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Bankruptcy is not an Option

By SEYMOUR P. LACHMAN and ROBERT POLNER

Most American governors and mayors, whether Democratic or Republican, are faced with the daunting task of balancing their budgets after a long and deep recession and a sluggish economic recovery.

And increasingly, they are considering declaring bankruptcy as a way out.

Indeed, the B-word is being discussed in debt-strapped Detroit; in Harrisburg, the capital of Pennsylvania; and in Alabama's most populous county, Jefferson. Former Los Angeles Mayor Richard Riordan predicted that his city, the second-largest metropolis in the country, would declare bankruptcy by 2014 as a way out of its financial problems. Newt Gingrich suggests the new Republican majority in the House push for creation of a bankruptcy provision for states, noting that court protection from creditors is only available for municipalities.

With states facing $140 billion in deficits in the next fiscal year, according to the Center on Budget and Policy Priorities, why not embrace bankruptcy as a way out from under union contracts, bonded indebtedness and expenses associated with suppliers, personnel, welfare recipients? Is it not a reasonable avenue to taxpayer relief?

The answer is no. Just look at New York City's harrowing near-brush with bankruptcy in 1975.

Back then, bell-bottom jeans, disco and the Dodge Cougar were in style, but one thing was similar to now: a harsh, long-lingering recession. New York City was squeezed as factories and other big employers moved out, along with the middle class, drawn to the suburbs and the Sunbelt. City borrowing, particularly short-term notes, rose ever higher as tax revenues stalled.

Abe Beame was New York's mayor. Known as the man "who knows the buck," the former two-time city comptroller downplayed talk of a potential city bankruptcy, branding it precipitous, even unseemly. But by the spring of 1975, the big commercial banks headquartered in the city were refusing to buy or sell city notes, fearing an imminent default and possible legal culpability for failing to warn investors.

Much more was at stake than the commercial banks' portfolios and reputations. Then New York Gov. Hugh Carey, a pragmatic liberal Democrat who had served on the House Ways and Means Committee and had represented one of the city's most conservative congressional districts, argued that if the nation's largest city was allowed to slip into bankruptcy, then the New York state government would soon find itself insolvent, too; their finances were interdependent. And, he said, other states and localities would see vastly higher borrowing costs.

When President Gerald Ford vowed to oppose federal aid to the beleaguered and, he believed, errant city and its underwriters, the leaders of France and West Germany -- worried about the impact on their own economies from a New York collapse -- responded that the bankruptcy of New York would be like the "bankruptcy of America." In the end, the president relented and supported seasonal loans to keep New York above water, in part because of the willingness of Carey, helped by the pension funds of the municipal unions, to confront the city's budget problems head-on with wage deferrals, layoffs, state aid and tax increases.

Even banks were forced to stomach what became a moratorium on the repayment of $1.6 billion in debts they and other bond holders were owed, a stopgap measure that took a full year for bankers to overturn in the state's highest court.

As Carey argued, bankruptcy was a wild card that can poison relations with labor, sow lasting public disillusionment and disrupt municipal bond markets with far-reaching, even global, implications. He also predicted riots.

Now, 36 years later, bankruptcy is again being bandied about as a quick fix and an alternative to the kind of ugly civic showdowns under way in Wisconsin.

But the B-word remains as risky and unwarranted a choice as ever.

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