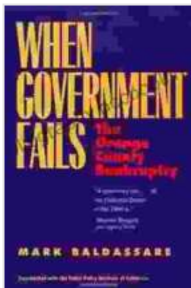
When Government Fails: The Orange County Bankruptcy

On December 6, 1994, Orange County, California, filed for bankruptcy. It was the largest municipal bankruptcy in U.S. history, and it sent shockwaves through the financial world.

How could a wealthy county like Orange County, with a AAA credit rating, suddenly find itself bankrupt?

The answer lies in a complex series of factors, including government failures, investment misjudgments, and the actions of a few key individuals.



When Government Fails: The Orange County Bankruptcy by Mark Baldassare

4.2 out of 5

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Text-to-Speech	: Enabled
Screen Reader	: Supported
Word Wise	: Enabled
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Government Failures

One of the key factors that contributed to the Orange County bankruptcy was a series of government failures.

First, the county government failed to adequately oversee its investment portfolio. The county's investment pool was managed by a private investment firm, PIMCO. PIMCO invested heavily in derivatives, which are complex financial instruments that can be risky.

Second, the county government failed to disclose the risks of its investment portfolio to the public. The county's financial statements did not adequately disclose the county's exposure to derivatives.

Third, the county government failed to take steps to mitigate the risks of its investment portfolio. The county did not have a risk management plan in place, and it did not have a contingency plan in place in case its investments lost value.

Investment Misjudgments

The Orange County bankruptcy was also caused by a series of investment misjudgments.

First, PIMCO made a series of bad investment decisions. PIMCO invested heavily in derivatives, which are complex financial instruments that can be risky. PIMCO also invested heavily in emerging markets, which are often more volatile than developed markets.

Second, the county government relied too heavily on a single investment firm. PIMCO was responsible for managing the county's entire investment portfolio. This concentration of risk made the county vulnerable to the actions of a single firm.

The Actions of a Few Key Individuals

The Orange County bankruptcy was also caused by the actions of a few key individuals.

First, Robert Citron, the head of PIMCO, made a series of bad investment decisions. Citron invested heavily in derivatives, which are complex financial instruments that can be risky. Citron also invested heavily in emerging markets, which are often more volatile than developed markets.

Second, William Popejoy, the Orange County Treasurer-Tax Collector, failed to adequately oversee PIMCO's investment decisions. Popejoy relied too heavily on Citron's expertise, and he did not take steps to mitigate the risks of the county's investment portfolio.

Consequences of the Bankruptcy

The Orange County bankruptcy had a number of consequences, including:

- The county lost $1.7 billion, which was the largest municipal bankruptcy loss in U.S. history.
- The county's credit rating was downgraded to junk status.
- The county's bondholders lost billions of dollars.
- The county's taxpayers had to pay higher taxes to cover the cost of the bankruptcy.

Lessons for Other Governments and Investors

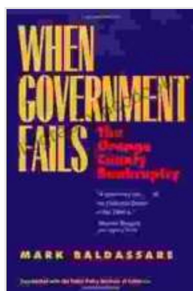
The Orange County bankruptcy offers a number of lessons for other governments and investors.

First, governments should adequately oversee their investment portfolios. Governments should have a risk management plan in place, and they should have a contingency plan in place in case their investments lose value.

Second, governments should not rely too heavily on a single investment firm. Governments should diversify their investment portfolios by using multiple investment firms.

Third, investors should be aware of the risks of investing in derivatives and emerging markets. Derivatives are complex financial instruments that can be risky, and emerging markets are often more volatile than developed markets.

The Orange County bankruptcy was a cautionary tale about the dangers of government failures, investment misjudgments, and the actions of a few key individuals. By learning from the mistakes of Orange County, other governments and investors can avoid a similar fate.



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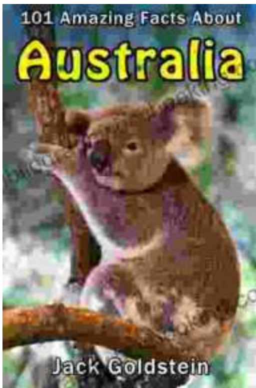

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