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## The Big Question: Can States and Cities Recover from Covid?

**A Q&A with municipal finance experts Richard Ravitch and Antonio Weiss on why local government shortfalls put the U.S. economy at risk.**

**Brian Chappatta:** U.S. states and cities are projected to face massive revenue shortfalls in the coming years due to the coronavirus pandemic. And yet, Congress can't seem to agree to another round of fiscal aid that supports municipal budgets. What's the holdup in Washington? Just how critical is federal support?

**Richard Ravitch, director at The Volcker Alliance and former lieutenant governor of New York:** The estimates for revenue loss for states and cities range from $600 billion to $900 billion. The House passed a bill that appropriated $900 billion to cover revenue losses incurred subsequent to 2019. But the only revenue loss that we can measure today is the sales tax lost so far in 2020. Property taxes are the largest source of revenue for almost every municipality in the U.S. But people don't file their property tax returns until the year following the end of the tax year. Similarly, with income-tax revenues, we won't have those numbers until next year when people file their 2020 tax returns.

The size of the revenue loss is such that borrowing is a temporary stopgap. You can't encumber cities and states with a massive amount of new debt, which will have to be repaid at a point in time where cities are recovering and should be devoting resources to help all the people who have suffered so egregiously for health reasons and unemployment reasons. Therefore we're totally dependent on what Washington does.

**Antonio Weiss, senior fellow at the Harvard Kennedy School's Mossavar-Rahmani Center for Business and Government and director at The Volcker Alliance:** The "skinny" relief bill, which was introduced by McConnell and was passed by 51 of his members in the Senate, not only contained no state and local fiscal relief, but it also sunset the Municipal Liquidity Facility at the Federal Reserve on Dec. 31 and provided for no repurposing of prior appropriated funds to allow for relief.

It's a mean-spirited exercise in inflicting pain on states and municipalities and it flies in the face of all of the economic evidence about what is required in a sharp recessionary environment. It's forcing states and municipalities to consider a set of draconian reductions to expenditures, workarounds to replace funding with financing and in some cases increases in taxes at the very moment when the opposite should be happening.

States and municipalities have a number of differences from the federal government. Forty-nine of them have either a constitutional or statutory requirement to balance their budgets. States don't have their own currencies, they don't have their own central banks, and they cannot print money to get out of a crisis. So when faced with an exogenous shock of this magnitude, they become entirely reliant on the federal government.

We don’t know yet what the magnitude of the revenue loss will be for certain. I tend to believe the estimates that are closer to $500 billion in state shortfalls over the next two fiscal years, and that cascading down to municipalities through a variety of means could bring the total close to $1 trillion. We are putting a substantial part of any recovery from the Covid-induced recession at risk by creating necessary fiscal relief at the federal level and necessitating contraction at the state and local level.

**BC:** You are both clearly passionate about the functioning of state and local governments. How did you get interested in the intricacies of municipal finance?

**RR:** I’ve been interested in this since I was lieutenant governor and I was appalled by the fact that [state legislators] made a $600 million contribution to the pension system by borrowing the money. I thought it was so outrageous that I tried to stop it. And everybody, the unions, the politicians, they all opposed me. I was very conscious of the fact that the borrowing to cover operating expenses and pension contributions, in order to meet contractual obligations to the retired employees of the government, was outrageous. So that’s what got me interested.

I want to tell you a story. In 1975, when the governor of New York State, Hugh Carey, asked President Ford for help for New York City, Ford said no. That produced the famous headline, “Ford to City: Drop Dead.” Well, two days later, the governor and I convened all the top businessmen to the governor’s office in New York. It was a Sunday afternoon. The governor said if we don’t get some help from the federal government, we’re going to have to file a bankruptcy petition for the city of New York.

The business leadership of New York — the chairman of Citibank, the chairman of JPMorgan, of airlines, of AT&T, of insurance companies — they all went to Washington. Several of them played golf with Mel Laird, who was the secretary of defense and who was Gerald Ford’s best friend. Several went down and saw Bill Simon, the secretary of Treasury. Felix Rohatyn contacted all of the major European banks, which let Bill Simon know that a bankruptcy of New York City would have a very adverse effect on the entire world banking system. And about 20 of these business leaders spread out and talked to members of Congress.

Well, a month later, I was sitting in the Treasury Department working out the details of a $3 billion line of credit from the Treasury, ultimately as a result of the business pressure.

Now, the business community in New York, most of whom gave a lot of political contributions to McConnell and Trump, there’s no evidence they’re doing anything to use those political relationships. Instead, they write a letter to the mayor saying he has to solve all the problems. Well, the mayor doesn’t have the money to do it and has rapidly diminishing resources to address a complex set of problems.

**BC:** So that’s one takeaway from New York City’s brush with bankruptcy — that business leaders need to use their clout to fight for their cities. Antonio, you were intimately involved with the more-recent Puerto Rico bankruptcy, during your time at the Treasury Department. Is there anything we can extrapolate from that crisis and apply to potential cash crunches among U.S. states and cities?

**AW:** Puerto Rico is neither a state nor a municipality: It is a territory of the U.S. The relationship with the federal government remains unresolved 120 years after the Spanish-American War. And so the imposition of an oversight board in Puerto Rico, no matter how carefully designed it was at the time, was going to be an offense just due to the colonial relationship between Puerto Rico and the U.S. and the neglect of Puerto Rico as a priority despite the fact that its millions of residents are American citizens.

I don't know that one can analogize anything that happened in Puerto Rico to the state and local crisis that's pending across the country, because so much of Puerto Rico's problem is structural and stems from a neglect on the part of the federal government, which itself is in part a result of this unresolved colonial relationship. That's not to say that there isn't blame to go all around. But the reason that the problems reached these unprecedented levels in terms of debt as a percentage of general fund expenditures, or the zero funding of pensions, among other items, is due to the fact that the U.S. has never really come to grips with the proper relationship that should exist with Puerto Rico, nor afforded Puerto Rico a path to determine its own status. It's important not to take what is a very specific set of circumstances and generalize across the country on that basis.

**RR:** Antonio did a brilliant thing in designing PROMESA [Puerto Rico Oversight, Management and Economic Stability Act]. It gave this board the ability to file a bankruptcy petition, if it couldn't arrive at a contractual understanding with the government, with the debt holders and with the trustees for the debt holders for how much debt to haircut. The power to file was the leverage that the board had to get bondholders to agree to very substantial reductions in the amount of debt, without which Puerto Rico would never have been able to survive.

The point is: control mechanisms are very useful. I'll tell you another marvelous anecdote. There was a control board created in New York. The governor asked me to spend a lot of time with the mayor. Every time the control board forced the city to cut an expenditure, like to reduce the number of garbage pickups to save money in the sanitation budget, Mayor Ed Koch would go on television and criticize the control board. When he got off camera, he would turn to me and say, "Thank God for the control board." If we're going to pump federal money, state money or borrowed money into a local government, the public is entitled to know that there's some reasonable oversight over their expenditures, and that politicians are not spending money to enhance their re-election.

**BC:** Dick, given that you were a former chairman of the Metropolitan Transportation Administration, I have to ask: how does the MTA get through this? Bankruptcy isn't an option. Its credit rating was just cut again by Moody's. It's about to issue even more debt. What's the way out?

**RR:** Federal money. The bill the House passed provides the money that the MTA needs for operating purposes, because ridership is way down and the revenues therefore are dramatically reduced. That's their most immediate problem. The longer-term problem is they have to restore their financial credibility in order to be able to continue to borrow to meet their capital needs. But in the short-term, to ensure there continues to be mass transit available, they're going to have to get federal aid.

**BC:** What's the bottom line — what are the most important things that state and local leaders need to do right now, from a fiscal budgeting standpoint, to get to the other side of this pandemic?

**AW:** I suspect one will see even greater borrowing by various states and municipalities. They will become creative in how they can issue debt notwithstanding the constitutional and statutory limitations on borrowing that they face. The municipal markets themselves are extraordinary healthy right now. The debt markets are open, but the reality has already set in, with the layoffs and furloughs, which are at unprecedented levels in recent history.

As the reality of the cuts that must be made to the main budgetary items in states becomes evident — everything from healthcare and education to grants and assistance to municipalities — the loss of essential services is going to hit the most vulnerable populations at the very moment when more, not less, aid is needed in order to offset the direct healthcare and economic consequences of the pandemic. There is a real need for engagement by civil society, by business leaders and labor, to make clear to Congress that deficit financing is not going to come anywhere near to substituting for the funding that the federal government has to provide in the next Covid relief package.

We’re talking about an extraordinary, once-in-a-century exogenous shock to the country. And the solution to an exogenous shock is for the federal government to step in and protect the citizenship from the consequences of that shock, in supporting the healthcare system and the economy broadly. As part of that, the federal government has got to channel support to states and municipalities. This is not a question of mismanagement, as some in the political leadership would assert. It’s a question of a radical reduction in revenues due to an exogenous shock. It’s the very essence of why we require a federal government — to protect the people against what is in essence a national security threat.

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