Bankruptcy"

Daniel DiSalvo
Senior Fellow

Stephen Eide
Senior Fellow



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About the Authors

Daniel DiSalvo is a senior fellow at the Manhattan Institute and an associate professor of political science in the Colin Powell School at the City College of New York–CUNY.

DiSalvo's scholarship focuses on American political parties, elections, labor unions, state government, and public policy. He is the author of *Engines of Change: Party Factions in American Politics, 1868–2010* (2012) and *Government Against Itself: Public Union Power and Its Consequences* (2014). DiSalvo writes frequently for scholarly and popular publications, including *National Affairs*, *City Journal*, *American Interest*, *Commentary*, *The Weekly Standard*, *Los Angeles Times*, *New York Daily News*, and *New York Post*. He is coeditor of *The Forum: A Journal of Applied Research in Contemporary Politics*. DiSalvo holds a Ph.D. in politics from the University of Virginia.

Stephen Eide is a senior fellow at the Manhattan Institute. His work focuses on public administration, public finance, political theory, and urban policy. His writings have been published in *Politico, Bloomberg View, New York Post, New York Daily News, Academic Questions, The Weekly Standard, Wall Street Journal*, and *City Journal*.

Eide was previously a senior research associate at the Worcester Regional Research Bureau. He holds a B.A. from St. John's College in Santa Fe, New Mexico, and a Ph.D. in political philosophy from Boston College.

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Executive Summary

Many local governments today are on the verge of insolvency. Prominent examples include Atlantic City, New Jersey; the Chicago Board of Education; and Hartford, Connecticut.

For various structural reasons, including entrenched poverty and near-historical debt levels, many more cities are likely to suffer fiscal distress in the coming years. The risk of insolvency for large cities is now higher than at any point since the federal government first passed a municipal bankruptcy law in the 1930s.

But the recent experience of some bankrupt cities, as well as much legal scholarship, casts doubt on the effectiveness of municipal bankruptcy. To strengthen government's ability to address municipal insolvency, this report argues that federal bankruptcy and state intervention, which are often posed as alternative approaches, should be combined. We call this approach "intervention bankruptcy."

Crucially, state governments, whose consent is legally required for any locality to file for bankruptcy, should intervene at the outset and appoint a receiver before allowing a city or other local government entity to petition for bankruptcy in federal court. No municipal bankruptcy should be authorized if local officials will direct it.

Key Findings:

- Cities' debt levels are near all-time highs, and the risk of municipal insolvency is greater than at any time since the Great Depression.
- Recent experience with municipal bankruptcies indicates that when local officials manage the process, they often fail to propose the changes necessary to stabilize their city's future finances.
- Suggested legal changes to grant federal judges more power in municipal bankruptcies are, at best, uncertain to be enacted and are, in any event, ill-suited to this nation's federalist structure.
- Many fiscally distressed cities need operational reforms, in addition to less debt and a balanced budget. State-appointed experts are best positioned to implement such restructuring programs.

WHEN CITIES ARE AT THE FINANCIAL BRINK | The Case for "Intervention Bankruptcy"

I. Introduction

In a corporate bankruptcy (Chapter 11), federal judges have significant latitude over the company's finances, operations, and exit plan. They do not have equivalent control over a municipality because to do so would allow an arm of the federal government (a bankruptcy court) to intrude into state and local affairs and violate principles of federalism and local democracy. Instead, municipal bankruptcy (Chapter 9) allows cities great control over their budgets, assets, operations, and plan of debt adjustment. Courts do not restructure a city's operations—and the local officials in charge when a city went bankrupt prepare the plan for exiting bankruptcy.

Consequently, some cities—most notably, those in California (Vallejo, Stockton, San Bernardino)—have emerged from bankruptcy only modestly improved. In response to political pressure from public-sector unions and other stakeholders, the cities' officials declined to avail themselves of the full scope of bankruptcy's powers. They are thus at risk of another trip through bankruptcy in the future.

But California takes a notably hands-off approach to municipal insolvency. Others states, such as Michigan and Rhode Island, have appointed a receiver to manage municipalities' bankruptcy process. They have fared better in federal court. State governments are, to be sure, hardly models of fiscal probity. But nonelected state appointees are less likely to bend to local political pressures than mayors and city council members. Based on experience, we argue that before allowing a city to file for bankruptcy, states should intervene and appoint disinterested experts in bankruptcy law, public finance, and related fields who are not affiliated with any local interested parties.

Legal scholars have long been aware of the ineffectiveness of municipal bankruptcy and have offered several recommendations for reform. Some have proposed modifying municipal bankruptcy law to give federal judges more power over local finances and operations. Others have argued that judges should find indirect ways to assert their authority through the existing Chapter 9 framework. Still others have argued that municipal bankruptcy should, in effect, be replaced by more aggressive interventions by state governments to take preventive action against municipal fiscal distress. Some have even suggested empowering states to create their own bankruptcy courts.

The "intervention bankruptcy" proposal in this report has the advantage of making bankruptcy more effective without needing to modify federal law or empower judges who may lack the competence or perceived legitimacy to restructure bankrupt city governments. States' debt-adjustment powers are extremely limited. When solvency requires breaking contracts—collective bargaining, bond covenants, and retirement benefit obligations—municipal bankruptcy under federal law is necessary. State authorities' ability to break contracts is legally uncertain, at best.

In the following report, we (1) document how the threat of fiscal distress still looms over the municipal landscape; (2) explain the different purposes of oversight, intervention, and bankruptcy; (3) contrast the outcomes of a number of recent bankruptcies; and (4) make the case for what we call intervention bankruptcy. States should make bankruptcy available to their insolvent cities as a last resort, but they should not authorize a city's Chapter 9 petition without first appointing a receiver. The receiver should craft the plan of adjustment and work hand in glove with the federal bankruptcy judge if the petition is granted.

II. Fiscal Distress, Insolvency, and Bankruptcy

In discussing the financial challenges of America's state and local governments, several different terms are used, sometimes interchangeably and without precision. It is therefore useful to define "fiscal distress," "insolvent," and "bankruptcy."

A *fiscally distressed* city is one whose recurring revenues cannot fund both its contractual spending commitments and reasonable public demands for government services. Cities in this condition face tension between the obligations of the past and the needs of the present and future. Frequently, cities react to distress through delay and gimmicks.

A structural budget imbalance, in which recurring expenditures exceed recurring revenues, may be temporarily addressed through one-time fixes such as selling or leasing city-owned assets and then dedicating the proceeds to operating costs, or by drawing down reserves. In the mid-1990s, Washington, D.C., backdated its property-tax calculations to book $174 million in revenues for fiscal year 1993 instead of 1994.[1] To balance its fiscal year 2017 budget, Hartford, Connecticut, transferred a city park to its retirement system and counted this as part of its annual pension contribution.[2]

Cities can perform such fiscal triage for many years. Some localities have remained in Pennsylvania's Act 47 program for distressed cities since the mid-1980s.[3] However, some cities reach a point where it becomes impossible to service their debt without cutting public services to unacceptably low levels. It is at this point that a city is in danger of becoming *insolvent*.

All insolvent cities are fiscally distressed, but not all fiscally distressed cities are insolvent. An insolvent city cannot pay its bills as they come due. It is in default and susceptible to a lawsuit from one or more of its creditors. Delay is no longer possible, and a decision must be made whether to file for bankruptcy, try to negotiate a "workout" with creditors, or obtain extraordinary assistance from state government.

In addition to creditors, cities are concerned about residents. Some municipal bankruptcy judges have recently spoken of "service-delivery insolvency," connoting a state when municipal outlays for core services cannot be cut further.[4] Public finance attorney James Spiotto has argued that cutting government services below a certain level, even if necessitated to fund other fiscal obligations such as pensions, is illegal because it violates provisions in state constitutions that require municipalities to maintain an adequate level of public services.[5] However, in practice, it can be difficult to distinguish between a distressed city's *unwillingness* to pay its debts and its *inability* to do so.

Bankruptcy is often used in a casual or figurative way today by journalists and others to indicate that a city is either insolvent or in severe fiscal distress. (States cannot go bankrupt.) The technical meaning, however, refers to a specific legal status, in which a municipality is protected from creditor lawsuits while it negotiates with creditors and prepares a plan for debt adjustment to be approved by a federal judge.

In principle, any insolvent city could negotiate a consensual plan with its creditors without the assistance of a federal court. But when collective action problems

make that impractical—the longer that creditors hold out, the more leverage they gain over a debtor who is eager to settle with them—Chapter 9 provides a specific process for renegotiating debts. Bankruptcy, therefore, carries with it certain privileges—most notably, the ability to cut debt obligations over creditors' objections.

Congress did not grant cities access to bankruptcy until the Great Depression. Municipalities are the legal creations of state governments, and up until the 1930s, it was held that federal intervention into local government finances, as municipal bankruptcy would entail, was prohibited out of respect for the Tenth Amendment and states' sovereignty. Nor did states have municipal bankruptcy laws because they were prohibited by the Constitution (Article I, section 10) from impairing the obligation of contracts—something only the federal government can do.[6]

III. Why the Risk of Municipal Insolvency Is Now So High

To access bankruptcy, federal law requires that a city pass a "cash-flow insolvency test," by which it demonstrates to the court that it truly cannot pay its contractual debt obligations on time and in full. State government must authorize the filing—cities cannot simply "declare" bankruptcy, and there is no constitutional right to municipal bankruptcy.[7]

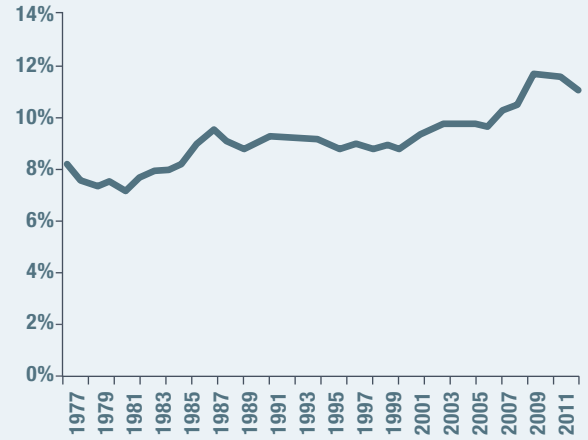
In a corporate bankruptcy, a federal court or a creditor may propose a bankruptcy exit plan. In a municipal bankruptcy, the city (i.e., the debtor) retains that right. A bankrupt city's plan of adjustment concerns how much less it should pay its "Main Street" (retired workers) and "Wall Street" (bondholders) creditors relative to what they were owed. In deciding whether to approve a city's plan, federal law requires that judges assess the plan's "floor" (does it provide all creditors with at least some payment?) and "ceiling" (does it cut enough to truly stabilize a municipal debtor's finances?).

Municipal bankruptcy is a rare event, especially for large, general-purpose local governments, such as cities. The requirements of cash-flow insolvency and state consent impose high barriers that have prevented even cities that filed for bankruptcy from accessing it, such as Bridgeport, Connecticut, in 1991; Camden, New Jersey, in 1999; and Harrisburg, Pennsylvania, in 2011. Since bankruptcy was made available to cities in the 1930s, courts have dismissed as many as one-quarter of Chapter 9 petitions.[8] Chapter 9 is mostly used for small, single-purpose government entities, such as water or park districts, that rely on a specific revenue source to provide an equally specific service and may not even have any employees. A 2012 study by Spiotto and his colleagues found that of the 262 "municipalities" that filed for bankruptcy between 1980 and 2011, only 49 were "cities, villages and counties."[9] According to Omer Kimhi, a law professor at the University of Haifa, of the 40 general-purpose municipal bankruptcies filed between 1976 and 2009 in the U.S., only about 30 were approved, and the median population of those municipalities was only about 1,000.[10]

Cities are often reluctant to file for bankruptcy because of the cost, time, and uncertainty associated with the process. After filing for bankruptcy in the summer of 2012, San Bernardino, California, only recently had its bankruptcy exit plan approved. Navigating the Chapter 9 process requires a city to, in effect, create a new

FIGURE 1.

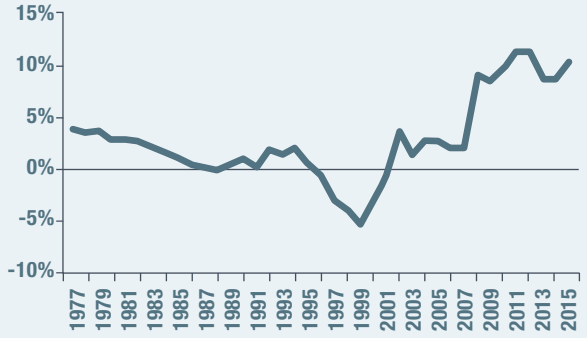
Local Governments' Debt as a Share of GDP, 1977–2013



Source: The U.S. Census Bureau and Bureau of Economic Analysis[14]

FIGURE 2.

State and Local Pension Debt as a Share of GDP, 1977–2015



Source: The U.S. Census Bureau and Bureau of Economic Analysis[14]

"bankruptcy department" composed of highly compensated lawyers, consultants, and finance experts. This is a significant burden for an insolvent city. Vallejo, California, spent in excess of $10.6 million on lawyers' fees alone.[11] Detroit's bill for bankruptcy-related professional services was $170 million.[12] And the outcome of bankruptcy is uncertain. Cities that place too much priority on exiting bankruptcy as soon as possible may find themselves forced to settle with creditors on unfavorable terms. The more leverage that creditors (i.e., bondholders and pensioners) have, the less a city and its taxpayers will get out of the bankruptcy process.

Although still rare, the number of large-city bankruptcies has been growing. Of the five largest municipal bankruptcy filings in American history, all but one (Orange County, California) occurred within the last six years.[13] The trend is likely to continue for three reasons. First, localities' debt levels are near an all-time high. **Figure 1** shows how local governments' bonded debt total has grown relative to GDP since the 1970s. **Figure 2** shows how state and local pension debt has grown relative to GDP since the 1970s.

The rise in retirement benefits debt is particularly troubling. In contrast to much bonded debt, debt associated with retirement benefits is not subject to statutory limits or requirements for voter approval. Pension debt represents the gap between assets (the size of the jurisdiction's pension fund) and liabilities (how much has been promised in the way of benefits). Because a worker's defined benefit pension is calculated based in part on years of service, the size of a city's liability automatically increases each year.

Public pension systems' funding plans assume an investment rate of return of 7%–8%, which means that these systems actually need close to a 10% return on their stock portfolios—since the funds also own much lower-yielding bonds.[16]

Thus, even if the economy is growing and investment returns are positive, if equity returns remain in the single digits, pension systems fall behind on their funding schedules and must ask for increased contributions from city taxpayers. (Employees and retirees do not bear any investment risk in defined-benefit pensions.) Using conservative actuarial assumptions, states' and localities' estimated pension ($2.5 trillion–$4.1 trillion)[17] and retiree health-care benefit ($900 billion–$1.1 trillion)[18] debt totals exceed the size of their bonded debt obligations ($3 trillion).[19]

In the wake of the 2008 financial crisis, nearly every state enacted pension reforms that mandated increased employee contributions and/or reduced benefits.[20] These reforms generally applied to future benefits and left in place benefits that had already been promised. Hence in a long-term perspective, as Figure 2 shows, states' and cities' recent pension reforms have to date had little effect on pension debt levels.

The second reason for the growing risk of municipal insolvency is that cities have less fiscal flexibility than in the past. One way to express this is in terms of workforce head counts **(Figure 3).**

Compensation is the largest cost for any city budget, and reducing salaries and benefits is difficult, particularly in a unionized context. Paring back one form of compensation through collective bargaining often requires providing some other offsetting benefit. Thus, reducing the number of employees, either through attrition or layoffs, is the strongest tool that city governments can use to cut spending. Figure 3 shows that, though local government jobs have been growing over the last three years, they remain about 300,000 below where they were in 2008. This suggests that governments may have relatively little fat to trim, should the economy fall into recession again.

Compensation is the largest cost for any city budget, and reducing salaries and benefits is difficult, particularly in a unionized context.

Of course, head counts are not a perfect measure of the "right size" of a given city government. But head counts are a useful measure of cities' fiscal flexibility insofar as each round of layoffs brings local officials and managers closer to what they, and possibly also the public they serve, believe to be a condition of "service delivery insolvency."

Third, many cities in America have struggled with concentrated poverty for at least a half-century. The Appendix lists the 40 poorest major (population above 100,000) cities in America. The median city saw its poor population grow by 13% in the 1970s, and almost 75% over the past half-century. During this span, overall median population has decreased by 15% (Appendix).

Clearly, after decades of trying to attract more investment and middle-class jobs, many urban economies continue to decline. Economically healthy cities can afford to keep pace with expensive debt commitments even if they spend proportionately less on services. Cities with struggling economies and large populations of low-income citizens face not only service cuts but a risk of insolvency. Their past record on economic development suggests that poor, shrinking cities are unlikely to grow sufficiently to relieve bonded and pension debt burdens. They also have less fiscal flexibility because of their constituents' heavy service needs and their inability to pay tax increases. In jurisdictions where much of the population lives in rental housing, raising property taxes creates a very real threat of abandonment if landlords cannot raise rents.

A high concentration of poor residents or historically high levels of retirement benefit and/or bonded debt does not destine a city for insolvency. But the convergence of these factors makes the incidence of municipal bankruptcy more likely than in the past.

IV. The Role of State and Federal Governments

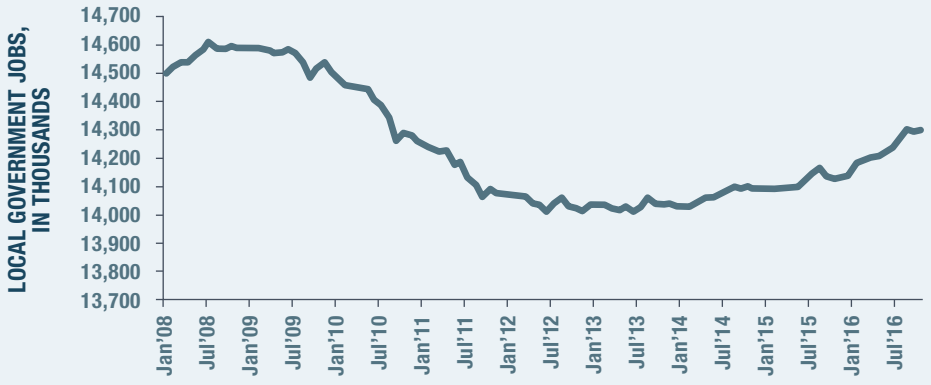
Fiscal distress represents political failure.[22] Almost by definition, the challenges faced by an insolvent city cannot be resolved at the local level. Accordingly, the policy debate over what to do about distressed or insolvent municipalities has centered on the proper roles for the federal and state governments.

The only ongoing source of assistance that the federal government provides to fiscally challenged cities is to make bankruptcy available to them. Indirectly, many federal policies benefit local budgets, such as safety-net programs, the tax exemption on interest earned on municipal bonds (which lowers cities' borrowing costs), and the state and local tax deduction (which softens the blow for federal income-tax filers in high-tax local jurisdictions).[23] But healthy cities, along with their distressed cousins, benefit from these programs.

Instances of discrete federal-to-local emergency financial assistance programs are extremely rare. The Obama administration never seriously considered a bailout for Detroit. During New York's mid-1970s fiscal crisis, the federal government did provide the city with a short-term loan and loan guarantee, collectively worth about $4 billion.[24] But

FIGURE 3.

Local Government Jobs, 2008–16



Source: Bureau of Labor Statistics[15]

these extraordinary measures were deemed necessary because of fear that a default by New York City would have dangerous repercussions for the region and state, as well as for the nation's financial system and municipal bond market.[25]

States, however, have significant legal latitude to intervene in municipal fiscal affairs, since municipalities are the legal creations of state governments. Before the onset of distress, they can monitor localities' finances and evaluate the risk of distress.[26] States can monitor localities' debt-management practices and even veto planned debt issuances that they view as imprudent.[27] Bonded debt limits, to which virtually all municipal governments are subject, are imposed by state law. After distress has developed, states can appoint a receiver to take full fiscal and administrative control of a local government's day-to-day operations,[28] or appoint a control board to monitor budgets and other major fiscal decisions.[29] State government sometimes requires oversight as a condition of financial assistance, either in the form of a direct cash contribution or some sort of loan or loan guarantee.[30] States can establish a generalized program that defines in advance what distress is and a protocol for addressing it.[31] Or they can pass specially tailored legislation to deal with individual cases of distress on a discrete basis.[32] Pennsylvania allows cities in its Act 47 program additional taxing power, such as the ability to raise earned income and property taxes above the normal statutory limits;[33] Yonkers, the only city in New York State other than New York City to levy a personal income tax, was granted this authority, as a legacy of its past fiscal crisis.[34] The Pew Center reckons that 22 states "make some effort to monitor the fiscal health of local governments" and that "19 states . . . have enacted laws allowing intervention."[35] According to a recent study, "proactive" states are host to municipalities with lower borrowing costs than states with a more hands-off approach to fiscal distress.[36]

States are well positioned to prevent insolvency from arising in the first place, but pensions, bond obligations, and collective bargaining contracts cannot be altered outside bankruptcy. Insofar as insolvency is a debt problem, it cannot be truly resolved at the state level, and bankruptcy will remain necessary.[37]

V. Legal Controversies

Over the past 30 years, the scholarly literature on municipal bankruptcy has focused chiefly on why it has, historically, done so little to assist fiscally struggling cities. Chapter 9 has been used far less frequently than Chapter 11, and the results have been underwhelming. In an influential article from the 1990s, law professors Michael W. McConnell and Randal C. Picker went so far as to conclude that municipal bankruptcy "serves little function at all."[38]

Scholars tend to connect Chapter 9's problems to what has been referred to as the "pro-debtor orientation" of municipal bankruptcy.[39] Bankrupt cities retain control of their operations and assets and are subject to far less oversight by federal judges than bankrupt corporations. As a consequence, municipal bankruptcy tends to be overly focused on reducing debt and not enough on restructuring.[40]

In corporate bankruptcy, a primary objective is to reconfigure businesses to make them more efficient. As with bankrupt businesses, bankrupt cities are often saddled with more problems than just too much debt. Municipal insolvency nearly always coincides with administrative dysfunction. Examples include inefficient work rules, antiquated IT, fragmented managerial structures, and low human capital among top and mid-level bureaucrats. The local tax code may be in need of revision, and privatization might be a logical approach to take toward certain assets and/or government functions.

Some forms of dysfunctional operations, such as the hour-long police-response times for which bankrupt Detroit was notorious, are apparent to the press and public. But there are often numerous other ways in which an insolvent city government cannot make the most out of its limited resources that are only apparent to managers on the inside or to independent consultants hired to perform an operational audit. Federal law does not require local officials of bankrupt cities to identify and root out such inefficiencies; nor does it empower bankruptcy judges to do so.

Municipal dysfunction may be a cause of the underlying fiscal distress but may also be an effect of it. Having focused inordinately on budgetary triage, local officials may have neglected various fixes over the years.

Legal scholars disagree on how to make municipal bankruptcy more effective. David Skeel and Clayton Gillette argue that the federal judges should use their leverage over the confirmation of municipal bankruptcy plans to take a more active role in the restructuring of cities.[41] McConnell and Picker recommend that federal law be changed to allow states to create more powerful bankruptcy courts that could change the political structures of fiscally distressed cities. Such a move would hand the presiding judge (in a state bankruptcy court) the authority to raise taxes, reduce expenditures, sell assets, and perhaps even change the city's boundaries. Others essentially argue for abandoning Chapter 9 altogether. Kimhi argues that states should enact laws to create state financial boards and that such boards are likely to be a more effective response to a locality in fiscal distress than Chapter 9, which is too limited in scope.[42]

VI. The Lamp of Experience: Municipal Bankruptcies in California, Michigan, and Rhode Island

For some cities, however, municipal bankruptcy will remain necessary. To think through how to make the process more effective, some recent episodes of municipal bankruptcy are worth examining.

Vallejo, California, filed for bankruptcy in May 2008 and exited in November 2011. Stockton, California, filed in June 2012 and exited in February 2015. Even though retirement benefit debt was widely acknowledged to be a major cause of both cities' fiscal struggles, neither reduced pensions in bankruptcy. Stockton cut its bonded debt obligations by 50% and Vallejo by 40%, whereas pensioners' recoveries were 100% in both cases.[43] The year after it emerged from bankruptcy, Vallejo's unfunded pension liability stood at $146.6 million, $57.9 million larger than the year in which it filed for bankruptcy.[44] **Figure 4** and **Figure 5** express these cities' post-bankruptcy pension burdens as a rapidly growing share of payroll. For every dollar that Vallejo pays this year in salary to its police and fire personnel, it must contribute about 60 cents for pensions. In the case of Stockton, the figure is 49 cents.

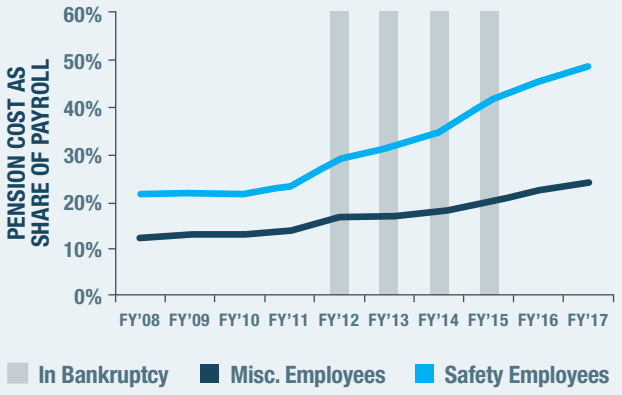
Vallejo's and Stockton's bankruptcies were directed by city managers serving at the pleasure of the local city council members. The bankruptcies of Detroit, as well as Central Falls, Rhode Island—in which state-appointed receivers were at the helm—did result in pension cuts. Robert Flanders, a former judge, was appointed receiver of Central Falls in January 2011 and filed for Chapter 9 in August 2011. The first factor that he cited in making this decision was Central Falls's "overwhelming pension obligations."[46] Flanders's plan of adjustment, which was approved in September 2012, effected pension reductions on a means-tested basis, with some retirees seeing benefit cuts of 55%.[47]

Detroit eliminated cost-of-living increases for its uniformed as well as civilian retirees, reduced civilian pensions by 4.5%, and imposed a clawback on benefits that workers and retirees had reaped from a special pension-enhancement program known as the "annuity savings program."[48] If not for the so-called grand bargain, through which the city monetized the city-owned Detroit Institute of Arts to mitigate deeper benefit reductions, the pension cuts would have been, according to Emergency Manager Kevyn Orr's initial proposal to creditors, "significant."[49]

More important is that under Orr's leadership, Detroit reformed its pensions on a going-forward basis. For uniformed and civilian employees, Orr put into place

FIGURE 4.

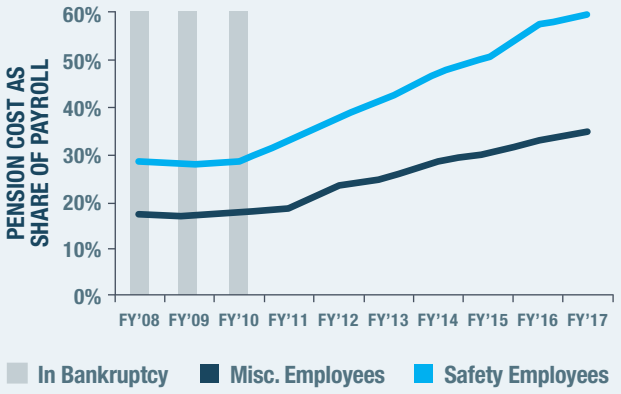
Employer Pension Contribution Rates, Stockton, California, FY 2008–17



Source: Actuarial valuations and comprehensive annual financial reports[45]

FIGURE 5.

Employer Pension Contribution Rates, Vallejo, California, FY 2008–17



Source: Actuarial valuations and comprehensive annual financial reports[45]

hybrid plans that require risk-sharing between city government and plan beneficiaries. As laid out in the city's bankruptcy plan, when either of Detroit's new retirement systems dips below full funding, a series of triggers kick in that require increased employee contributions and benefit reductions until the plan returns to full funding.[50]

In a 2014 report, Moody's suggested that because Vallejo and Stockton failed to do more to reduce their pension burdens in bankruptcy and San Bernardino looked unlikely to do so as well, "the burden of these rising obligations will challenge their recoveries after bankruptcy."[51] Moody's went so far as to suggest that "Vallejo now faces the risk of a second bankruptcy" because of its increasing pension costs. By contrast, Moody's considered Central Falls's bankruptcy plan "credit positive"[52] and gave Detroit an upgrade in July 2015.[53]

VII. Conclusion: The Case for Intervention Bankruptcy

Municipal bankruptcy is no one's conception of an ideal solution to insolvency. But it can be seen as an effective one, using the dual standards for evaluating policy as defined by the political scientist Edward Banfield: "feasible and acceptable."[54] Bankruptcy is feasible in the sense that it is legal and the benefits outweigh the costs. It is acceptable in that political officials have shown themselves willing to support it if they have no other option.

The benchmark of feasible and acceptable should also guide policymakers in determining how to maximize bankruptcy's core benefits of stabilizing a city's budget and allow it to invest in its future once again. Altering federal law to allow municipal bankruptcy judges to reconfigure the political institutions of a city may be an unconstitutional violation of state sovereignty and thus not feasible. More radical solutions to the problem of insolvency, such as dissolving cities and merging them with larger units, would have to be considered politically unacceptable to state and federal officials.

A more promising approach would be for state-appointed receivers to manage municipal bankruptcy plans—subject, of course, to federal court approval. This is preferable to leaving local officials in charge, or to giving more power to the federal judge, for the following reasons:

1. Recent experience with municipal bankruptcy suggests that cities that appointed a receiver in advance of filing addressed their pension debt struggles in a more forthright manner than those that did not.

2. It is not obvious what state government's role should be in restoring solvency when all other options have been exhausted. Oversight, monitoring, and offering outside advisory services are most effective before insolvency has emerged, but they are of little assistance in reducing contractual debt obligations. Directing the bankruptcy, as well as funding the costs associated with it, is an appropriate form of assistance for states to provide to insolvent cities.

3. Intervention bankruptcy is an attractive alternative to reforming Chapter 9. The prospects of changing the law through Congress are uncertain, and giving more power to federal judges to intervene in municipal affairs is sure to raise federalism concerns. Intervention bankruptcy requires no change in federal law.

4. When cities need more than mere debt adjustment, an appointed receiver, with staff and resources provided to him by state government, will be better positioned to ensure that a city gets the most out of bankruptcy, in terms of its budget, balance sheet, and operations.

5. State officials have more political distance from the situation than local officials. True, states have their own long record of fiscal irresponsibility; but when it comes to a municipal bankruptcy, state-appointed receivers are more likely, based on experience, to do the right thing than local officials.

6. The California approach of addressing insolvent cities, in which state government simply passes the buck to federal courts, arguably violates the original intent behind municipal bankruptcy law. Law professor Juliet Moringiello explains that Congress's goal in crafting Chapter 9 was "to bring together two sovereigns, the state and the federal government, to accomplish something that neither could accomplish alone. ...States could provide active fiscal oversight, but could not impose binding debt adjustments on nonconsenting creditors. Federal legislation could force debt reductions on creditors but could not provide the active fiscal guidance that was needed to ensure that a municipality could both resolve its current problems and avoid future problems."[55] Intervention bankruptcy provides the best of both worlds: the debt-reduction powers of federal court; and the oversight powers of state government.

Implementing intervention bankruptcy is straightforward. Since localities can access bankruptcy only with state approval, the state must simply pass a law saying that no bankruptcy can proceed without a receiver in place.

Laws to appoint receivers before a city is allowed to file for bankruptcy should be high on states' agendas. Cities' debt levels are at all-time highs, and policymakers are constrained because they have already trimmed their workforce head counts. The risk of municipal insolvency is greater than at any time since the Great Depression—and recent experience with the five largest municipal bankruptcies in American history suggests that those where a receiver was in place fared better than those directed by local officials.

Appendix: Historical Poverty and Population Trends for the Forty Poorest Major Cities in America[56]

CITY	PERCENT IN POVERTY, 2010–14	NUMBER IN POVERTY, 2010–14	PERCENT INCREASE IN POOR POPULATION, 1970–80	PERCENT INCREASE IN POOR POPULATION, 1970–2014		POPULATION ON APRIL 1, 1970	POPULATION, 2010–14	PERCENT INCREASE IN POPULATION, 1970–80	PERCENT INCREASE IN POPULATION, 1970–2014
Flint, Michigan	41.6	40,889	13.0	73.9		193,317	100,569	-17.4	-48.0
Detroit, Michigan	39.8	272,739	17.1	23.5		1,514,063	695,437	-20.5	-54.1
Cleveland, Ohio	35.9	136,860	-2.6	6.8		750,879	392,114	-23.6	-47.8
Gainesville, Florida	35.8	40,396	37.9	217.6		64,510	126,465	26.1	96.0
Brownsville, Texas	35.7	63,473	17.6	165.9		52,522	179,834	61.8	242.4
Dayton, Ohio	35.3	45,633	21.4	36.7		243,023	141,776	-16.3	-41.7
Syracuse, New York	35.1	46,060	9.9	72.8		197,297	144,648	-13.8	-26.7
Hartford, Connecticut	34.4	40,519	26.0	56.1		158,017	125,211	-13.7	-20.8
Rochester, New York	33.8	68,222	14.1	92.1		295,011	210,461	-18.1	-28.7
San Bernardino, California	33.0	68,257	12.7	320.6		106,869	213,044	9.9	99.4
Laredo, Texas	31.2	75,145	1.5	143.7		69,024	245,048	32.5	255.0
Tallahassee, Florida	31.1	53,663	22.6	-21.4		334,859	185,395	3.6	-44.6
Birmingham, Alabama	31.0	63,546	-9.1	-6.3		305,893	211,705	-7.0	-30.8
Buffalo, New York	30.9	77,748	5.5	13.5		462,768	259,959	-22.7	-43.8
Cincinnati, Ohio	30.9	88,335	-5.0	14.5		453,514	297,117	-15.0	-34.5
Fresno, California	30.6	152,516	17.8	439.8		165,655	506,132	31.7	205.5
Springfield, Massachusetts	30.1	44,527	29.2	118.8		163,905	153,836	-7.1	-6.1
Provo, Utah	30.1	32,274	93.5	234.2		53,131	114,804	39.5	116.1
Miami, Florida	29.9	122,301	38.3	859.1		72,624	416,432	12.3	473.4
Jackson, Mississippi	29.9	50,137	0.6	38.4		153,968	173,631	31.8	12.8
Newark, New Jersey	29.9	79,805	26.2	-5.8		381,930	278,750	-13.8	-27.0
Providence, Rhode Island	29.7	48,914	-6.6	52.6		179,116	178,562	-12.5	-0.3
Lansing, Michigan	29.4	33,412	30.2	156.7		131,403	114,382	-0.8	-13.0
Waco, Texas	29.4	35,223	4.7	80.8		95,326	127,796	6.2	34.1
Milwaukee, Wisconsin	29.4	170,943	6.1	112.6		717,372	598,078	-11.3	-16.6
Paterson, New Jersey	28.4	41,115	45.6	73.4		144,824	146,341	-4.7	1.0
South Bend, Indiana	27.8	27,329	11.9	134.3		125,580	100,422	-12.6	-20.0
St. Louis, Missouri	27.8	85,714	-21.2	-30.2		622,236	318,727	-27.2	-48.8
New Orleans, Louisiana	27.7	98,937	-7.8	-36.6		593,471	368,471	-6.1	-37.9
Toledo, Ohio	27.7	76,518	14.8	85.0		383,062	283,932	-7.4	-25.9
Erie, Pennsylvania	27.4	26,330	9.5	85.2		129,265	100,832	-7.8	-22.0
Memphis, Tennessee	27.4	175,412	8.6	37.4		623,988	656,715	3.6	5.2
Grand Rapids, Michigan	26.7	48,995	-2.5	104.3		197,649	190,739	-8.0	-3.5
Akron, Ohio	26.7	51,696	8.7	60.9		275,425	198,492	-13.9	-27.9
Philadelphia, Pennsylvania	26.7	401,219	16.0	36.7		1,949,996	1,546,920	-13.4	-20.7
New Haven, Connecticut	26.4	32,122	18.5	40.8		137,707	130,553	-8.4	-5.2
Springfield, Missouri	26.4	40,034	5.2	137.5		120,096	162,333	10.8	35.2
McAllen, Texas	26.4	35,294	19.0	142.6		37,636	135,048	76.1	258.8
Allentown, Pennsylvania	26.3	29,936	14.1	193.4		109,871	118,793	-5.6	8.1
Savannah, Georgia	26.1	34,596	0.8	12.8		118,349	141,298	19.5	19.4
	Median Change		12.9	73.7		Median Change		-7.3	-14.8

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Abstract

Many local governments today are on the verge of insolvency, including Atlantic City, New Jersey; the Chicago Board of Education; and Hartford, Connecticut. Thanks to near-historical debt levels and entrenched poverty, many more cities are likely to suffer fiscal distress in the coming years.

Recent experience of some bankrupt cities casts doubt on the effectiveness of municipal bankruptcy proceedings in federal courts. To strengthen government's ability to address municipal insolvency, federal bankruptcy and state intervention, which are often posed as alternative approaches, should be combined. We call this approach "intervention bankruptcy."

Crucially, state governments, whose consent is legally required for any locality to file for bankruptcy, should intervene at the outset and appoint a receiver before allowing a city or other local government entity to petition for bankruptcy in federal court. No municipal bankruptcy should be authorized if local officials will direct it.

Key Findings

1. Cities' debt levels are near all-time highs, and the risk of municipal insolvency is greater than at any time since the Great Depression.

2. Recent experience with municipal bankruptcies indicates that when local officials manage the process, they often fail to propose the changes necessary to stabilize their city's future finances.

3. Suggested legal changes to grant federal judges more power in municipal bankruptcies are, at best, uncertain to be enacted and are, in any event, ill-suited to this nation's federalist structure.

4. Many fiscally distressed cities need operational reforms, in addition to less debt and a balanced budget. State-appointed experts are best positioned to implement such restructuring programs.

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