Bankrupt states turn to short-term loans

by H. Graham Lowry

With no economic upturn in sight, the major industrial states of the United States are increasingly resorting to massive short-term borrowing to sustain budget outlays that have already been drastically cut back. Over the next three to nine months, billions of dollars in short-term notes will come due, plunging state governments into fiscal crises which could lead to complete breakdowns.

In a single two-week period beginning late September, the money markets were flooded by $7.5 billion in short-term notes from just four states, led by a staggering $5 billion sale by depression-wracked California. Generally priced to yield a tax-free return of between 3.1% and 3.5%, the notes were grabbed up on Wall Street as a lucrative alternative to taxable Treasury bills yielding barely 3%.

The California sale of short-term revenue anticipation notes was the largest tax-exempt note offering ever recorded, and came barely one month after adoption of a $10.7 billion budget cut. Pennsylvania—which lost nearly a third of its blue-collar work force during the 1980s and placed the bankrupt city of Philadelphia under receivership last year—had to raise $600 million in nine-month tax anticipation notes Sept. 22. The next day, New Jersey floated $1.6 billion in short-term notes. Two weeks later, the state laid off 1,500 public employees and transferred thousands more into lower pay classifications. Illinois, which earlier this year imposed emergency budget cuts of over $300 million, had to turn to short-term borrowing for another $300 million at the end of September. New unemployment claims shot up 16.7% the next week.

California: looming disaster

This desperate resort to a short-term fix may push some major government breakdowns past the November elections and into next year, but current economic policies will only continue to flatten the revenue base needed to pay off the notes.

The most dramatic proof is the case of California. State revenue collections have fallen by $25 billion in the last two years. State Treasurer Kathleen Brown expects a further shortfall of up to $2 billion by next June—an extremely modest estimate, given the current rate of collapse of the California economy. Yet on the $4 billion in fixed-rate notes in California's $5 billion sale, $500 million will come due in January, another $1 billion in April, and $2.5 billion in May. Another $1 billion in notes is also due in April. The question no one wants to answer is, where will the money come from?

A recent private forecast projected the loss of 30,000 more jobs in California's already devastated aerospace sector over the next year, and the elimination of 37,000 public employees through budget cuts by next June. Then, on Oct. 6, the Commission on State Finance projected that cuts in federal defense spending, which cost California 180,000 jobs in the last two years, will eliminate 60,000 more aerospace workers by 1994. Outright shutdowns and cutbacks at U.S. military bases in California are projected to eliminate 21,000 civilian workers as well. California is already suffering its highest unemployment rate since the Great Depression, with nearly 1.5 million workers officially unemployed.

The state's construction industry continues its biggest plunge since World War II. Construction loans fell again in August by 4.2% from July, and are down more than 75% from their August 1989 level. Against August of a year ago, such loans have declined by more than 52% in Los Angeles, nearly 54% in San Diego, and almost 41% in Orange County. The number of California's construction workers has dropped by 190,000 over the last two years.

The state budget cuts for the current fiscal year are beginning to reduce local payrolls as well, further collapsing the revenue base. Education cuts have left the Los Angeles school system with a $400 million deficit, and its Board of Education adopted a budget Oct. 2 that eliminates 1,334 jobs and slashes the payroll for remaining employees by $178 million. Most of the district's teachers face a pay cut of 12%.

Legislature mired in failed policies

In the face of this economic disaster, California's legislative leaders have declared it a crisis, but have offered no solutions beyond the usual fatal remedies. Assembly Democrats released a 125-page report Oct. 6 entitled "Toward an ADEPT California," with the clumsy acronym standing for Assembly Democratic Economic Prosperity Team. Echoing most of the absurdities in Washington, the report urges tax breaks for multinational corporations which expand in California, a reduction in the capital gains tax, making businesses in the state more "cost-competitive," reducing school dropout rates, and improving vocational training.

It points to the need for greater investment in transportation, water, and other infrastructure projects, but doesn't address the massive flow of low-interest, federal credit which would be needed to carry that out. State Treasurer Brown is calling for a "comprehensive economic plan" to attract industries to California, but doesn't identify what ruined so many of the ones it had. Instead, she says, "we should be hustling. We have a lot of hustling to do." Especially when all those short-term notes come due.