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Can the hole be filled?

In the latest edition of BARRON'S, there was an interesting article entitled "The \$2 trillion dollar hole". It dealt with the emerging problems of under-funded municipal pension liabilities. To highlight the matter, the author chose a small grossly mismanaged city (Vallejo, CA) who filed for chapter 9 to make the case of a broader pension fund crisis. Specifically, the article took a legitimate crisis where immediate action was called for, and tried to use it as a template for an evolving problem. As always, we are not attempting to minimize the growing difficulties embedded in these pension systems. They are large!! However, using a city whose pension obligations exceed 90% of the overall budget as the norm is misleading at best.

Generally speaking, Municipal pension obligations are an intermediate to long-term problem that may have solutions without implementing draconian choices. As unnerving as these types of articles are, they perform a very useful function. The problem becomes public, politicians are scrutinized, and pressure builds for reforms in order to bend the cost curve. Even Mayor Richard Daley of Chicago (not one known for his financial stewardship) has begun to notice the social implications of outsized compensation packages for state and local government workers. He is recently quoted in the Chicago Tribune as saying: "Remember, people across the nation and in Chicago, they are angry at what they see as a system that puts government bureaucrats ahead of taxpayers. At this very same time they are threatened with losing their jobs and pensions." Although one quote from the Richard Daley's of the world doesn't change the math immediately, it is the necessary ingredient to begin the process of fiscal responsibility.

Since it has become fashionable to cite California as our Greece, let's look at what actually happened in Greece. They hid debt, they falsified the books, and swelled the number of state workers on the payroll. Only when the world threatened to stop funding their irresponsible behavior, did the political leaders begin to find religion. Since the lifeblood of any country is funding from investors, there was never a serious consideration of default or renegotiating lower debt payments. Instead, they slashed government jobs, pensions, and proposed to raise some taxes in an attempt to close the deficit. Only time will tell if more needs to be done. However, one thing is clear, if the bondholders are injured and the funding dries up, the country will grind to a halt. As is the case with municipalities, if state and local governments can't fund themselves, they can't preserve themselves.



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Sincerely,

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