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The Rise of Zombie Governments.

Just in time for Halloween, Truth In Accounting has updated its Zombie Index for state governments.

TIA's Bill Bergman explains what the Zombie Index is and why ranking at the top of the list is not a good thing for the residents of the states that do:

> This index is inspired by the work of Edward Kane, Professor of finance at Boston College. Kane wrote books warning about the developing crisis in the deposit insurance system in the late 1980s. Kane coined the term "zombie bank," referring to banks and thrifts that were effectively insolvent but allowed to remain open via untruthful accounting and regulatory forbearance.
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> Kane called them "zombies" because they were really dead but allowed to walk among the living, and false accounting delayed loss recognition. Zombies had incentives to take large risks to try, in Kane's words, to "gamble for resurrection" – especially considering moral hazard generated by expectations that taxpayers would get the downside of the gambles. These incentives, in Kane's view, amplified the cost of the savings and loan crisis for taxpayers.

Becoming a zombie is bad for a bank, but at least the damage is contained to that private institution and its customers when it finally goes under. For a government, transforming into a zombie institution is exponentially worse, because the damage from the fallout when the Ponzi-like schemes of the politicians seeking to keep the state government running while hiding how bad its fiscal condition has become hits everybody when their financial deterioration can no longer be hidden.

Bergman identifies the states that have become the most zombie-like and what they could do to reverse their zombification:

> The biggest 'Zombies?' New Jersey, Massachusetts, New Mexico, Connecticut, and Illinois. Taxpayers and citizens in those states could benefit from more oversight of risk exposure in investments backing retirement funds.

The primary way that state governments hide the full extent of their liabilities is by omitting their pension obligations from their financial statements, where the states in the worst shape have an extended history of offering lavish pension benefits for public employees while failing to adequately fund them, counting on investment returns to carry the load of making good on the obligation.

Consequently, the worst-run governments turn to riskier and riskier investment schemes to try to make up the difference, which all too often turn into even bigger problems when they can't deliver the high returns they were counting upon. When they eventually go bust, as happened in Dallas, Texas just last year, essential government services like trash pickup appears to be suffering because the city's money troubles meant it couldn't buy enough new garbage trucks to replace aging ones.

On the plus side, reforms that Dallas has made to fix its public pension disaster appear to be working, so it is possible for a fiscally strapped government to repair the damage.

The real question for zombie government politicians is why wait until a crisis has forced the issue to put themselves onto a fiscally sustainable path?

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