Bond Case Briefs

Municipal Finance Law Since 1971

Distressed Cities and the Lessons of California.

A new study finds reasons for optimism for municipal finances. But California is the outlier.

It might seem, given the spate of municipal bankruptcies of recent years, that there's little to be hopeful about for some of America's harder-pressed cities. But the picture may not be as bleak as we've thought.

A recent study from Boston College's Center for Retirement Research finds that in the wake of Detroit's bankruptcy, other cities are not poised to fall like dominoes. And contrary to what we hear with increasing frequency, pensions are not the biggest problem for cities that are in financial trouble.

But the relatively good news comes with one major caveat: None of this applies if you happen to live in California. It is from California's mistakes that other state and municipal leaders should learn.

The study, "Are City Fiscal Woes Widespread? Are Pensions the Cause?", looked at 32 American cities identified in press reports as being in financial trouble. The authors applied various measures of financial mismanagement, overall economic condition and pension burden to each city and found that financial mismanagement has the biggest impact and pension burden the least.

But California is the outlier. It is home to 10 of the 32 cities identified as being in financial trouble. For them, pensions are indeed a major problem.

The authors identify three causes of California's woes. First is the explosion of government-b--initiative that occurred in the wake of Proposition 13 in 1978, which limited skyrocketing property tax hikes. To prevent state leaders from making up for the loss of property tax revenue by raising other taxes, the measure required a two-thirds legislative majority for any tax increase.

A spate of subsequent initiatives have called for either tax cuts or new programs but, due to the required supermajority for new taxes, simply punted on finding the money to fund the initiatives. As a result, the state has lost control of its finances, and local governments have borne much of the impact.

The problems were magnified when California was hit harder than most other states by the 2008 financial crisis and subsequent recession. Even now, the state's rate of municipal revenue growth is far lower there than in most other states.

On the pension front, California retroactively expanded benefits in the 1990s, which has made its pension costs among the nation's highest. State law also protects the pension benefits of current public employees, which takes away some of the flexibility needed to address the problem.

California succumbed to two classic temptations. First, it became convinced that the good times would last forever and conferred benefits that could not be sustained during lean years. Second, it sacrificed the future for short-term political gain by enacting popular new programs or tax cuts without paying for them.

If the authors of the Boston College study are right, many municipal leaders can exhale. But their constituents can't afford for them to fall into the same traps that still have Californians reeling.

Read the study at:

http://crr.bc.edu/wp-content/uploads/2013/12/slp_36.pdf

BY CHARLES CHIEPPO | JANUARY 8, 2014

Copyright © 2026 Bond Case Briefs | bondcasebriefs.com