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U.S. State Bankruptcy Was a Farce Then and Now.

Mitch McConnell tries to revive a long-dead idea that would counteract the government's relief efforts.

No one was asking, but it turns out a global pandemic isn't enough for Senate Majority Leader Mitch McConnell to take a break from fretting about purportedly "borrowing money from future generations."

Never mind that the three-month-old coronavirus crisis has led to more than $2.3 trillion in congressional appropriations, to say nothing of the $484 billion relief package that passed the U.S. Senate on Tuesday. Much of those funds, after all, aided small businesses and hospitals, sent direct payments to families and expanded unemployment insurance. All of this promises to blow an almost $4 trillion hole in the federal government's 2020 budget.

Apparently, helping out U.S. states is a bridge too far for the Kentucky Republican. In a response to a question on the syndicated Hugh Hewitt radio program, McConnell declared, "I would certainly be in favor of allowing states to use the bankruptcy route." He added that "it's saved some cities, and there's no good reason for it not to be available." Hewitt singled out California, Illinois and Connecticut, three states that just so happen to reliably vote Democratic (no mention of New Jersey, repeatedly downgraded during Republican Governor Chris Christie's eight years).

McConnell went on:

> "My guess is their first choice would be for the federal government to borrow money from future generations to send it down to them now so they don't have to do that," he said. "That's not something I'm going to be in favor of."
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> "I said yesterday we're going to push the pause button here, because I think this whole business of additional assistance for state and local governments needs to be thoroughly evaluated," McConnell added.
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> "You raised yourself the important issue of what states have done, many of them have done to themselves with their pension programs," he said. "There's not going to be any desire on the Republican side to bail out state pensions by borrowing money from future generations."

Again, never mind that an article from the latest Bloomberg Businessweek magazine is about how seven years after bankruptcy, Detroit is once again staring down a huge budget shortfall that puts it on the brink of a state takeover. Far from a panacea to get out from under onerous obligations, municipal bankruptcies have proved to be so messy, costly and time-consuming that they're often not enough to solve the underlying issues. Case in point: Puerto Rico.

McConnell's idea isn't a novel one by any means. The idea of state bankruptcy was raised after the

last recession, too, including by David Skeel, who now sits on the Financial Oversight & Management Board for Puerto Rico. He wrote an article for The Weekly Standard in November 2010 titled "Give States a Way to Go Bankrupt." When I asked him about it in December 2011, after muni bonds posted a 10.7% return and a meltdown never materialized, he said "the political enthusiasm for the state bankruptcy idea has temporarily dimmed." That's one way of putting it. Here's another from Bloomberg News's William Selway and Danielle Moran: It was dropped after a single hearing in the House of Representatives.

The concept of state bankruptcy as a solution to get through this unprecedented period is little more than a farce. Even President Donald Trump appears to realize that. After meeting with Governor Andrew Cuomo of New York on Tuesday, he said that states will need assistance, adding that "I think most Republicans agree, too, and Democrats." Governors have asked for some $500 billion.

As much as McConnell tries, this is not about profligate Democratic governors and their underfunded public pension funds. At a basic, fundamental level, many states will have to impose draconian austerity measures without federal support because governors need to balance their budgets. That means either more state employees joining the ranks of the unemployed, higher tax rates (and therefore less money changing hands in local economies), further neglect of critical public infrastructure improvements, or once again shortchanging the pension promises of tomorrow to make the numbers add up today. Potentially all of the above.

Withholding state support, in other words, would directly counteract the measures that McConnell and his fellow senators have already set in motion to bolster the American economy. What good is a $1,200 check if states are backed into raising taxes that take most of it away? Will small businesses bounce back if their neighbors are unemployed, or local roads and bridges remain decrepit?

Fortunately, while McConnell and Republican senators have a "fulsome" discussion on whether and how to send more aid to state and local governments, the Federal Reserve has taken the unprecedented step I advocated for a year ago and will buy up to $500 billion in muni bonds. It was almost too predictable how this would play out:

> The easy answer would be directing more cash from the federal government to the states. But the 2009 stimulus program already transferred an unprecedented amount of money into state coffers and the results were middling at best. In the current political climate, and with U.S. deficits already running close to $1 trillion, it's anyone's guess whether a similar package could come together.
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> That means it might be up to the the Fed to get involved in the $3.8 trillion municipal-bond market to give states a much-needed boost.

For now, the muni market can take some solace in knowing the Fed has its back. That should prevent any sort of wild swings like last month. And it buys some time for House Speaker Nancy Pelosi, who said on Bloomberg TV on Wednesday that a "major package" of aid for state and local government will be in the next stimulus legislation considered by Congress, putting her clearly at odds with McConnell.

For all the posturing, no politician truly wants to impose austerity. Just before the 2018 midterm elections, McConnell brought up the idea of slashing spending on Social Security, Medicare and Medicaid, and that's gone nowhere. Expect the same for state bankruptcy.

Bloomberg Opinion

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April 22, 2020, 11:51 AM PDT

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