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‘You’re Cornered if You’re a City.’ How Concentration in the Municipal Bond Market Is Raising Borrowing Costs.

Cities and states are in a fiscal crisis. Municipal bond defaults are now at their highest in a decade. Despite a $500 billion Federal Reserve intervention, with more potentially on the way, regulators have yet to address a longstanding structural problem—a group of the nation’s biggest banks that has cornered the market for municipal bond underwriting. This concentration of power has the potential to raise the interest rates on the bonds local governments urgently need to salvage their finances and the costs could be in the billions. While some municipalities will default on their debt, others will need to increase borrowing to continue providing public services. But the structural issues in the municipal-bond market could make borrowing costlier and alternatives are needed.

The municipal bond market is “very concentrated,” said Margaret Levenstein, a University of Michigan professor who has testified before Congress on the issue. “It’s important to understand these firms divide markets in ways that definitely raise the cost to municipalities in issuing municipal bonds.”

States and municipalities pay for most public services and infrastructure projects, such as hospitals, bridges, roads, and broadband internet, by issuing bonds that are typically purchased by retail and institutional investors in the municipal bond market. Large Wall Street banks act as underwriters, purchasing these bonds and reselling them to investors. Taxpayers in states and municipalities then pay off the bonds through taxes and fees for public services, such as sales taxes or road tolls.

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