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State and Local Governments' Ticking Debt Bomb.

As uncomfortable as it has been to watch, the unfolding drama in Greece has had one clear benefit: It has forced many other countries, including our own, to take a closer look at debt, as well as revenues, costs, growth rates, demographics and so on.

Fortunately the United States, compared to most European countries, doesn't look too bad. Our economy has bounced back from the Great Recession far faster than others. Still, our national debt as a share of gross domestic product has leveled out at a rate somewhat higher than most European countries'. Between that and the unnaturally low level of current interest rates, an aging population and a likely pickup in health-care costs, economists are betting that the overall federal debt will resume its historic rise, leaving only about 5 percent of GDP available for all discretionary federal programs, including defense.

Former Democratic Sen. Robert Kerrey of Nebraska and former Republican Sen. John C. Danforth of Missouri, who co-chaired the 1994 Bipartisan Commission on Entitlement and Tax Reform, recently warned in a retrospective on the commission's report that "the cost of servicing our higher debt will become the fastest-growing category of the budget." Already, they noted, "federal spending on major investment programs is 2.7 percent of GDP and 12.8 percent of the budget — both historic lows." Clearly if Washington is to right the ship — an almost humorous notion in this age of dysfunction — there will have to be significant tax and entitlement reform, as well as elimination of many subsidies handed out over the years to special interests.

That's the federal picture, but what about states and localities? The fiscal outlook is mixed, but there are some general conclusions one can draw. According to a survey conducted by 11 associations of state and local officials, most states and localities are experiencing modest improvement in revenues. Forty-one states expect to meet or exceed their revenue projections for 2015. A recent study by Moody's reveals that state debt levels last year declined for the first time in 28 years. Ending balances for cities are nearing their pre-recession highs, though they are still below the levels achieved in 2006. Counties are recovering even more slowly and unevenly, but they are recovering.

Meanwhile, the most politically sensitive and worrisome economic issue state and local leaders face involves public pensions. The news here is also somewhat contradictory. In mid-July, the Pew Charitable Trusts released a research report covering the period through 2013, warning that the total state pension shortfall is creeping up on $1 trillion, with the funding gap between what has been promised and what is available rising by 6 percent to $968 billion.

But another report on state and local plans prepared by the Center for Retirement Research at Boston College — considered the gold standard in the analysis of public pensions — is a bit more sanguine. It notes that when the disastrous year of 2009 was rotated out of the so-called "smoothing process" in 2014, it resulted in "a sharp increase in actuarial assets and … the first improvement in the funded status of public-sector plans since the financial crisis." The average percentage of required contributions paid last year bounced up to 88 percent from the average of 82 percent over the past few years.

In other words, a slowly improving economy and healthier financial markets offer a slight ray of hope. “What happens from here on out depends very much on the performance of the stock market,” the Boston College report stated. “In 2018, assuming a healthy stock market, plans should be at least 80 percent funded.”

That’s a significant figure, because somewhere around 80 percent funding is considered the minimum to deem a pension plan healthy. We haven’t seen that level in some time. But the Pew study includes a significant warning: “State and local policymakers cannot count on investment returns over the long term to close this gap and instead need to put in place funding policies that put them on track to pay down pension debt.”

So despite some recent improvement, serious problems remain, some of which dominate headlines. If this country has a Greece, it’s probably Illinois, with Chicago as its Athens. Or perhaps it’s a commonwealth like Puerto Rico, now some $70 billion in the red and seeking permission from Washington to restructure its debt in bankruptcy.

Localities may still depend on federal assistance in the case of natural disasters like hurricanes or floods. But the report from the 11 state and local associations makes clear what they don’t want: “State and local governments can weather difficult economic periods and officials are taking steps to restore fiscal stability,” it said, but added that “interference in the fiscal affairs of state and local governments by the federal government is neither requested nor warranted.”

Translated, that means “hands off.” But that gets tricky. The courts have struck down a number of both state and local reform efforts in places like Arizona, California, Illinois and Oregon, putting new pressure on governors and legislatures to come up with meaningul, systemwide overhauls. So Washington and many states and localities are running out of options for significant financial reforms, not just for pension systems, but their balance sheets as a whole. The sooner they meet their responsibilities, the better.

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