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Bankruptcy not a Cure-all

Allowing states to file for bankruptcy is not going to cure all the public pension problems, according to one expert. Professor Joshua Rauh of Northwestern University told a congressional hearing this recently. However, Professor Rauh said the prospect of bankruptcy would likely give states more negotiating power in pension and labor contracts.

At present, states are not allowed to file for bankruptcy protection because they are considered sovereign entities.

But the estimated total pension liability of the states is $700 billion. Key Republican lawmakers in the House of Representatives recently introduced legislation that threatened states with a steep penalty for under-reporting pension liabilities – the elimination of federal tax exemptions for municipal bonds. There is an increasing support among Republicans in the House for bankruptcy to be allowed for the states. The rationale behind this is that bankruptcy would make it less likely for the state government to ask for a federal bailout.

A committee hearing was held on this matter not too long ago and representatives would not say when legislation allowing state bankruptcy would be introduced. The chairman of the sub-committee on bailouts, Patrick McHenry said he would continue holding hearings leading to a report on how to solve the states' burgeoning pensions liabilities and budget problems.

Professor Rauh has cast doubts over whether state bankruptcy would avoid a federal bailout. He said, "…there is a bankruptcy code for corporations in the United States, and that has not stopped federal bailouts of corporations."

Furthermore, last year he released a paper that shows the traditional 8% returns states expect on their pension funds investments has only a one-third chance of achieving that rate over 30 years. This was the rate of returns most state and local pension funds expect because of historically high returns but Professor Rauh reduced the expected returns and discovered that pension funds might fall short by as much as $3 trillion.

Investment returns of public pension funds have nosedived due to the sluggish economy as employers cut back on contributions in the face of dwindling revenue. The states have been putting the blame on pension payments for their budget problems.

According to Professor Rauh, "without significant tax increases," state and local governments could not keep pension promises and take care of other debts.

If you are thinking of filing for bankruptcy for yourself or your business, call us at (813) 200 4133 for a free consultation.