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Vitter Reintroduces Bill Banning State and Local Bailouts.

WASHINGTON — Sen. David Vitter, R-La., has reintroduced legislation that would prevent the federal government from providing assistance to any state or local government that defaults or is at risk of defaulting on its obligations. The bill, however, contains exceptions for responses to disasters.

Vitter introduced S. 94 — legislation he has offered in the two previous Congress' — on Jan. 7. The bill provides for broad restrictions against the use of federal funds to support troubled state and local governments. Vitter has previously touted the bill, which has failed to gain traction in the past, as “The State Bailout Prevention Act.”

The bill has four sections. The first is a broad prohibition against the use of federal money to purchase or guarantee obligations of, or to issue lines of credit to, or to provide grants and aid to, any state or local government that has defaulted on its obligations since Jan. 26, 2011, or is at risk of defaulting, or is likely to default without federal assistance. The legislation does not specify how to measure that risk.

The second section prohibits the Treasury from providing assistance to state and local governments under those same conditions, and the third section bars the Federal Reserve Board of Governors from providing similar support.

In a July 2013 press release, Vitter’s office specifically cited Detroit as an example of a distressed municipality that the federal government should not be in “the business of bailing out.”

The final section of the bill makes clear that it does not preclude federal assistance for disaster relief, ensuring that Louisiana will continue to get federal support for hurricanes like Katrina.

If enacted the bill might not have much direct effect on traditional muni finance, because the Internal Revenue Code already prevents direct or indirect federal guarantees of tax-exempt debt, lawyers said.

“Thus, such bonds already are precluded from being issued, unless the issuer wants to offer them on a taxable basis, which would seem unlikely,” said Mike Solet, an attorney at Mintz Levin in Boston. Solet said there are some exceptions related to housing and student loan bonds, but that those are mainly issued by authorities that would not seem to fall under the umbrella of the bill’s first section.

James Spiotto, managing director at Chapman Strategic Advisors in Chicago, said that the legislation has troubling implications because it would bar federal assistance like the more than \$2 billion the federal government provided to New York City during its financial crisis in 1975.

“You would hate to think we would pass a law that would prohibit helping a municipality that was in trouble, or a state that was in trouble,” Spiotto said. “Sometimes people need a bridge to recovery and liquidity.”

Economic recovery at the local level is beneficial to the federal government in the long run, Spiotto said, creating more wealth that flows back to the Treasury in taxes and keeping more individuals off

the federal welfare rolls.

The bill is awaiting action by the Senate Committee on Banking, Housing, and Urban Affairs.

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