

Analysts Debate the Effectiveness of Municipal Bankruptcy on Improving Cities

by Joel R. Glucksman on August 22, 2013

Five years after the Great Recession began, a number of cities across the country are still struggling to recover from fiscal shortfalls, budgetary constraints, and financial mismanagement. As is well known, this has prompted many to seek protection under Chapter 9 - the municipal bankruptcy part of bankruptcy law. Although the media have generally focused on the bankruptcies of Jefferson County, Alabama, and Central Falls, Rhode Island, few filings have garnered as much national attention as that of Detroit, which recently filed the largest municipal bankruptcy in U.S. history.

However, analysts are now questioning whether this legal safeguard will truly help municipalities recover and return to economic vitality, or if the procedure is simply a band aid to a much more complex issue. Bloomberg News cited a statement made by David Skeel of the Weekly Standard, in which he called for more municipal bankruptcy proceedings as a way to encourage reforms and adjustments in municipal pension systems. Indeed, many of today's municipal proceedings are due in large part to under-funded pension liabilities, but they are coupled with the millions of dollars in debt that cities owe to creditors. The combination has led to struggles over whether the pension systems or the creditors should be favored during insolvency proceedings.

Other analysts, however, argue that while bankruptcy proceedings may shed light on some of these issues, they may do little in the way of encouraging municipal reforms and implementing safeguards that might improve the financial management of city resources, Bloomberg explained. In addition, bankruptcies may not improve other aspects that play a role in city's financial health, such as lowering unemployment rates, reducing crime, strengthening the tax system, or improving the housing and commercial markets.

There is no finite way to determine if municipal bankruptcies will lead to the long-term health of most cities. However, as more metropolitan areas struggle to meet their debt and pension obligations, it is one of the few resources they have to begin the recovery process.