



## Burdening the Future: It's Not Just the Feds

Stephen Goldsmith | February 18, 2010

The recently released federal budget has shed a harsh spotlight on government's tendency to spend today while leaving the bill for our children to pay. The budget projects \$8.3 trillion in deficit spending between 2011 and 2020 on top of an already massive debt.

But last week's strong action by New Jersey Governor Chris Christie to pull debt-ridden New Jersey out of its economic free fall reminds us how many state and local governments have also been burdening the future by making unsustainable commitments.

While most states may not run up unconstrained debt like the federal government they can through other devices layer on costs to future taxpayers. Some of these methods represent subtle tradeoffs—whether to fix a bridge now or put it off till later. Other methods involve explicit political decisions, such as committing to pension and health care increases that will never be affordable, even in the distant future. Government budgets, unlike private sector accounting, make it possible to ingeniously “kick the can down the road.”

There are signs that they may have reached the end of the road. Governor Christie took his extraordinary action to cut the totally unaffordable state budget in a bold effort to elevate the interests of New Jersey's future generations over a wide array of entrenched current interests. Over the howls of opponents in the legislature, the governor pushed the limits of his powers to right the budgetary ship. Containing 375 cuts to schools, colleges, hospitals, transit and more, the budget is unlike anything seen in Trenton in a long time.

Though critics painted Christie as cold-hearted and mean-spirited, in a speech announcing the budget Christie appealed to a sense of intergenerational fairness: “Our love for our children requires that we do not shove today's problems under the rug only to be discovered again tomorrow. Our sense of decency must require that we stop using tricks that will make next year's budget problem even worse,” said Christie.

As Governor Christie noted in his remarks [on union renegotiations]: “Make no mistake about it, pensions and benefits are the major driver of our spending increases at all levels of government—state, county, municipal and school board.”

While all of the hundreds of organizations touched by the budget cutting—from institutional advocates, to special interests to unions--will make a great deal of noise on behalf of those they serve, Christie's budget will force an honest conversation about the hard choices facing the state, and whether there aren't better ways to do deliver services.

I remember early in my first term as mayor when negotiating a labor agreement with the police union, struggling to balance taxpayer versus officer interests. The union suggested we could hold down the pay increases for two years if we agreed to increased pension benefits and increases in later years. While fine in the short term, the long-term consequences would have been crippling to future mayors. As Governor Christie noted in his remarks: “Make no mistake about it, pensions and benefits are the major driver of our spending increases at all levels of government—state, county, municipal and school board.”



Politicians always face the temptation to push costs to a latter day when times will hopefully be better. Even the best of politicians struggle with balancing the pressing, vocal demands of the moment against the silent cause of the future. Politically, there is every incentive to pay expenses today with revenues collected in the future. We've fallen into a trap of expecting something for nothing.

The problem, of course, is that this approach unfairly transfers today's costs to our children who face a future of paying something—a great deal actually—for nothing. In addition these delayed payment methods discourage the sort of institutional improvements that if made now could spur more efficient service delivery and create a foundation for a stronger economy in the future.

A clearer understanding of the ways the future gets burdened with the debt of the present is a good place to start.

### 1) **Paying employees with promises**

Set aside any discussion as to how much public officials ought to be compensated. Instead, focus solely on how they get paid. In general, public workers earn both current salary and benefits plus credit toward promises of future compensation, most notably pension and retiree health care benefits. The problem with this is that today's elected officials rarely put away enough to cover expected payouts.

As economic and population growth slows or turns negative particularly in larger, older cities, the wishful thinking that bets on growth as the path out of economically unsound public retirement and health commitments looks more and more risky. These benefit decisions operate in very different ways from the private sector, which has the market and financial transparency to act as a check.

In the public domain the decision on how generous the government should be plays out in a political environment where politically potent public employees play a significant role in elections or today often even sit on the city council that votes on their benefits.

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The public sector is one of the last bastions of now unaffordable defined benefit pensions. It also is the citadel of complex, murky retirement rules that foster scamming including bumping up final pay, early claims of disability, or credit for volunteer service such as on a town's library board.

Public workers deserve a fair retirement and it does them no favor with voters or taxpayers when public officials tolerate benefit gaming. For example, California allows public safety workers to retire early (known commonly as DROP programs) and return to work the next day as consultants, double dipping from public coffers at considerable taxpayer cost.

This "generosity" comes with a steep price. A senior advisor to Governor Schwarzenegger recently wrote that \$3 billion of tax revenue was diverted from current programs to pay for pension shortfalls.

### 2) **Borrowing to stay Afloat**

The amount of municipal debt presents challenges to city and state governments. And when government borrows for capital purposes leaders need to make the case for why the investment produces a strong foundation for the community and why the debt matches the life cycle of the asset. A riskier problem occurs when officials borrow to manage operating deficits. Essentially this is the difference between



a family that takes out a mortgage for their home and one that takes out a second mortgage to help finance their credit card purchases.

Another debt issue occurs when state governments like California build up greater and greater levels of debt to bridge over budget deficits. Even in areas where monetization usually makes sense—like the privatization of an asset—if the result converts the lifetime value of a hard asset into a shorter budget filler the next generation will pay for this one's mistakes.

For example, whether Arizona having recently “sold” \$735 million in state office buildings is prudent depends on whether the transaction increases or decreases future debt-- an issue which depends not only on the price of the transaction but also on whether the funds are invested in a manner that reduces future state costs.

Indiana under Governor Mitch Daniels did it right when he invested the Indiana toll road proceeds in fully funding the state's infrastructure deficit. He did so in a way that will reduce long term costs due to accelerated deterioration of the roads and the affect on economic vitality

### **3) Accepting Medicine That Makes the Patient Worse (a Short Term Fix)**

No stressed mayor or governor faced with layoffs and budget cuts can rationally turn down stimulus money. But instead of investing the money in transformative approaches to public services that will permanently reduce the cost of production, the federal government forced local officials to temporarily keep public jobs at unsustainably higher levels—thus ensuring an even steeper cliff event when the money runs out.

### **4) Deferring maintenance on infrastructure**

Very few governments maintain a true capital budget reflecting depreciation. Therefore officials have little incentive to defer today's needs to prepare for tomorrow's infrastructure crisis. Yet this deferred maintenance comes at a very steep price eventually as the neglected small repairs of today become the huge replacement expenses of tomorrow. Recently enacted GASB rules 43 and 45, helpfully require governments to account for the costs of unfunded liabilities on their balance sheets, belatedly forcing some attention to this issue.

Clearly most officials care about the future of their communities but now they will be called on more than ever to discharge their responsibilities by taking on political risks that once could be avoided—in essence they will need to net present value not just the capital costs but the political ones as well.

Large doses of courage and transparency will be necessary for today's state and local officials to protect the voters of tomorrow despite the complaints by today's highly organized public spending beneficiaries. Leadership involves not just facing down employee groups, recipients of grants, state associations and the like but also the tough job of educating the general public that government has overgrown its resources and its capacity, which in turn is slowing job and economic growth. Governor Christie is off to a good start in showing other's the way.