The Fiscal Bluff: Debt and Sustainability in Jefferson County, AL

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Introduction
Cities across the United States are struggling to provide essential services, make payroll, and fulfill benefit obligations, while tax revenues and state transfers have declined due to economic and migration trends. Debt financing can help municipal governments build and maintain infrastructure, but the story of Jefferson County, Alabama—which declared bankruptcy in 2011—serves as a warning against overexposure to market-leveraged public debt. This paper began with a question about how debt affects economic development, but exploration of this question revealed that the crisis began with an environmental issue and undermined social equity. Thus, this paper adapts the framework from Scott Campbell’s article “Green Cities, Growing Cities, Just Cities: Urban Planning and the Contradictions of Sustainable Development” (1996) to explore debt’s relationship to environmental quality, social equity, and economic growth in Jefferson County. The paper considers political, economic, and institutional dynamics that exacerbated the conflicts between sustainability goals, to conclude with policy implications for economic development. Planners should consider the implications of Jefferson County’s case, as many municipalities face fiscal challenges like aging infrastructure, growing benefit obligations, and shrinking tax bases.

The Conflicting Goals of Sustainable Development
In his article “Green Cities, Growing Cities, Just Cities,” Scott Campbell (1996) describes the three goals of sustainable development—economic growth, social equity, and environmental quality. He explains that the goals conflict with each other, and positions the planner as a mediator between them. His “planner’s triangle” provides a useful framework for considering planning challenges, because it helps identify competing urgencies and evaluate policy solutions. As shown in Figure 1, this paper adapts the framework to Jefferson County, using it as a lens to explore the emergence and implications of the County’s debt crisis. This section describes each goal and the conflicts between them, as experienced in Jefferson County.
The Environmental Goal and the Resource Conflict

The environmental goal makes the most logical starting point for exploring Jefferson County’s “planner’s triangle.” In 1993, a local environmental group sued the County for violating the Clean Water Act. The plaintiffs showed that during heavy storms, wastewater treatment facilities dumped untreated sewage into the Cahaba River, the region’s main source of drinking water. The Environmental Protection Agency (EPA) issued a consent decree in which the County committed to consolidate more than 20 municipal sewer systems and repair degraded pipes (Howell-Moroney and Hall, 2011). Initial project cost estimates ranged from $250 million to $1.2 billion.

Campbell (1996) refers to conflicts between environmental and economic goals as “resource conflicts,” defined as the “tension between [natural resources’] utility in industrial
society and their ecological utility in the natural environment” (p. 299). The Jefferson County sewer problem illustrates the resource conflict at its most elemental: as civilizations grow they produce waste and use the natural environment as a sink for that waste. Cities build sewage treatment infrastructure to preserve water quality and promote growth. The resource conflict catalyzed and pervades Jefferson County’s fiscal crisis, through decisions about financing the sewer project.

**Inequity and the Development Conflict**

Unfortunately, the County created an intergenerational equity problem by incurring excessive debt to repair the sewer. In 1997 the County issued $600 million of revenue bonds—guaranteed by sewer system revenues only, not the County’s general operations budget. Project costs ballooned and the County issued more bonds almost every year until 2003, when the sewer debt totaled $3.3 billion (Howell-Moroney and Hall, 2011). Governments often use debt to finance capital improvements; this practice is not unsustainable per se. However, in Jefferson County’s case, the debt rose to a level that inequitably burdened future residents who would repay the debt. Over-burdening future ratepayers represents a “development conflict” between ensuring decent quality of life for all social groups and preserving the natural environment (Campbell, 1996, p. 299).

**Economic Loss and the Property Conflict**

Because of the growing debt, sewer rates shot up, demonstrating the tension between the equity and economic goals. The terms of the bonds leveled the cost burden between current and future residents by requiring the County to maintain a 1:10 ratio between annual sewer revenues and debt service costs (Howell-Moroney and Hall, 2011). In 1997—the same year the County Commission began issuing debt—it instituted automatic rate hikes to maintain this ratio. As a result, from 1995 to 2008 the average household’s monthly sewer bill rose 368%, from $13.48 to $62.90 (Howell-Moroney and Hall, 2011, p. 236). The average household paid $593 more in sewer costs in 2008 than in 1995, on the same order of magnitude as the economic stimulus payments that some households received in 2008 (Bureau of Labor Statistics, 2009).
Assuming inelastic demand for sewer services, Jefferson County households did not consume more for these higher rates; they paid more for the same service (a welfare loss). In total, the county’s households paid $156 million more in sewer costs in 2008 than they did in 1995 (U.S. Census Bureau, 2010). This figure represents money not spent on other consumption, which drives growth in economic models. Thus, economic theory suggests rising rates would stunt growth.

In addition to undermining economic growth, rate hikes exacerbated inequity. Campbell calls the inability to achieve both equity and economic growth the “property conflict.” Given low-income households’ relatively inelastic demand for necessary services, high sewer rates impacted these families disproportionately. The County entered a vortex of issuing debt and raising sewer rates which exemplifies the property conflict. Even with dramatic rate hikes, the debt coverage ratio remained below the required floor after 1998, and the County needed a new solution.

**Market Exposure and Bankruptcy**

The 2002 election ushered in the flamboyant Larry Langford as President of the County Commission. Under Langford’s leadership, the County arranged variety of bond swaps to generate quick cash that it could pay back over a long time, without the high interest rates usually associated with long-term bonds. The County’s 2003 bond issue consisted of $2.24 billion in auction-rate bonds, which are long-term bonds with variable interest rates (Howell-Moroney and Hall, 2011). The County sold these bonds once, but purchasers could trade them at periodic auctions. If demand was too low to buy the bonds offered at a given period’s auction, the interest rate automatically rose. Auctions could fail because of declining confidence in the issuer’s solvency, or because of economic downturns. The County thus bet on its own credit rating and on continued market growth when it traded long-term, high-interest debt for long-term, auction-rate debt.

The housing bust of 2008 sent Jefferson County into a tailspin. Because of bond insurance companies’ exposure to subprime mortgages, the rating agencies downgraded the
insurers’ credit ratings. The downgrades trickled down to municipal bonds the insurers guaranteed. Market activity slowed, bond auctions began to fail, and the bonds’ interest rates rose in response. Because of the failed auctions, rating agencies downgraded Jefferson County’s sewer bonds, which spurred more failed auctions and higher rates. By 2008, the sewer bonds were rated as junk or just above junk, at which point the swap agreement required Jefferson County to repurchase its bonds from the banks. The County would not (or could not), and Standard and Poor’s (S&P) “declare[d] the county in default” (Howell-Moroney and Hall, 2011, p. 238). Since the Commission funded the project with revenue bonds—backed by sewer system revenues instead of the County’s general fund—the problem remained somewhat contained. However, a battle over an important source of general fund revenue tipped the County from limited liability default into general bankruptcy.

In 1999, Alabama’s state legislature repealed an occupational tax that generated about 25% of the county’s revenue (Birmingham News Editorial Board, 2012; Fehr, 2012). A twelve-year legal battle followed, in which the Alabama Supreme Court upheld the legislature’s decision, overturned on procedural grounds a legislature-approved replacement tax, and the legislature refused to back new debt or replenish the County’s general fund (Wright, 2009; Birmingham News Editorial Board, 2012; Selway, 2012). The County filed for Chapter 9 bankruptcy in November, 2011.

Projected Economic and Equity Implications

How might Jefferson County’s bankruptcy hinder growth and equity in the future? Jefferson County already suffers from a competitive disadvantage. Figure 2 shows the relative influences of national growth, competitive advantage, and the local industrial mix in accounting for employment changes in the county. In addition to high sewer rates’ impact on household economics, the competitive effect’s negative influence suggests that something about Jefferson County as a place has harmed its labor market. Could debt contribute to Jefferson County’s competitive disadvantage?
Based on a shift-share analysis of industries that compose a relatively large proportion of its economy, Jefferson County suffers from a lack of competitive advantage but a favorable industrial mix. Until 2008-2010, the county also did not keep pace with national growth (U.S. Census Bureau, 1998-2010).

Tax theory suggests that debt may undermine growth by compromising the County’s ability to provide public services. Local governments face “tradeoffs” between reducing taxes (to attract businesses) and providing services, and public services positively impact businesses’ decisions to locate in an area. Public services may even overcome the negative influence of high taxes on businesses’ locational choices (Gabe and Bell, 2004). To the extent that low taxes prevent a government from providing services, they may deter businesses rather than attracting them.

Like low taxes, debt impacts service provision by reducing the revenues available for public service spending. Jefferson County has experienced this firsthand: it has cut $132 million from its 2013 budget and needs to cut another $40 million (Fehr, 2012). The county has slashed capital funding for building and road maintenance and cut staff across the board. One County jail is overcrowded and understaffed, a new jail cannot open because of insufficient staff, and the County’s indigent care hospital has closed its inpatient unit (Wright, 2012; Fehr, 2012; Walsh, 2012; Jefferson County, 2012). General Motors’ chairman underscored debt’s economic development implications, commenting that his company does not intend to build new plants in “states with large debts or lackluster schools” (Story, 2012).

The GM chairman’s comment raises equity concerns about County spending cuts. Education spending has a stronger positive influence than other types of spending on
businesses’ locational decisions (Gabe and Bell, 2004). Jefferson County has 12 school districts, whose funding varies with property values. In theory, wealthy municipalities’ schools will weather County spending cuts better than poorer places because of their higher local property tax revenues. Thus, if poor schools deter businesses, low-income areas may feel lost economic development opportunity more acutely than independently wealthy municipalities within the county.

**Inside the Planner’s Triangle: Implications for Economic Development**

How did Jefferson County get sucked into such a vicious vortex? To protect against municipal default, Alabama and most other states limit the amount of debt local governments can issue. However, Alabama only imposes a limit on GO debt, and, as Figure 3 shows, most of the County debt was revenue bonds (Howell-Moroney and Hall, 2011). Voter approval requirements also limit indebtedness, but revenue bonds do not require voter approval in Alabama (Howell-Moroney and Hall, 2011). The creativity with which Jefferson County worked around state debt limits suggests a need to broaden the types of debt to which limits apply.

![Figure 3: Jefferson County's Debt Profile, 2011](image)

Figure 3: Jefferson County has also only issued about $1 billion in GO debt, of its roughly $4 billion in total debt (CRC, 2011; Howell-Moroney and Hall, 2011).

Additionally, since the repeal of Jefferson County’s occupational tax sent it over the bankruptcy cliff, the case raises questions about fiscal federalism in Alabama. Alabama’s Constitution does not allow counties to pass new taxes but requires the state legislature to
approve new county taxes (Fehr, 2012). Thus, when the legislature voted to repeal Jefferson
County’s occupational tax, the County had no recourse. Jefferson County’s situation might
tempt home rule advocates to argue for expanding local autonomy (Fehr, 2012; Birmingham
News Editorial Board, 2012; Bronner, 2012). However, to the degree that the state’s institutional
structure did allow local discretion, corruption was rampant. Investigations have traced high
project costs to inflated prices charged through no-bid contracts, repairs the consent decree did
d not require, and poor management (Howell-Moroney and Hall, 2011). Larry Langford,
President of the County Commission, went to prison for taking bribes in exchange for sending
bond deals to an old friend. JP Morgan paid the Securities and Exchange Commission $722
million to settle claims that it charged the County twice the normal fees for bond swap deals
and channeled $8 million to Langford’s crony. By the time the County declared bankruptcy,
over 20 officials had been convicted of “illegal acts” related to the sewer project (Baynes, 2011).
An argument for greater local autonomy seems foolish when public officials, financial
institutions, and local businesses have so thoroughly betrayed the public trust.

Still, the political dynamics between the state legislature and County Commission raises
troubling issues. Regional science suggests that attracting jobs to one place draws them away
from others, which pits local economies against each other for growth (Bartik, 1994). If
politicians act to advance their local economies, those from outside Jefferson County are
incentivized not to act in a way that will advance Jefferson County’s economy in competition
with their own. Wealthy municipalities’ relative fiscal independence from the County for school
funding complicates political dynamics that may exacerbate economic and equity failures.

Conclusion
Jefferson County’s fiscal crisis suggests that economic development planners should
concern themselves with matters that may seem peripheral—in this case, infrastructure
provision. Using the planner’s triangle as an analytical lens shows how an environmental issue
morphed into equity and economic challenges. Across the U.S., water and sewer systems are
approaching the end of their intended lifespans, while municipal governments face declining
state transfers, and a federal government with its own fiscal crisis (Ayanian, 2008). Financing improvements without undermining equity and economic growth presents a challenge. Indeed, the Federal Reserve Bank of New York has warned that municipal bond defaults are much more common than ratings agencies report, but suggests that water and sewer revenue bonds are relatively safe since “water and sewer utilities provide essential services and thus have a strong ability to generate revenue” (Appleson, et al, 2012, p. 2). Jefferson County’s experience counters this assertion; debt securitization raises critical questions for taxpayers, states, and municipalities. Financial managers should consider risk before exposing public debt to market risk; economic development professionals can help illuminate debt financing’s implications for the community.

The Jefferson County case also demonstrates a need for federal and state policy changes. Dillon’s rule operates strikingly in this case: the state has undercut municipal solvency by slashing the County’s tax base and refusing to enact a new revenue source. Still, neither expanded local autonomy nor centralized governance is a panacea. Instead, states should improve rules that foster transparency and oversight, and adapt them to fit modern financial instruments. Voter approval requirements should apply to revenue bonds. Furthermore, since voter approval may not have limited market exposure and complex bond swaps stretch the financial literacy of many voters, states should impose risk analysis requirements on municipalities that engage in bond swaps or invest their debt (Howell-Moroney and Hall, 2011). The Dodd-Frank Wall Street Reform and Consumer Protection Act (2010) institutionalized certain reforms at the federal level, by limiting financial transaction fees (Selway, 2011). The law could prevent corruption. Meanwhile, at the municipal level, planners interested in promoting prosperity need not wait for new regulations to assess the risk associated with market-based debt.
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