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Leading a Government to Solvency

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FINANCIAL RESTRUCTURE FOR BUSINESSES AND GOVERNMENTS

LEADING A GOVERNMENT TO SOLVENCY

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I. Old Fashioned, Public Spirited, Political Leadership

A. To lead to solvency, Government leaders need to (i) understand how bad financial problems are, (ii) figure out how much expense cutting and revenue increase can reasonably be done, (iii) based on this, negotiate with major creditors intending to succeed, (v) and be willing to use all of the available levers of power to cause implementation of the Government's restructure plan if it becomes impracticable to reach agreement.

1. One definition of solvency is ability to pay bills when they come due.

2. Solvency is really a sustainable balance between taxpayers and suppliers of labor and capital that permits debts to be paid when due on a sustained basis.

B. A plan for solvency will inevitably have to deal with five things:

1. deciding what services the Government can afford to provide;

2. operating more efficiently with the Government's existing revenue;

3. trying to raise more revenue, including deciding whether it is wise to try to raise taxes any further or sell any assets;

4. dealing with promises to suppliers of labor;

5. dealing with promises to suppliers of capital.

II. First, conduct in-depth studies to understand how insolvent the Government is and how much it can afford to pay.

A. Analyze debt structure and cash flows, comparing revenue versus expenditures (including expenditures for fixed obligations) to understand the size of the Government's near and long-term deficit if no changes are made (an "**Insolvency Study**" composed of two studies, a "**Cash Flow Study**" and a "**Debt Structure Study**").

1. The **Debt Structure Study** seeks to understand the Government's fixed obligations that must be paid out of cash flow.

2. The **Cash Flow Study** focuses on when the Government might run out of cash as it pays its fixed and discretionary obligations if no changes are made.

3. The projected excess of expenditures over revenue is the deficit that the Government must overcome to return to solvency (a "**Deficit**").

4. If the Cash Flow Study shows that the Government has a **Deficit** and will run out of cash in the near future unless changes are made, it shows insolvency.

5. Exhibit A is a Template to help a Government start doing a **Cash Flow Study** and a **Debt Structure Study**.

6. While a Government can do a **Debt Structure** and **Cash Flow Study** through its own financial staff and working with lawyers to understand fixed debt obligations, it is often helpful to hire outside financial restructure professionals who have done this work before.

B. Determine how much the Government can reasonably afford to pay after it has reduced its expenses and increased its revenue trying to reduce its **Deficit** (an "**Affordability Study**").

1. Focus on core mission. Ask what are the most important services the Government provides, what services can it afford, or not afford, to provide?

2. Figure out how to become more efficient in the provision of services.

3. Make a preliminary judgment about how the Government might raise more revenue.

a. Make a judgment whether there are assets that should be sold or monetized.

b. Figure out how much, if at all, taxes might be raised without this becoming counter-productive.

1. Will a tax increase be counterproductive by causing people with money to pay taxes to move away?

2. Will there be enough political support to raise taxes?

4. This Affordability Study will tell you how much is reasonably available to pay major creditors and how much shortfall still remains to be dealt with (**the "Reduced Deficit"**).

III. Second, negotiate with labor and capital providers to overcome the Reduced Deficit.

A. Start with labor providers, who are generally the largest expense in a Government's budget, and ask them to make a significant contribution to reducing the **Reduced Deficit**.

Title search: Leading a Government to Solvency

Also available as part of the eCourse
Issues in Business Bankruptcy

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