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McConnell State Bankruptcy Remarks Raise Constitutional Questions.

Municipal finance experts say that it may be unconstitutional for Congress to allow states to declare bankruptcy, and that even if it is constitutional, it would be a bad idea.

Experts on state and local government finances say that Congress may not have the right to grant states the ability to file for bankruptcy under the Constitution. They also argued that bankruptcy wouldn't be particularly helpful in addressing states' coronavirus-related challenges.

"Bankruptcy is just not a viable solution to the issues state and local governments are facing," said Michael Decker, senior vice president for federal policy at the Bond Dealers of America.

People are talking about the issue because Senate Majority Leader Mitch McConnell (R-Ky.) this week suggested it would be better for states to be able to declare bankruptcy rather than have the federal government provide more money to help them through the coronavirus crisis.

"I would certainly be in favor of allowing states to use the bankruptcy route," he said on conservative talk show host Hugh Hewitt's program.

"There's not going to be any desire on the Republican side to bail out state pensions by borrowing money from future generations," he added.

A senior Senate GOP aide said McConnell's comments came after he was asked specifically about the issue. The leader doesn't see allowing states to file for bankruptcy as being a priority for the next coronavirus bill and is well aware of the law. But the aide said McConnell's larger point was that some states were in tough financial straits due to prior mismanagement or overspending.

The U.S. bankruptcy code does not include provisions that allow states to declare bankruptcy. Local governments have the ability to file for bankruptcy under Chapter 9 of the code, but only if their state authorizes them to do so.

Very few localities have filed for bankruptcy over the years, with the most prominent recent example being Detroit in 2013. Congress passed a law in 2016 that created a bankruptcy-like process for the federal territory of Puerto Rico.

Professors who have studied the issue say there would be obstacles to Congress allowing states to declare bankruptcy, and that a law on this topic would likely spur a legal case that would likely go to the Supreme Court.

Kenneth Katkin, a law professor at Northern Kentucky University, said that a law about states filing for bankruptcy would set up a debate over whether Congress's ability to write bankruptcy laws preempts the prohibition in the Constitution on states impairing their own obligations under contracts.

“It’s not clear how the court would rule,” he said.

Others have suggested that there could be concerns about whether allowing states to file for bankruptcy would conflict with the 10th amendment of the Constitution, which states that powers not delegated to the federal government nor prohibited for states are reserved to the states.

Municipal finance experts also said that even if a law on state bankruptcies was found to be constitutional, it would be an unwise policy because it would make it harder for states to sell bonds used to finance capital projects.

Such a law “would upend the traditionally low borrowing costs of state and local governments,” said Richard Ciccarone, president of Merritt Research Services.

Frank Shafroth, director of the Center for State and Local Government Leadership at George Mason University, said that if states could declare bankruptcy, it would allow state politicians to pass off some decision-making to a judge.

“It would save too many governors and state legislators from making hard decisions,” he said.

Experts also said that bankruptcy might not be a particularly helpful remedy for the challenges states are experiencing due to the coronavirus crisis. Because of the pandemic and measures taken to reduce the number of infections, states have new spending needs and are facing a decline in tax revenues.

Eric Kim, head of the state government group at Fitch Ratings, said that companies will file bankruptcy to address long-term liabilities, but states’ main issue is currently the economy and lower revenues rather than long-term liabilities.

“Declaring bankruptcy doesn’t fix the economy,” he said.

States have been asking for additional funds from the federal government, not the ability to seek bankruptcy protection.

The National Governors Association earlier this week asked Congress for $500 billion in direct aid to states to replace their lost revenue. The group’s leaders, Maryland Gov. Larry Hogan (R) and New York Gov. Andrew Cuomo (D), have both blasted McConnell’s comments on bankruptcy.

Brian Sigritz, director of state fiscal studies at the National Association of State Budget Officers, said states on the whole were in a strong fiscal position prior to the coronavirus-related economic downturn, experiencing strong revenue growth and putting more money into their rainy-day funds.

“They had been taking steps to prepare for the next downturn,” he said. “No one was planning for a decline like this.”

McConnell expressed concerns about state pensions. Some experts said that while some states have pension challenges, pension funds are not overall a major burden.

“State pensions generally actually are in pretty good shape,” Kim said. He added that in the long run, state pensions could be affected by market declines, but the current pressing problem for states is revenue losses, not pensions.

However, desire among state politicians for pension relief from Congress is not zero. Last week, Illinois state senate president Don Harmon (D) sent a letter to the state’s congressional delegation

asking for $10 billion in pension relief, arguing that state pension payments crowd out funding for other services and that the crowding out will be exacerbated this year due to revenue losses. Illinois is among the states with the biggest pension issues.

Additional aid to states is becoming a key issue in the debate in Congress over subsequent coronavirus relief legislation.

Funding for states is a top priority for many Democrats, who want quick congressional action on another bill. But McConnell has said he wants to take a “pause” to see which parts of previous bills are working and which are not.

“I think this whole business of additional assistance for state and local governments need to be thoroughly evaluated,” McConnell told Hewitt on Wednesday.

Karol Denniston, a municipal bankruptcy lawyer at Squire Patton Boggs, said that McConnell’s comments to Hewitt are starting a conversation about what other options might exist besides additional federal money for state and local governments, even if bankruptcy isn’t the best alternative.

McConnell’s comments have “opened up the discussion,” she said.

THE HILL

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