Bond Case Briefs

Municipal Finance Law Since 1971

Present Consequences of Unfunded Pension Liabilities and Ways Forward.

State governments with large unfunded pension liabilities are paying more to borrow from capital markets than are other states, according to Chuck Boyer of the University of Chicago Booth School of Business.

In the paper, *"Public Pensions, Political Economy and State Government Borrowing Costs,"* to be presented at the 2018 Municipal Finance Conference at Brookings this week, Boyer argues that markets view states with large pension deficits as riskier investments. His evidence suggests that states are already paying for municipal government's unfunded pension liabilities in the form of higher borrowing costs. He asks two questions: 1) how are state governments' borrowing costs affected by unfunded pension obligations? and 2) do states with political constraints face higher borrowing costs?

Boyer constructs a panel dataset using each state's Comprehensive Annual Financial Reports for the period 2005 to 2016. He focuses on balance sheet variables—revenues, expenses, assets, and liabilities—to capture a state's financial health and credit default swap (CDS) spreads – the premium paid to protect buyers from an issuer defaulting – to measure borrowing cost. The author reasons that CDS reflects market sentiments better than market yields because CDS are more liquid, and because they are standardized, whereas market yields may be affected by additional features of a particular bond.

Continue reading.

The Brookings Institute

by Jeffrey Cheng and David Wessel

Monday, July 16, 2018