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The Looming Debt Crisis: A State & Local Perspective

The federal government currently owes nearly $20 trillion in gross debt. All projections indicate the debt will continue to rise dramatically unless Congress and the President move to get the budget in order. At a September Joint Economic Committee hearing, members of Congress and expert witnesses investigated the drivers and options for reform. Although the hearing focused on federal debt, the Honorable Mitch E. Daniels, Jr., President of Purdue University and former Governor of Indiana, noted America's debt problem extends beyond the federal level:

> *We're here today talking about trillions in federal debt, but there are several trillions of unfunded liabilities sitting out on states' books that sooner or later may be a problem for some future Congress.*[1]

President Daniels is referring to the many looming fiscal crises facing American state and local governments.

In 2013, the most recent year of data, the Census Bureau estimates that state and local debt totaled just under $3 *trillion*. Approximately $1.13 trillion of the debt is on a state level and about $1.82 trillion is local debt. However, these numbers are just the tip of the iceberg. Buried beneath the almost $3 trillion in debt are *trillions* more in obligations that governments have promised current and future retirees. President Daniels is rightfully worried about how governments will fund these obligations to retirees and their families while still fulfilling necessary responsibilities such as education, infrastructure, and safety.

Unlike the federal government, states and localities have a limited set of tools to work with. They cannot inflate away their debt through monetary policy, and their tax base is more mobile than at the national base. Cities and municipalities are allowed to enter bankruptcy as a last resort, but rarely do so for fear of a lower credit rating. Alternatively, they could ask their state to assist them with financing to cover their debt. States are not allowed to enter bankruptcy and are obviously larger entities, and thus a state debt crisis could quickly become a federal issue as it wrestles with the increasing burden of obligations. This could put Congress and the President in the position of bailing out states, a potentially dangerous precedent, and one that would further add to the bloated federal debt.

Although economists often focus on the raw numbers, stories of human costs in cities and states that have gone through fiscal crises prove fearsome. Citizens affected by these crises have endured the loss of services, including reductions in both police and firefighting forces, higher taxes, reduced retirement or health benefits, and uncertainty about the future of their communities. Examining these realities could provide a glimpse into the future of many American cities and states. More optimistically, these examples could provide lessons on how to avoid disaster early and mitigate the cost to citizens.

Solving the fiscal problems that state and local governments face is essential to ensure their long-run solvency. Although state and local government tools are less powerful than federal tools, they can be much more flexible. For example, localities have experimented much more with Public-Private Partnerships (PPPs) than the federal government has. PPPs allow governments the ability to offload the operation and cost of providing services to the private sector. Even with such flexibility, many governments need to be more realistic in assessing the costs they face. With severe underfunding of retiree benefits and guaranteed benefit programs, it behooves local leaders to address these costs early before they become an iceberg poised to sink the fiscal ship. Finally, states should not expect a federal bailout. The federal government already faces a debt and entitlement crisis that is eating away at its fiscal sustainability, and it would prove unwise to add to its nearly $20 trillion in total debt.

The Use and Misuse of Debt

In contemporary discourse, debt often carries a very negative connotation. However, the use of debt is not inherently bad, and it serves a very important function in the funding of worthwhile projects. Debt is used by households, firms and governments to finance a variety of purchases, including capital investments. It is the nexus occupied by people who have savings they are willing to lend and people who want to borrow for a purchase and repay funds over time with interest.

Many Americans deal with debt on a regular basis. People use debt to purchase numerous goods and services including cars, houses, and education. Using debt to finance purchases can be a sound decision. For example, families who want to purchase a home can take out a mortgage, buying the house with a combination of an initial down payment and the loan. Absent the loan, the family would have to save income in the amount of the home's full price and forego other things that they may need or desire. With the loan, the family need only save a fraction of the home's price, purchase the property, and enjoy the benefits while repaying the mortgage over many years.

Firms regularly use debt to finance expenses or purchases required for production. For example, a farmer may take out a loan early in the season to buy seeds, upgrade a tractor, and cover payroll costs. The farmer borrows the money to finance a year's worth of crops and pays off the loan once the crops are harvested and sold. In a similar vein, a startup manufacturing firm may borrow money from venture capitalists or banks to purchase commercial space, invest in equipment, and pay employees. Once production begins, the business owner hopes revenue will soon cover the debt incurred from startup costs. Both of these are examples of projects that require an initial loan to cover costs, with the expectation that the business will ultimately prove successful, adding value that yields a stream of benefits in the future.

The logic does not change when applied to state and local governments. A government may invest in a large project, such as a school, bridge, or road that is very costly initially, but will yield long-term benefits like higher standards of living and more commerce. Without the ability to finance the construction, the state or local government would either have to fund the project with current tax receipts or save until it has the money. Funding the project out of a single year of tax revenue could severely curtail other services provided, such as education, police or fire protection, trash pickup, etc. Alternatively, saving the money needed for the project could require many years and delay the benefits of the new project. With debt finance, a government is able to begin the project sooner and provide the benefits quicker.

Although debt is a useful tool, it carries the temptation of misuse. In the examples above, a government can choose to invest in a project like building a school because, with careful analysis, the project provides a clear future benefit. Governments may also use debt for short-term smoothing of cash flows. For example, municipal employees have to be paid regularly, but the government does not always receive revenue at the same rate as its payroll. To cover this, governments may issue debt. However, there is a distinction between smoothing out payments and borrowing money that a state or locality cannot afford to pay back. There is no hard and fast rule, but it is generally unwise for governments to use debt to pay off other debt. The analogous situation in a household would be the use of a new credit card to pay off an old credit card bill. While this does buy time and flexibility, the problem can quickly spin out of control when governments cross that line.

Fiscal Crisis

Once a local government's finances reach an unsustainable level and become uncontrollable, a contentious debate ensues over which program or creditor is going to receive payment first, and under what terms, for past promises. These debates pit multiple stakeholders against one another with many valid grievances over broken promises. Leaders and voters are left in the unenviable position of having to make difficult decisions about what promises will be broken and to what degree. Such decisions might require tax hikes, increased fees (such as higher parking fees and infraction fines, charges for services, etc.), sales of property, broken labor contracts, laid off workers, pension cuts, or creditor payment cuts. With these options, it was not an exaggeration when bankruptcy lawyer James C. Behrens stated "Citizens are not proud to live in a bankrupt city, nor are leaders proud to lead one."[2] Simply put, some people, whether it is taxpayers, workers, retirees, or creditors, will lose money, and usually, it is all four.

Some state governments have laws and procedures in place to help distressed municipalities, but this is far from universal. State laws vary considerably. For example, Pennsylvania law allows for the state to intervene and assist financially troubled municipalities. However, other states do not have such mechanisms. Further, state assistance is not guaranteed. States may not have the funds necessary to assist. Recent reports indicate that states are cutting their spending to make room for increased Medicaid expenditures under the *Affordable Care Act*.[3] Beyond funds, assistance may require voter approval, and citizens in financially stable parts of the state might resist the use of their tax dollars to assist a local government that did not keep its finances in order. The reality is that citizens from other parts of the state could delay or prevent the assistance needed by the ailing municipality. The same notion applies at the federal level. Citizens or legislators from financially stable states would likely resist sending money to rescue other states or municipalities.

The last recession led to a rising number of cities and counties filing for bankruptcy. The United States Bankruptcy Code contains a special chapter designed to assist localities with reorganization of debt. It is generally considered more advantageous for localities to utilize Chapter 9, under which they maintain greater flexibility and control during the process, as opposed to the more common Chapter 11, under which the bankruptcy court exercises more control. However, Chapter 9 has higher hurdles for qualification. Specifically, eligibility is presumed for Chapter 11, but a municipality must meet several criteria for Chapter 9 protection and creditors can challenge its eligibility. In addition, state approval is required before the process begins. Certain states ban the practice altogether. Once in Chapter 9, a city can use the process to help sort out the debts and put it on a more sustainable fiscal path.[4]

The recent number of municipalities filing for bankruptcy is relatively low, historically. In 2011, the Congressional Research Service found the average use of Chapter 9 bankruptcy, or so-called "municipal" bankruptcy, averaged less than ten per year.[5] Due to the stigma, legal fees, and increased borrowing costs, municipalities prefer to ask their states for help. States generally have a process in place to assist municipalities in need. An entertaining version of this was portrayed in the season two finale of NBC's show *Parks and Recreation* when the fictional town of Pawnee had financial problems. A team of state auditors is sent in to determine the depth of the crisis and figure ways to get the city back on track. But unlike municipalities, states cannot enter bankruptcy.[6] When a state encounters a crisis, it must raise taxes, cut spending, or find other innovative ways to pay the bills.[7]

Causes of Fiscal Crises

Fiscal crises come in all shapes and sizes, and similar drivers that push the federal budget toward an unsustainable path are felt sooner and deeper on a local level. Below are five major causes of fiscal crises that American localities and states have recently experienced. Unfortunately, many governments are currently dealing with more than one of these causes. For example, Detroit experienced all five causes to varying degrees over the years. In the interest of drawing broad lessons, each cause will focus on one example, but further details and narratives can be found in the endnotes.

Demographic Changes

America is experiencing incredible demographic shifts during the new millennium. The population is getting older. Baby boomers are starting to retire and claim the benefits they were promised while they were working. This presents tough challenges for budgets around the nation. On the federal level, the aging population creates a ticking time bomb of a slower growing tax base and increasing entitlement spending. As illustrated below, states and localities face the same crisis in pensions and benefits, but they must also grapple with the risk of its population leaving. Individuals and families choosing to move can accelerate a fiscal train wreck that otherwise may seem years away.

The quintessential example of a declining population causing a fiscal crisis can be found in Detroit. In the mid-20th century, the aptly named "Motor City" was the center of America's car manufacturing industry. With a city population approaching 2 million people in the 1950s, almost one-third of the entire population of Michigan was living within the city.[8] The suburbanization of America and the turbulence of the 1960s began driving people and jobs out of the city. The trend continues even to this day. In 2010, the Census Bureau found that Detroit lost 25 percent of its population, or 237,000 residents, between 2000 and 2010.[9] Further estimates from the Census Bureau project that Detroit has lost an additional 5 percent of its citizens since 2010.[10]

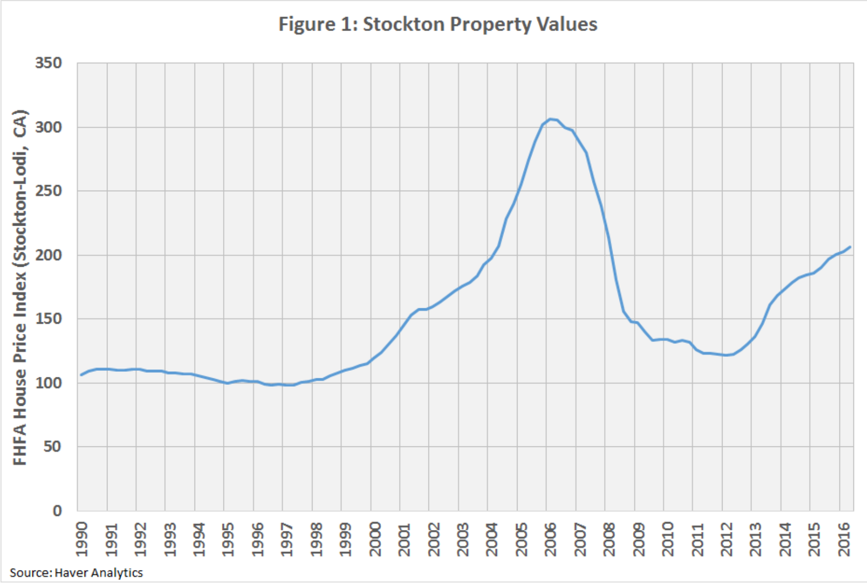
Facing the declining population, the city government should have taken a critical look at its future budget and made changes to reflect the new reality. Instead, officials over the years increased taxes, delayed downsizing, and allowed legacy costs to grow, including granting bonuses colloquially known as "13th checks" to retirees. This led to massive fiscal shortfalls, which Detroit filled by issuing debt. As chronicled by the *Detroit Free Press*, the city had opportunity after opportunity to put itself closer to a sustainable path, but it never seized them. Former Detroit Mayor Roman Gibbs put it quite succinctly:

> *You can't continually borrow money and use it for operating expenses and expect never to have trouble paying it back. That's where you end up going bankrupt.*[11]

That is exactly where Detroit ended. In July 2013, Detroit filed the largest municipal bankruptcy case in American history. At the time, the state-appointed emergency manager of the city estimated a total debt tally of $18 to $20 billion. Almost immediately after the bankruptcy, many called for a federal bailout.[12] Detroit emerged from bankruptcy with hundreds of millions in state aid, cuts to retirees' pensions and benefits, over $177 million in bankruptcy costs, and a still unclear future.[13] This disaster could have been avoided if leaders took bold and decisive action earlier when the costs would have been smaller and the insolvency was still decades away.

Overly Optimistic Revenue Estimates

When considering projects or investments, all governments must be acutely aware of future economic growth and revenue. Growth is essential because as the economy grows, so does tax revenue. Much tax revenue for localities comes from property taxes. Property taxes are usually levied on the value of the land in the town. Even without raising the tax rate, growing property values will increase tax revenue. Certain towns may find themselves in the position of declining property values, and hence decreasing cash flow in the future (see Detroit example above). If there is not enough future cash flow to cover the city's costs, municipalities will quickly run into problems. Even without declining property values, cities and towns may encounter problems if they assume that property values and property tax revenue will grow faster than they actually do.



Stockton, California, is an example of a city that counted on robust growth until it was too late. Stockton is located just over eighty miles east of San Francisco, and unlike Detroit, it experienced significant population growth. In 1950, just under 71,000 residents lived in Stockton, and by 2010, it had grown to more than 290,000. Property values grew as well, especially in the late 1990s and early 2000s. As shown in Figure 1, from 1998 to 2006, Stockton's property values essentially tripled. With these higher prices came more tax revenue for the city. Between 2001 and 2007, general tax revenue increased by 33 percent. It should be noted that even before the jump in revenue, the city was offering generous pensions and retiree health benefits to its employees. Bolstered by the booms of the 1990s and early 2000s, government officials were confident they could afford the pension costs, but this ultimately proved false. The city's emergency manager described the situation succinctly: "Debt had been 'back-loaded' on the mistaken assumption that revenues would increase over time."[14]

Unfortunately, by 2007, revenues from property taxes crashed and the housing bust began to spread across the United States. Stockton was hit particularly hard. According to the new city manager, property values plummeted 70 percent and unemployment peaked at 22 percent. The ensuing budget crunch caused city officials to lay off 25 percent of the police force and 30 percent of firefighters.[15] Police were so short staffed that they could only respond to in-progress crimes of immediate danger.[16] Even with all these cuts and more, the city did not have enough revenue to meet its obligations and had to file for Chapter 9 bankruptcy in July 2012. The bankruptcy process took the city two-and-a-half years to navigate. When the final agreement was reached, the voters had to approve a sales tax increase, retirees had to take pension benefit cuts, and local government creditors had to accept pennies on the dollar.[17]

Failed Investments

All states and localities undertake projects to benefit their residents. The projects can range from the smallest infrastructure investments, such as a new sidewalk, to massive complex projects like a new bridge or school. Responsible governments will ask many questions before committing to starting a project. What are the costs? How will it benefit the citizens? Can it fit within the budget? Would PPPs prove beneficial? Should debt be used to finance the project? What are the risks? For many investments, these questions are asked, publicly debated, answered, and a decision is made to go forward or not based on the conclusions. When this process breaks down, it can put governments in terrible fiscal positions, leaving citizens on the hook for the losses.

The city of Harrisburg, Pennsylvania, provides a unique example of how the lack of responsibly questioning an investment can lead to fiscal ruin. In the 1970s, Harrisburg opened a garbage incinerator plant that turned trash into steam and helped power the city's Bethlehem Steel factory. It was relatively profitable until the 1990s when the plant incurred losses due to stricter environmental regulations and a nearby city choose to fulfill its garbage disposal needs elsewhere. By 2003, the incinerator plant was outdated, and at the end of its useful life, had accumulated $104 million in outstanding debt.[18]

Instead of shutting the facility down, elected officials decided to retrofit the plant. The city contracted with an inexperienced engineer who estimated he could retrofit the plant for $40 million less than what other major garbage disposal companies proposed. However, the engineer could not secure performance bonds, a form of insurance that would compensate the city in the event the contractor fails in his duties for the construction. Although these are significant red flags for any project, the city approved the contract and issued $125 million in bonds to finance the construction.[19]

Problems arose, and in 2005, city officials issued further debt to make payments for additional construction costs and to cover the debt servicing of previous debt. When the engineer finished working in 2006, the city discovered the rebuild had not been completed to specifications and would prove unprofitable. However, the city and its citizens still had to make bond payments on the more than $300 million in debt for the project. The city increased taxes and fees for waste service in an attempt to cover the debt payments, but eventually had to be rescued from fiscal ruin by the state of Pennsylvania and Dauphin County.[20] By the time the city sought help, the amount of debt totaled $6,970 per resident.[21] After prolonged political toil, the city, state, and creditors agreed to a rescue plan in 2013.[22] The plan required selling the incinerator plant for $120 million, extending an income tax of 2 percent, and doubling parking fees for the city.[23] This disaster could have been avoided if officials had properly considered all the costs, benefits, and risks associated with the incinerator.

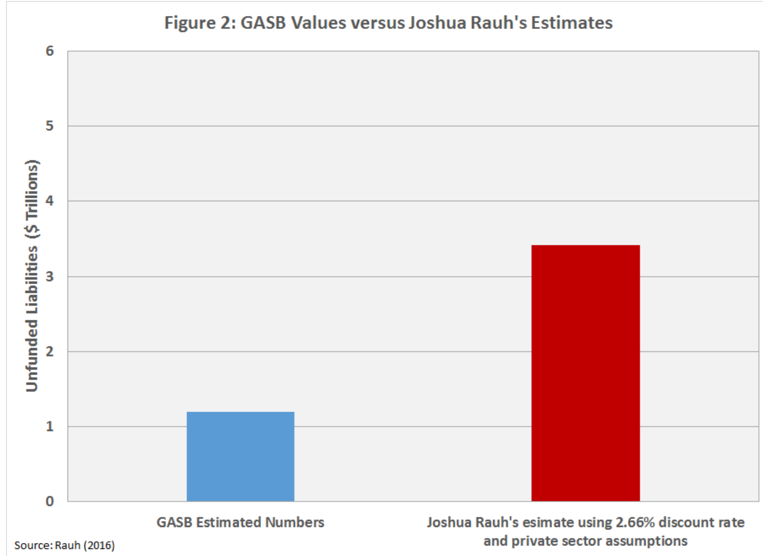
Lack of Coordination and Oversight

At the federal level, agency oversight is an important part of the governing process. At the state and local level, the lack of such scrutiny can impact residents sooner and more intensely as budgets are more limited and the decisions are much closer to the citizens. When a locality spends millions of dollars on an unsuccessful project or loses track of finances, it can quickly spiral out of control and become a full-blown crisis, as Harrisburg illustrated above. Situations like Harrisburg are catastrophic but rare. Even absent a massive project, regular budgetary oversight and coordination are necessities. A lack of coordination could lead to a budget crunch, affecting all aspects of local government.

Petersburg, Virginia, provides an example of how a lack of coordination and oversight put a city in fiscal crisis. In March 2016, the mayor fired the city manager after a project involving “smart” water meters began failing. The billing system incorrectly billed residents, and over time revenue from the meters fell dramatically. Once a new manager was appointed, she and state officials began investigating the city’s finances and found it had millions in unpaid bills, rendering the city unable to pay its workers by the end of the year. After bringing this to the attention of the city council and its constituency, Standard and Poor’s downgraded Petersburg’s debt to BBB-, a “junk” rating, and the lowest of any locality in Virginia.[24]

With millions in unpaid bills and effectively shut out of the debt market, the city faced an immediate fiscal crisis. Local leaders, left with no alternatives, began laying off workers, raising taxes, and shutting down museums to ensure the city continued to meet its monthly debt payments and payroll obligations.[25] Recent discussions include potential cuts to police and education, as well as repossessions of fire protection equipment.[26] The cuts have angered many of Petersburg’s citizens who feel both blindsided and frustrated with their lack of input on the financial plan. Since the city began implementing the plan, there have been calls for the mayor to resign, protests, insults, and frustration on all sides.[27] As with all of these examples, small actions such as proper vetting of projects or more coordination between all the programs could have prevented disaster if implemented before the finances got too far out of hand.

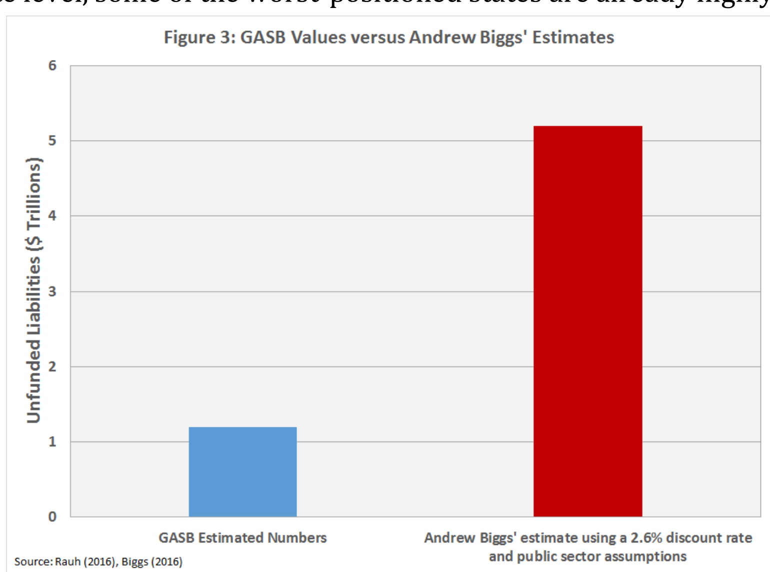
Overpromised Benefits



Proper oversight and coordination cannot be overstated when it comes to public pensions and retiree benefits. The largest drivers of future state and local debt are the unfunded pension and benefit obligations. Unlike debt, which is shown on a government balance sheet, promised future benefits are hidden because they run beyond the time frame of any given budget window. To pay for these benefits when they come due, many governments will have to raise taxes, cut services, or if the markets allow, issue additional debt. Further, pension liabilities' off-balance-sheet nature could fly under the radar of state balanced budget amendments requiring current spending to match revenue. While helpful for fiscal discipline, these balanced budget requirements are not necessarily a guaranteed solution to this long-term problem. The benefits and their financing structure must be carefully thought out and designed to account for future liabilities.[28]

The size of future liabilities at the state and local level is massive. Estimates of total state and local unfunded liabilities run into the trillions of dollars. In a study conducted by the Hoover Intuition's Joshua Rauh, state and local governments reported $1.2 *trillion* in unfunded pension liabilities using accounting practices recommended by the Governmental Accounting Standards Board (GASB). However, as Rauh notes, these forecasts assume unrealistic rates of return on the assets. With more realistic assumptions that adjust forecasts to reflect private-sector pension accounting methods, the unfunded liabilities more than double to $3.4 trillion.[29] In a later estimate using different data, Andrew Biggs of the American Enterprise Institute found a much larger total liability of more than $5 trillion. Biggs' estimate begins with a slightly larger reported liability of $1.4 trillion and it does not reflect the accounting adjustments that make the public plans more comparable their private counterparts.[30] Estimates from American Legislative Exchange find similar liabilities over $5 trillion.[31] Although economists and analysts can use complex and differing assumptions, all conclusions point in one direction: a massive wave of unfunded pension liabilities.

When examining pension and health benefits at a state level, some of the worst-positioned states are already highly taxed. New Jersey, Connecticut, and Illinois all have massive unfunded pension and retiree health costs, and all are in the top 10 of WalletHub's 2016 tax burden rankings.[32] In Truth in Accounting's *Financial State of the States* for 2015, these three states are ranked 1, 2, and 3, respectively, with the largest taxpayer burdens.[33] Making the situation even worse, both Connecticut and Illinois experienced significant net outmigration over the past four years.[34] Raising taxes further to meet obligations could accelerate this exodus, resulting in an increasingly smaller and highly taxed citizenry shouldering an increasing burden of liabilities.



Illinois is already dealing with the consequences of a fiscal crunch due to overpromised benefits. The situation is so dire that *The Economist* has compared it to the situation Greece faced in 2014.[35] According to the Manhattan Institute's Diana Furchtgott-Roth, between 1999 and 2013, Illinois pension obligations increased 450 percent.[36] Further, estimates from the Mercatus Center's 2016 State Fiscal Rankings show that Illinois possessed almost $300 billion in unfunded liabilities.[37] On top of these massive future payments, the state is buried with over $35 billion in debt.[38] A 2015 court case, which upheld that pensions are guaranteed under the Illinois constitution, has further accelerated the crisis.[39] A bipartisan-passed law attempted to reform the state's pension system, including benefit cuts, but was rendered ineffective virtually instantaneously by the Illinois Supreme Court ruling. The current situation is so dire that Moody's has downgraded $26 billion in state debt to two steps above a "junk" rating.[40]

The Way Forward

Although the above examples paint at times a depressing picture of state and local finances, there are always opportunities for reform, particularly early in the process. As President Daniels emphasized in the previously mentioned Joint Economic Committee hearing, "You can do more than you think you can, and boldness and decisiveness can be rewarded. You can live to tell about it."[41] Boldness requires doing the proper cost-benefit analysis for every initiative under consideration and a willingness to say "no" if it cannot be afforded at the time or poses an undue risk to the budget.

Thanks to the current structure of our federal system, local governments have more leeway to experiment with different innovative solutions to help shore up their budgets in the event of a crisis. For example, under Governor Daniels' leadership, Indiana pursued a Public-Private Partnership to lease the Indiana Toll Road. After the bidding process ended, Indiana signed a 75-year lease with a private company. In return, Indiana received $3.8 billion for sale of the contract and delegated the maintenance responsibilities to the private company.[42] Detroit is another example. Foundations, private donors, and the state came together during the city's embattled bankruptcy to obtain outside funding to remove its art collection from the auction block. This allowed the art to remain available to the public while still providing Detroit with much-needed funds.[43] As we see time and time again, even during the worst times, Americans are finding innovative solutions to pressing problems.

Though continually ignored, future pension and retiree benefit liabilities pose significant risks. As countless scholars have noted, the assumed discount rates currently used by public pensions are unrealistic. By assuming a high rate of return, pension liabilities appear relatively low, while under more realistic assumptions they are much higher. States and localities should begin to shift their assumed rates of return to more realistic levels. Making the shift will be difficult. This year, the Illinois Teachers' Retirement System reduced its assumed rate of return by 0.5 percentage points, adding around half a billion dollars next year in required contributions.[44]

Further hastening the need to change are state court decisions and retirement offerings in the private sector. As referenced above, an Illinois Supreme Court decision provided a constitutional guarantee of pension benefits to retirees.[45] Separately, a state court case in Michigan has guaranteed the health benefits for retirees in the town of Kalkaska, adding both an unexpected cost to the town and an upfront bill that the town may be unable to afford.[46] State and local governments may be able to shift the type of retirement benefits offered. Most private employers no longer offer defined benefit pension plans to their employees. Instead, many match contributions to what is known as a defined contribution retirement savings plan, such as a 401(k), which is portable when converted to an individual retirement account and does not require an employee to stay with the same employer for decades to earn full benefits. Awareness of these possibilities and others, combined with bold action, can ensure the retirement security of current and future retirees and address the budget challenges of America's localities.

As seen during the Detroit bankruptcy, calls have increased for a federal government rescue of financially strapped states and localities. Further, rescue packages tend to be kicked up the chain of command. Harrisburg received guarantees from both Dauphin County and the state of Pennsylvania. Detroit received assistance from the state of Michigan. Almost invariably, each ever-larger crisis leads to calls for a federal government rescue.[47] The possibility of a federal rescue or bailout is uncertain. Nonetheless, a bailout at the federal level would pit the fiscally profligate states against those with better-managed finances. An open question remains as to whether those fiscally profligate states could convince their more fiscally responsible counterparts to approve such a measure. The difficulty in building a rescue package that members of Congress from other states would approve is a large question mark that a distressed city or state would face.

Beyond political issues, a federal bailout would be a bad idea on two fronts. First, as Mercatus Center scholars Mark Warshawsky and Eileen Norcross note, a bailout would create a moral hazard for states and cities. A bailout would remove the motivation to remain fiscally disciplined as required of responsible government, and it would put taxpayers around the nation on the hook for the irresponsibility of localities they do not live in. Second, as emphasized in the Joint Economic Committee hearing, "Federal Debt: Direction, Drivers, and Dangers," the federal government is already facing its own budget crisis in the near future.[48] Federal spending outpaced revenues to the tune of $600 billion in fiscal year 2016 alone.[49] Further, growth in mandatory spending, i.e., spending that grows on autopilot, will leave fewer funds for Congress to devote to discretionary spending on national defense and other priorities like medical research in the future. The Congressional Budget Office projects that mandatory spending will consume 96 percent of federal government revenue by 2026.[50] The federal government already faces difficult decisions and reforms that will be needed to ensure its fiscal solvency; it cannot afford to pick up the bill for states and localities as well.

The troubles encountered by cities and states in fiscal crisis also provide sobering lessons for the federal government. If the federal government fails to get its fiscal house in order, the consequences would be even more catastrophic than the cautionary tales outlined earlier in this paper. The imperative is for the federal government, as well as state and local governments, to make responsible decisions now in order to prevent more painful choices in the future.

This paper is part of an examination of the drivers, causes, and consequences of excessive debt in our country. For more details on debt, watch the Joint Economic Committee's hearing on "Federal Debt: Direction, Drivers, and Dangers" or read "The Looming Debt Crisis: An International Perspective" and "Debunking the Dangerous Claims of Debt Deniers."

Endnotes

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