Pennsylvania's capital city staggers towards bankruptcy

Samuel Davidson
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Harrisburg, the capital of Pennsylvania, this week narrowly averted defaulting on $3.3 million dollars in bond payments due on September 15 after the state intervened to expedite $4.4 million in scheduled payments.

Last week the city government sent letters to creditors warning that Harrisburg would not be able to meet the payment deadline. The city council scheduled a meeting for Tuesday to consider bankruptcy.

After saying that he would not help Harrisburg out of its financial crisis, Pennsylvania's Democratic governor Ed Rendell announced Sunday that the state would speed up payments owed the city, enabling it to avoid default on Wednesday. Underlining the parasitic and socially irrational nature of the financial markets, the funds from the state government are being diverted to bond creditors from scheduled payments to city workers' pensions and fire safety.

The city's financial problems are far from over. Between now and the end of the year city officials have to find a way to pay $68 million in debt and service fees due on $288 million in bonds that the city issued to fund what turned out to be a failed revamping of its trash-to-energy incinerator project.

The $68 million in service fees due is greater than the city's entire annual budget and more than four times what it collects in property taxes each year. Not counting the bond payment, Harrisburg is already facing a $7.7 million budget deficit due to declining tax and other revenues.

The city council and the mayor's office are divided on what to do. A majority of the city council favors allowing the city to enter bankruptcy. Municipalities that enter Chapter 9 bankruptcy are at the mercy of judges who can extend the terms of loans rather than liquidate them, force cities to raise taxes, cut services, sell assets, and impose cuts to the pay, benefits and pensions of city workers.

Harrisburg mayor Linda Thompson favors selling off city assets to raise the needed cash. She has proposed leasing the city parking garages and parking meters for 75 years to private investors. Last year a group of investors offered to pay the city $215 million up front for the facilities. However, after the city pays debt it owes on the garages, it would receive about $100 million—only enough to meet this year's debt payments and part of next year's on the incinerator project. Furthermore, the city collects $18.6 million each year in revenue from facilities it owns—or about one third of its annual revenue. Sale of these assets will lead to greater deficits in the future, forcing massive cuts in social services.

The mayor has also suggested selling to real estate developers all or part of the city's park, which sits on an island in the Susquehanna River. The island is currently home to a minor league baseball club and a soccer field and is a popular spot for people who work and live in the city.

Gov. Rendell has said he favors the sale of city assets, taking the unusual step of meeting with the city council to urge that they take such action.

Harrisburg, a city of 47,000 residents, sits in the center of Pennsylvania and has been the capital since 1812. Like the rest of Pennsylvania, it has been hard hit by the economic crisis. The official unemployment rate stands at 8.3 percent, but the real rate is much higher. Nearly 30 percent of the population lives below the official poverty level.

Much of the Harrisburg's debt stems from a massive public expenditure that did nothing to benefit the city's population.

In 2003, the city government decided to make a major renovation of its then-closed trash incinerator plant. Originally built in the early 1970s, the plant was always plagued with problems and after operating for nearly 30 years had been shut down because it released high levels of the poison dioxin into the air.

The idea was to burn trash from both the city and the surrounding counties and from this to produce steam that could be sold, or else converted to electricity and then sold.

Originally the project was to cost $45 million, but with delays and cost overruns it mushroomed to over $150 million. That brought the total debt owed on the plant to over $288 million. Currently just two of the plant’s three burners are working, and there is a major piping leak that prevents the selling of steam.

There are several suits filed against the contractor, Barlow Projects Inc., of Colorado, that was to retrofit the plant. The city is also considering legal action against law and engineering firms that advised it on the deal.

Barlow was not a major player in the trash incineration business. Prior to being hired, its largest project had been only one eighth the size of the Harrisburg project. It is believed the company used a technology in the incinerator that was not appropriate to the plant’s magnitude. Barlow has since moved to Texas and entered bankruptcy.

In addition to Barlow, the city also paid out nearly $15 million to the law and engineering firms that arranged the deal. Even though Barlow couldn't be bonded—meaning the city couldn’t buy insurance against the firm if it failed to do the work, a standard practice in the construction industry—legal and engineering experts hired by the city still advised it to go along with the deal.

As the project began to fall apart, city officials attempted to salvage the plant by throwing good money after bad. First the price tag rose to $77 million, then to $125 million, but the plant still was not up and working. The city attempted to push the cost onto residents with a 17 percent increase in taxes, along with increases in water, sanitation and trash removal fees.

Harrisburg is not the only city government that has gone into massive debt to build large projects that benefit real estate developers, bond market speculators, and contractors.

Pittsburgh for instance took part in the building of two new sports stadiums, a hockey arena, and a new conference center, taking on hundreds of millions of debt in the process. The Port Authority of Allegheny County, which operates metropolitan Pittsburgh’s public transit system, is in the process of building what has become known as “the tunnel to nowhere,” a $500 million project which is already more than $125 million over budget and has yet to be completed.

These debts incurred largely for the benefit of wealthy private interests are inevitably forced onto the working class through cuts to social spending and pay for government workers. Pittsburgh Mayor Luke Ravenstahl has just imposed a hiring freeze and presented a budget that calls for 10 percent cuts in all departments. The Port Authority is in the process of enacting massive cuts in public transportation.

As for Harrisburg, it will be increasingly difficult for it to borrow money to carry on necessary city functions. This past February, Moody’s Investors Service downgraded Harrisburg's bond rating to B2, five steps below investment grade, sharply increasing the “yield” it must pay on its bonds.

If Harrisburg is ultimately compelled to file for Chapter 9 bankruptcy protection it will be the largest municipality to do so since Orange County, California in 1994, which lost billions in the stock market.

The threat of default is also sending shock waves through the $2.8 trillion US municipal bond market, which could make it harder and costlier for all municipalities to borrow money. General obligation bonds have traditionally been considered among the safest for investors because they are backed directly with tax revenue.

But with local governments under increasing pressure as a result of falling tax revenues, there is a growing expectation that defaults and bankruptcies will become commonplace.

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