



Written by [Bob Adelman](#) on September 29, 2010

The Coming Third Trillion-dollar Bailout: The States

It was appropriate for Meredith Whitney to title her latest 600-page report for her investment clients *The Tragedy of the Commons*. That title was borrowed from an article written in 1968 by Garrett Hardin and published in *Science* magazine, illustrating the ultimate failure of people hoping to live off the incomes of others eternally.

Unable to obtain clear financial data from many of the states for her firm's routine client newsletter, Whitney instead invested two years in this massive study. She said, "It reminded me so much of the banks [prior to the recession] that we just kept working at it. We couldn't find anything that gave us a clear story.... We couldn't find any information that was transparent. So we did it ourselves." [She added](#),



The states represent a new systemic risk to financial markets. I see a lack of transparency and an abundance of complacency on the part of investors and politicians, just as we saw before the banks imploded....

It's not that my clients requested it. I was just so shocked by what I was seeing that I couldn't stop. Any long-term strategic plan needs to take account of the dangerous, mostly over-looked problems in state finances....

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You have to look at the states and the risk that the states pose, because the crisis with the states will result in an attempt ... *for a third near-trillion-dollar bailout*.... [Emphasis added.] That has consequences on the dollar, that has consequences on just about everything. It certainly has consequences on the US recovery.

Her study rates the financial condition of the country's largest states. Only two of them received positive ratings: Texas and Virginia. Five of the 15 received negative ratings, including California, Ohio, New Jersey, Michigan, and Illinois. Taken all together, the 46 states with budget shortfalls have budget gaps approaching \$200 billion, or more than a quarter of their outlays. There are two dangers in these numbers, she says: First, municipalities could start defaulting on their bonds. "People keep saying it can't happen, just like they said national housing prices could never go down. Now, it's a real danger."

Because municipalities receive one-third of their revenues from the state, any reduction in those revenues, as the states decide to pay its own bills instead, would put the bonds issued by those municipalities into jeopardy. "It has to happen," she said. "The states will secure their own shortfalls [first] and leave the cities to fend for themselves."



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The other danger is the impact such continuing shortfalls will have on any economic recovery. By imposing increasingly stringent limits on employment and services in order to balance their budgets, this will create an increasingly powerful head wind for any recovery. And as the push for federal bailouts continues, it will put the states at odds with each other. States that are in relatively good shape financially just aren't strong enough to support those who are sinking. She explained: "Other states such as Nebraska, even with larger ones like Texas, are not large enough in total to offset the weak growth in states that depended [so strongly] on real estate." And to add to the pressure, states that received Obama administration "stimulus" money will see that disappear next year.

Various strategies to reduce those shortfalls have been detailed [elsewhere](#), including raiding pension funds just to pay current bills. "The scary thing," says Whitney, "is that no one wants to talk about it. When you get the data and mechanics together, the situation is as basic as it was for banks or consumers. [Our report] should get people talking, and the daunting scale of the numbers should get them outraged."

Perhaps Whitney should have titled her report [Scylla and Charybdis](#).

Ulysses had been warned by Circe of the two monsters, Scylla and Charybdis....

Scylla dwelt in a cave high up on a cliff, from whence she was accustomed to thrust forth her long necks (for she had six heads), and in each of her mouths to seize one of the crew of every vessel passing within reach. The other terror, Charybdis, was a gulf nearly on a level with the water. Thrice each day the water rushed into a frightful chasm, and was thrice disgorged. Any vessel coming near the whirlpool when the tide was rushing in must inevitably be engulfed; not Neptune himself could save it....

On approaching the haunt of the dread monsters, Ulysses kept strict watch to discover them. The roar of the waters as Charybdis engulfed them gave warning at a distance, but Scylla could nowhere be discerned....

While Ulysses and his men watched with anxious eyes the dreadful whirlpool, they were not equally on their guard from the attack of Scylla, and the monster, darting forth her snaky heads, caught six of his men and bore them away shrieking to her den.

Ulysses was unable to afford any assistance.



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