State Government Debt Woes Worsen

State governments across the nation are facing debt problems that seem overwhelming. California, when all the state obligations are counted, has a debt equal to 37 percent of its annual income, at least according to one estimate. Pensions account for much of this problem. Andrew Biggs at the American Enterprise Institute observes that if those pension debts are included, the Rhode Island would be so deeply in debt that it would fall outside the 60 percent governmental debt limit set by the European Union, as would even oil-rich Alaska.

Overall, the combined state pension debts, according to Joshus Rauh of Northwestern University and Robert Levy-Marx of the University of Chicago, is a staggering $5.17 Trillion dollars. Only $1.94 Trillion has been set aside to pay those obligations, leaving a gap of $3.23 Trillion.

The problem of extravagant pensions and other problems and deferral of state debts has left nearly all state governments behind on their debts. Illinois, according to that state's comptroller, is $9 billion behind on payments to vendors. One consequence of this has been a downgrading of state bonds. Fitch Ratings, for example, recently downgraded several categories of Illinois state debt. California, which has resorted to issuing the equivalent of IOUs, also has had its bond ratings downgraded. That means the interest rate that the state will have to pay to bond purchasers is higher, and that the future debt obligation will become even bigger.

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States have become increasing creative in ways to address their debt. New Hampshire took $110 million out of a medical malpractice insurance pool — the State Supreme Court has since ordered that the money be put back in the pool. California has accelerated the payment of corporate income taxes into its coffers so that 70 percent must be paid by corporations in the first half of the year. Connecticut has attempted to make its own accounting rules. Hawaii has introduced a four-day school week.

The fundamental problem is that state governments, like the federal government, finds it much easier to give benefits and make future obligations to state employees than these governments do to live within their means and take a conservative and prudent approach to state spending, indebtedness, and pension obligations. States act more like the federal government, which can simply print money to pay debts, than the sovereign and responsible governments that they are supposed to be. State government policy makers also understand that many of their popular decisions bring immediate benefits to some (buying their votes) and long-term disastrous consequences for everyone (which often means after the politicians have left office or, if they have not, at least allows them to claim that all state politicians are equally to blame.)

Governor Christie of New Jersey, for example, has disclosed that the extent of his state's indebtedness was vastly understated by his predecessor, Jon Corzine. What makes this more troubling is that Corzine built his wealth as chairman and CEO of Goldman Sachs, so one must presume that Corzine understood just how dangerous the situation in New Jersey state government was.

State governments also realize that a true meltdown, like in California, could produce the sort of national economic crisis that could then provide federal policy makers with a pretext for bailing out California and other state governments. When the federal government is also spending much more money than in brings in with revenues, then the consequences of the federal government bailing out state governments will only increase the problems of the national debt and national deficit.