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United States General Accounting Office

GAO

Briefing Report to the Chairman, Committee on the Budget, House of Representatives

January 1988

BUDGET ISSUES

Overview of State and Federal Debt

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United States
General Accounting Office
Washington, D.C. 20548

Accounting and Financial
Management Division

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January 27, 1988

The Honorable William H. Gray III
Chairman, Committee on the Budget
House of Representatives

Dear Mr. Chairman:

You requested that we forward the results of our study on state and federal debt. The enclosed document is our report on that study. We undertook the work in order to provide an overview on the subject for Members of the Congress and others considering ways to better control the growth of federal debt. We felt that it would be helpful to provide background information on state and federal debt trends using various kinds of measures and to describe the major legal fiscal constraints used by states to control their debt.

Our approach was to use readily available information in order to provide a timely overview of the subject. Therefore, we used Department of the Treasury and state data compiled by the Bureau of the Census to identify state and federal debt trends from the end of fiscal year 1960 through fiscal year 1985. For information on state legal fiscal constraints, we relied on prior General Accounting Office reports and other published materials as well as on interviews with officials of state organizations. Our methodology is described further in the report itself.

Our study revealed the following major trends and practices.

-- There was a change in state and federal debt trends during fiscal years 1981 through 1985, when the average annual growth rate of federal debt surpassed the growth rate of state debt. Federal debt grew at a 15-percent rate during the 1981 through 1985 period, while state debt grew at a 12-percent rate.

-- There was an earlier change in the state and federal trend if only full faith and credit state debt--debt which involves a pledge of state tax resources--is counted. The average annual growth rate of federal debt surpassed the growth rate of state full faith debt in the 1976 through 1980 period. In those years, federal debt grew at an 11-percent rate, while state full faith debt grew at an 8-percent rate.

-- No one measure can provide an adequate overview of state and federal debt. For example, from 1961 through 1985, federal debt grew from $286 billion to $1.8 trillion. However, during this same period, federal debt as a percent of gross national product declined from 56 percent to 46 percent.

-- The two types of state debt, full faith debt and nonguaranteed debt, are used mainly for capital investments, while federal debt is used for operating expenses as well as for capital investments.

-- After 1975, the type of state debt which grew the fastest was nonguaranteed debt. For example, by the 1981 through 1985 period, the average annual growth rate for state nonguaranteed debt had risen to 16 percent, surpassing the federal debt growth rate of 15 percent, while the growth rate for state full faith debt had fallen to 4 percent. State nonguaranteed debt accounted for 71 percent of state long-term debt by the end of 1985.

-- Most states have constitutional or statutory provisions to control the uses and levels of full faith debt. This type of debt represented 29 percent of state long-term debt at the end of 1985. Twenty-five states control full faith debt through constitutional limits on the amount of full faith debt that may be outstanding. Thirty-four states control such debt through constitutional provisions which require that their governments execute balanced operating budgets.

-- Comparisons of state and federal debt are limited by the differing roles and institutional procedures of these two levels of government. Unique federal responsibilities for national defense and the economy may require intentional budget deficits at times. Also, some states employ debt control procedures that could not be adopted at the federal level without affecting the balance of power between the Congress and the President. Such state debt controls include authorizing the governor to make unilateral spending reductions to carry out balanced budget requirements.

Our study was not a review of any particular agency or state. Therefore, we did not obtain agency comments. We did, however, provide copies of the draft to officials of the National Association of State Budget Officers, the Advisory Commission on Intergovernmental Relations, and the Bureau of the Census for their comments. We incorporated their comments throughout the report as appropriate.

Because of widespread interest in this subject, we are sending copies of this report to other congressional committees; the Director, Congressional Budget Office; the Director, Office of Management and Budget; and other interested parties. We will also make copies available to others upon request. If you have any questions about the contents of this report, please contact me at (202) 275-9573.

Sincerely yours,

James L. Kirkman

James L. Kirkman
Associate Director

C o n t e n t s

ABBREVIATIONS

ACIR	Advisory Commission on Intergovernmental Affairs
CBO	Congressional Budget Office
GAO	General Accounting Office
GNP	gross national product
NASBO	National Association of State Budget Officers
OMB	Office of Management and Budget

OBJECTIVES OF REVIEW

TO CONTRIBUTE TO DISCUSSIONS ON WAYS TO BETTER CONTROL THE FEDERAL DEBT BY PROVIDING AN OVERVIEW OF

- **-- THE GROWTH OF STATE AND FEDERAL DEBT USING VARIOUS MEASURES**
- **-- HOW STATES USE DEBT RESTRICTIONS AND BALANCED BUDGET REQUIREMENTS TO CONTROL THEIR DEBT GROWTH**

INTRODUCTION

OBJECTIVES OF REVIEW

Growing federal debt has prompted interest at the federal level in the debt experiences of state governments. Some officials and observers have suggested that insights may be gained by examining debt trends at the state and federal levels and by studying how the states attempt to control their debt. We therefore undertook to develop an overview of these trends and practices. Our aims were to identify and describe

- -- the growth of state and federal debt over a 25-year period using various measures of growth, and
- -- the major legal fiscal constraints used by states to control their debt.

JOB SCOPE AND METHODOLOGY

USED DATA COMPILED BY THE BUREAU OF THE CENSUS

IDENTIFIED STATE AND FEDERAL DEBT AT 5-YEAR INTERVALS FROM THE END OF FISCAL YEAR 1960 THROUGH 1985

EXAMINED STATE AND FEDERAL DEBT USING SEVERAL MEASURES, TIME PERIODS, AND TYPES OF DEBT

CONCENTRATED ON HOW THE STATES USE DEBT RESTRICTIONS AND BALANCED BUDGET REQUIREMENTS TO CONTROL STATE DEBT GROWTH

INTERVIEWED KNOWLEDGEABLE OFFICIALS

REVIEWED PERTINENT PUBLICATIONS ON STATE DEBT EXPERIENCES

JOB SCOPE AND METHODOLOGY

In conducting our study, we collected statistics on the outstanding debt for individual states and the federal government, identified several time periods in which to measure debt growth, and utilized various kinds of measures to assess growth. We also identified the legal fiscal constraints used by the states to control their debt, such as debt limits and balanced budget requirements. Our general approach was to use readily available information in order to provide a timely overview of the subject.

We used Department of the Treasury and state data compiled by the Bureau of the Census because these data on governmental debt are comprehensive, widely used, and readily available. The Census data on federal debt measure gross federal debt, which includes both debt held by the public and debt issued to other federal government accounts, primarily trust funds. The more limited category of debt held by the public is sometimes used as the measure of debt burden. However, we used Census' figures on gross federal debt to maintain comparability with the state debt data reported by Census. The state debt data reported by Census pertains to gross state debt, which includes state debt held by the public and by state trust funds.

The Census debt totals include the full faith and credit debt of state and federal governmental bodies. According to Census, this is debt which the respective government promises to repay, by using its power of taxation to raise needed funds, if necessary. Census state debt totals also include nonguaranteed debt issued by state entities which Census has determined are part of a state's government. Nonguaranteed debt typically represents revenue bond issuances, where the activity being funded (for example, a toll road) generates the revenues pledged to pay the debt. According to Census, such debt does not constitute claims against other resources of the state in the event that the pledged revenues are insufficient for repaying the debt.

The Census debt totals for the federal government, however, do not include the nonguaranteed debt of federal government sponsored enterprises, such as the Federal National Mortgage Association, because these corporations are privately owned and are not part of the federal government. The debt of these enterprises at the end of fiscal year 1985 totaled $370 billion. Excluding the nonguaranteed debt of federal government sponsored enterprises is consistent with Office of Management and Budget (OMB) and Treasury reports and previous studies, which also exclude these amounts from the debt totals reported for the federal government. A Census official also informed us that the states do not have equivalent debt. The nonguaranteed debt at the state level is issued by state government entities, not private corporations.

For our examination of aggregate state and federal debt trends, we identified state and federal year-end debt at 5-year intervals over an extended period of time, from the end of fiscal year 1960 through fiscal year 1985. The 25-year period allowed us to identify overall trends. We used 1960 year-end debt as the starting point of our examination because at that time the two types of state debt--full faith and nonguaranteed--were of equal dollar value. Our use of 5-year intervals permitted us to analyze any major changes within the 25-year period. We used 5-year rather than 1-year intervals in order to avoid highlighting temporary, year-to-year changes reflecting special circumstances, such as a short economic downturn.

Census defines long-term debt as that debt which has a term of over 1 year. Long-term state debt accounted for about 99 percent of total state debt at the end of 1985. For most analyses in our study, our measurement of debt at the state and federal levels includes both long-term and short-term debt. However, our examination of the full faith and nonguaranteed parts of state debt includes only state long-term debt and how it is divided into these two parts. We used long-term debt for this analysis because the Census data on state full faith and nonguaranteed debt relates only to state long-term debt.

Because no one measure can completely describe the magnitude and significance of debt levels, we employed several techniques commonly used in debt analyses by economists and bond analysts. Each measure provides a different perspective.

-- We measured debt in current and constant dollars. The current dollar measure reflects actual reported amounts, while the constant dollar measure corrects for the effects of price increases.

-- Also, we measured debt in relation to gross national product (GNP). This facilitates judgments about the potential significance of debt levels for national economic activity.

In addition, we examined the 1985 fiscal year-end debt for each of the 50 states in order to contrast it with the aggregate analysis and identify variations which may occur due to individual state political and economic factors.

For our description of the legal fiscal constraints used by states to control their debt, we concentrated on the two major kinds of constraints in use--debt restrictions and balanced budget requirements. Preliminary information indicated that such constraints do not apply to all kinds of state activities and debt. Therefore, we undertook to identify their major areas of applicability.

We interviewed federal officials at the Department of Commerce's Bureau of Economic Analysis and Bureau of the Census to identify the best sources of debt data and most useful measures. We also interviewed budget officials in Florida, Illinois, and Oregon, and officials of two national organizations--the National Association of State Budget Officers (NASBO) and the Advisory Commission on Intergovernmental Relations (ACIR)--to identify sources of debt data and to gather information on the operation of state legal fiscal constraints. We reviewed related books, articles, and other published reports including prior General Accounting Office (GAO) and Congressional Budget Office (CBO) reports for background information on state legal fiscal constraints.

Our study was conducted in Washington, D.C., from January to March 1987 using interviews and published data. We did not conduct fieldwork at the state level or verify the Census data. This was not a review of any particular agency or state; therefore, we did not obtain agency comments. We did, however, provide copies of a draft of our report to officials of NASBO, ACIR, and Census for their comments. We incorporated their comments throughout the report as appropriate.

SUMMARY OF OBSERVATIONS

THE AVERAGE ANNUAL GROWTH RATE OF FEDERAL DEBT SURPASSED THE GROWTH RATE OF STATE FULL FAITH DEBT DURING FISCAL YEARS 1976 TO 1980 AND SURPASSED THE GROWTH RATE OF TOTAL STATE DEBT DURING 1981 TO 1985.

NO ONE MEASURE PROVIDES AN ADEQUATE OVERVIEW OF STATE AND FEDERAL DEBT

ANALYSIS OF THE 50 INDIVIDUAL STATES PROVIDES A DIFFERENT PERSPECTIVE THAN THE AGGREGATE DATA

THE TWO TYPES OF STATE DEBT--FULL FAITH AND NONGUARANTEED--ARE USED MAINLY FOR CAPITAL INVESTMENTS, WHILE FEDERAL DEBT IS USED FOR OPERATING EXPENSES AND CAPITAL INVESTMENTS

MOST STATES HAVE CONSTITUTIONAL OR STATUTORY PROVISIONS TO CONTROL THE USES AND LEVELS OF FULL FAITH DEBT

STATE NONGUARANTEED DEBT GREW FASTER THAN STATE FULL FAITH DEBT AND FEDERAL DEBT

COMPARISONS OF STATE AND FEDERAL DEBT ARE LIMITED BY THE DIFFERENT ROLES AND INSTITUTIONAL PROCEDURES AT THE TWO LEVELS

SUMMARY OF OBSERVATIONS

Over fiscal years 1961 through 1985, the states' aggregate outstanding debt grew from $19 billion to $212 billion, while the federal government's debt grew from $286 billion to $1.8 trillion. Recalculated into constant dollar terms, this represents a 217-percent increase in state debt over the 25-year period and a 77-percent increase in federal debt. The full faith part of state debt increased by 86 percent.

The lower overall debt growth rate for the federal government, however, does not reveal an important change that occurred in the 1981 through 1985 period when the average annual growth rate of federal debt surpassed the growth rate of state debt for the first time in this 25-year period. During the 1981 through 1985 period, federal debt grew at an average annual rate of 15 percent while state debt grew at 12 percent.

There was an earlier turning point if one counts only full faith and credit state debt, which involves a pledge of state tax resources. The average annual growth rate of federal debt surpassed the growth rate of state full faith debt in the 1976 through 1980 period. In those years, federal debt grew at an 11-percent rate, while state full faith debt grew at 8 percent.

Similarly, the 1981 through 1985 period saw a reversal in the trend of federal debt as a percent of gross national product. In the preceding 20-year period (1961 through 1980) that percent had regularly declined, from 56 percent to 33 percent, while in the 1981 through 1985 period, federal debt as a percent of GNP rose to 46 percent. The pattern of state debt as a percent of GNP was different. During the period 1961 through 1985, the state percent remained relatively stable at about 4 percent to 5 percent.

No one measure can provide an adequate overview of state and federal debt. For example, from 1961 through 1985, federal debt grew from $286 billion to $1.8 trillion. However, during this same period, federal debt as a percent of GNP declined from 56 percent to 46 percent.

The aggregate debt data also may not be representative of an individual state's debt experience. For example, while the aggregate debt data showed that during the 1981 through 1985 period the states' average annual growth rate was 12 percent, the individual states' data show some states above or below the aggregate average growth rate, such as Arizona with a 49-percent rate and Kansas with a growth rate of negative 6 percent.

A major difference between state and federal debt practices is the kinds of activities funded by debt. The two types of state debt, full faith debt and nonguaranteed debt, are incurred primarily for capital projects--highways, buildings, etc. On the other hand, the federal government incurs debt for both capital projects and operating expenses.

After 1975, the type of state debt which grew the fastest was nonguaranteed debt. For example, by the 1981 through 1985 period, the average annual growth rate for state nonguaranteed debt had risen to 16 percent, surpassing the federal debt growth rate of 15 percent, while the growth rate for state full faith debt had fallen to 4 percent. State nonguaranteed debt accounted for 71 percent of state long-term debt by the end of 1985.

Most states have constitutional or statutory provisions designed to control the uses and levels of full faith debt. This type of debt represented 29 percent of state long-term debt at the end of fiscal year 1985. One general type of control is debt restrictions, which directly control full faith debt by identifying the purposes for which the debt may be incurred--usually for capital projects--and by setting certain other conditions on the issuance of the debt. For example, 25 states have constitutional limits on the amount of full faith debt that may be outstanding. These limits are usually expressed in dollar terms.

The other general type of control over full faith debt is balanced budget requirements which also are usually contained in state constitutions. Thirty-four states indirectly control full faith debt by requiring their governments to execute balanced operating budgets. The operating budgets include debt service expenses stemming from full faith borrowings for capital projects and other needs. By requiring that debt service and other operating expenses be financed by annual nonborrowed revenues, the balanced budget requirements indirectly limit the level of full faith debt that may be issued.

Comparisons of state and federal debt are limited by the differing roles and institutional procedures of these two levels of government. The federal government has several major responsibilities not assumed by state governments. These include providing for the national defense and promoting national economic growth, employment, and price stability. In some circumstances, these unique federal responsibilities may require the federal government to incur intentional budget deficits.

Also, the states sometimes employ debt control procedures that could not be adopted at the federal level without affecting the balance of power between the Congress and the President. For example, in order to avoid potential operating budget deficits, state governors often have the authority to reduce available funding without the approval of the legislature. Such unilateral powers are not available to the President under existing law.

ANALYSIS OF AGGREGATE STATE AND FEDERAL DEBT

NO ONE MEASURE PROVIDES AN ADEQUATE OVERVIEW OF STATE AND FEDERAL DEBT

USING THREE TYPES OF MEASURES WE FOUND THAT STATES HAD

- **-- LESS DEBT**
- **-- HIGHER GROWTH RATES, UNTIL 1981 to 1985**
- **-- LESS DEBT IN RELATION TO GNP**

ANALYSIS OF AGGREGATE STATE AND FEDERAL DEBT

Because no one type of measure can completely describe debt levels, we used several measures to review debt. The following measures are commonly used in debt analyses by economists and bond analysts:

-- dollar level (in current and constant dollars),

-- average annual debt growth rates (in current and constant dollars), and

-- debt relative to gross national product.

Figure II.1: Total State and Federal Debt--1960 to 1985 at 5-year Intervals in Current Dollars

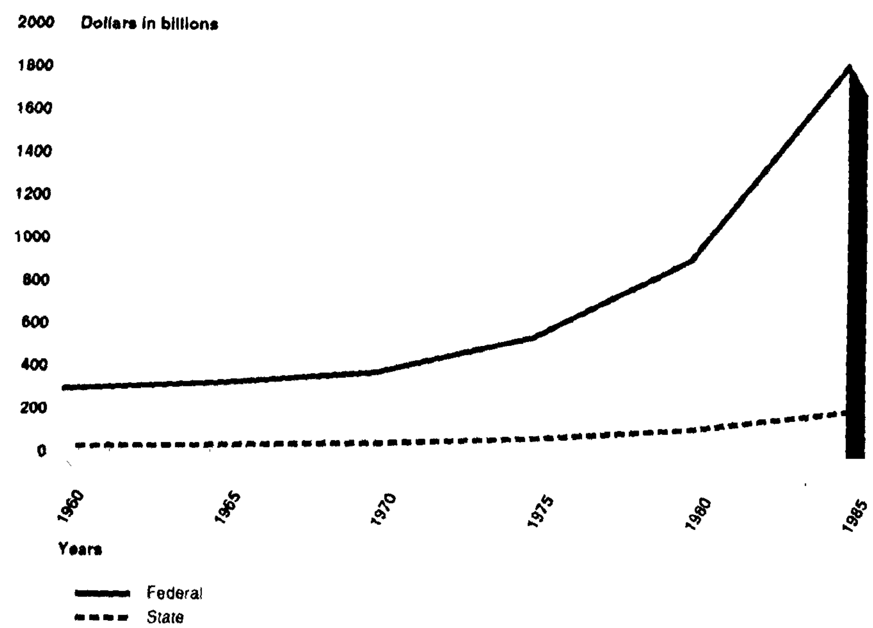
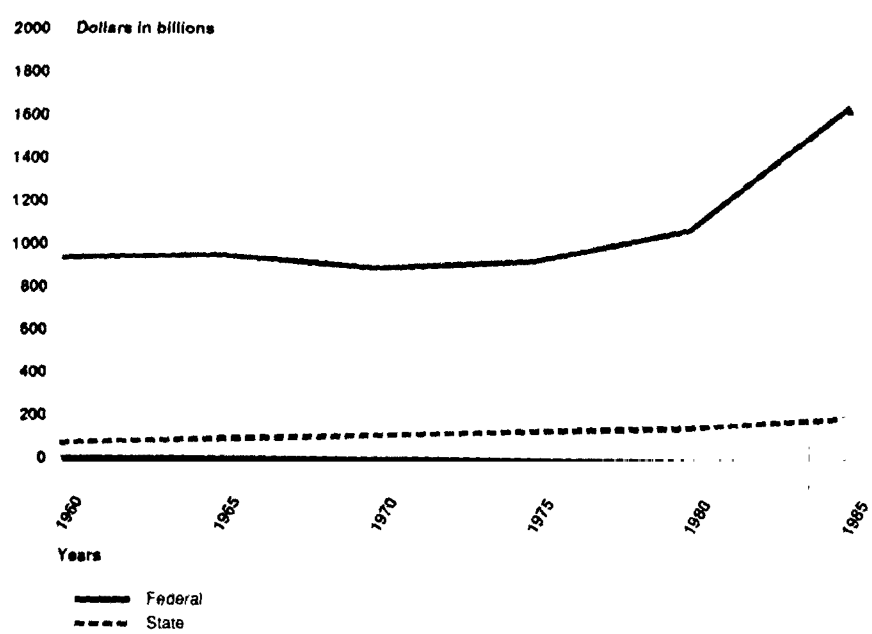


Figure II.2: Total State and Federal Debt--1960 to 1985 at 5-year Intervals in Constant Dollars



Note: 1982 is the base year.

AGGREGATE STATE AND FEDERAL DEBT IN CURRENT AND CONSTANT DOLLARS

We identified state and federal debt in current and constant dollars at 5-year intervals over a 25-year period from the end of fiscal year 1960 to the end of fiscal year 1985. This allowed us to examine overall trends and short-term (5-year) variations.

Current Dollars

Figure II.1 shows the differences in the magnitude of state and federal debt in current dollars. During the 25-year period, state debt grew from $19 billion to $212 billion while federal debt grew from $286 billion to $1.8 trillion.

During the last 5 years of the 25-year period, the differences in the magnitude of state and federal debt were even greater. While both state and federal debt increased significantly between 1981 and 1985, federal debt grew at a faster rate. During this period, federal debt increased by 100 percent from $914 billion to $1.8 trillion. At the same time, state debt increased by 74 percent from $122 billion to $212 billion.

Constant Dollars

To eliminate the impact of inflation, we converted the aggregate debt data into 1982 constant dollars through the use of the implicit GNP deflator.

The constant dollar graph in figure II.2 reveals a pattern similar to that seen in figure II.1. Both graphs show an overall increase in debt from 1960 through 1985 for the state and federal governments, with the sharpest increase in federal debt occurring during the 1981 through 1985 period. However, the constant dollar graph shows a more gradual growth in debt, particularly for federal debt. Indeed, when measured in constant dollar terms, there was a period (1965 through 1970) when federal debt declined somewhat.

Table II.1 shows, in both current and constant dollars, that federal debt was significantly more than state debt. However, the states experienced a greater percentage increase in debt than the federal government over the 25-year period. For example, in constant dollar terms, there was a 217-percent increase in state debt and a 77-percent increase in federal debt. The 217-percent increase at the state level was for total state debt, including both full faith debt and nonguaranteed debt. See appendix IV for a discussion of the growth trends of the two types of state debt.

Table II.1: State and Federal Debt in 1960 and 1985

	Current dollars		Constant dollars (1982 base year)	
	State	Federal	State	Federal
	(dollars in billions)			
1960	$ 19	$ 286	$ 60	$ 927
1985	212	1,828	190	1,639
Growth	$193	$1,542	$130	$ 712
Percent change	1,016	539	217	77

Figure II:3: State and Federal Debt--1961 to 1985 Average Annual Growth Rates at 5-Year Intervals in Current Dollars

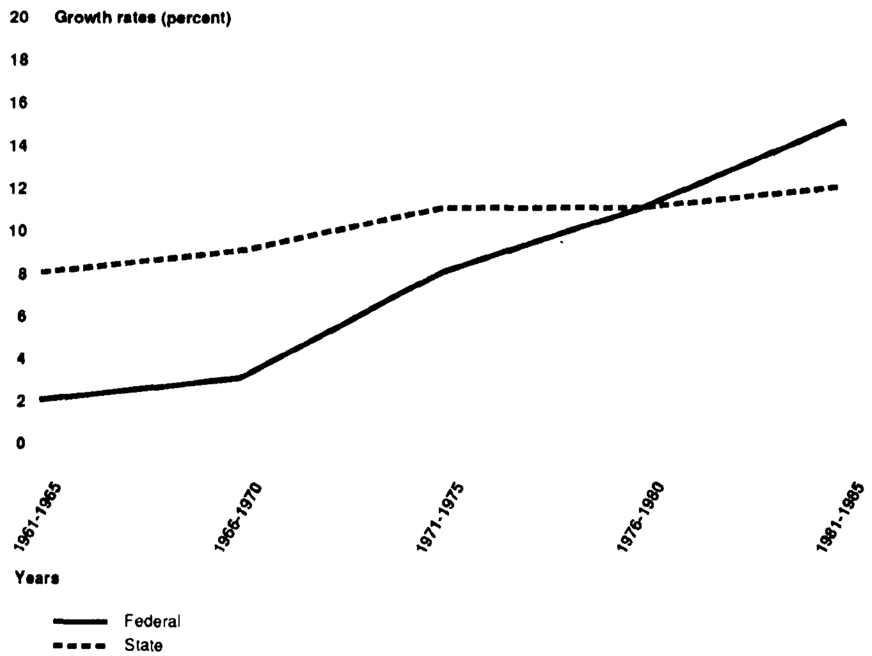
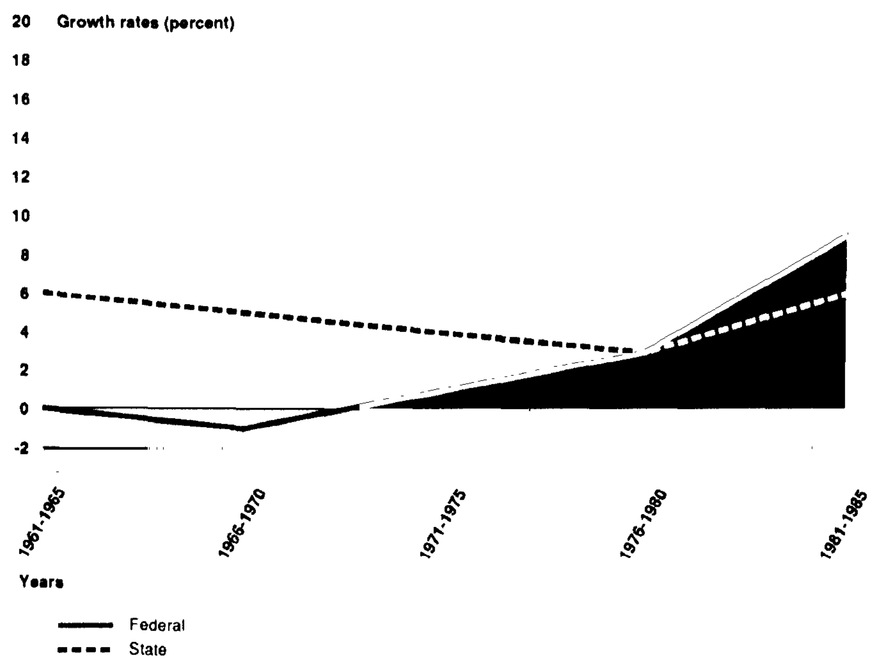


Figure II.4: State and Federal Debt--1961 to 1985 Average Annual Growth Rates at 5-Year Intervals in Constant Dollars



Note: 1982 is the base year.

AVERAGE ANNUAL GROWTH RATES IN CURRENT AND CONSTANT DOLLARS

We also examined state and federal debt in terms of average annual growth rates for 5-year periods over the same 25 years. This too was done in current and constant dollars.

Current Dollar Growth Rates

Figure II.3, the current dollar graph, shows that there was an important change in the 1981 through 1985 period. Prior to then, the states had higher average annual debt growth rates than the federal government.[1] The debt growth rates for the states from 1961 through 1980 ranged from about 8 percent to 11 percent a year, while the federal debt growth rates ranged from 2 percent to 11 percent. However, during the 1981 through 1985 period, federal debt growth rates surpassed state debt growth rates and rose sharply to an average of 15 percent a year. State debt growth during those 5 years averaged 12 percent.

Constant Dollar Growth Rates

The constant dollar graph in figure II.4 also shows that the growth rates of the federal debt surpassed the states during the 1981 through 1985 period. During this period, federal debt growth accelerated sharply, rising from about 3 percent to 9 percent. At the same time, state debt grew from 3 percent to 6 percent.

Figure II.4 further illustrates that when the inflation factor is eliminated using constant (1982) dollars, both federal and state governments had periods in which their debt growth rates either declined or showed negative growth. During the period 1961 through 1980, state growth rates decreased from 6 percent to 3 percent. Then, during the 1981 through 1985 period, state debt growth rates increased and again averaged 6 percent per year.

At the federal level, there was a negative growth rate trend (declining debt) during the period 1966 through 1970. While the constant dollar graph shows federal growth rates ranging from minus 1 percent (1966 through 1970) to a positive 9 percent (1981 through 1985), the current dollar graph shows the federal growth rates

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[1]A factor to consider in analyzing the growth rates is that state debt was significantly less than federal debt and that, therefore, smaller dollar changes in state debt could produce larger percent changes.

ranging from 3 percent to 15 percent over this same 20-year period. Thus, when constant dollars are used to measure the growth of federal debt, a pattern of generally increasing growth rates is shown, but the rates are lower than when expressed in current dollars.

Figure II.5: Total State and Federal Debt as a Percent of GNP--1960 to 1985 at 5-Year Intervals in Current Dollars

DEBT IN RELATION TO NATIONAL ECONOMIC ACTIVITY

It is also beneficial to view debt in relation to the level of national economic activity. This facilitates judgments about the potential significance of debt levels for national economic activity. Therefore, as shown in figure II.5, we compared state and federal debt to gross national product (GNP) from the end of 1960 through 1985 at 5-year intervals.

As a percent of GNP, state debt remained relatively stable from 1961 through 1985 at about 4 percent to 5 percent of GNP.

However, federal debt as a percent of GNP gradually declined from 56 percent to 33 percent during the 20-year period 1961 through 1980. This trend was reversed during the period 1981 through 1985 when federal debt as a percent of GNP grew to 46 percent by the end of 1985.

ANALYSIS OF INDIVIDUAL STATE DEBT

ANALYSIS OF THE 50 INDIVIDUAL STATES PROVIDES A DIFFERENT PERSPECTIVE THAN THE AGGREGATE DATA IN TERMS OF

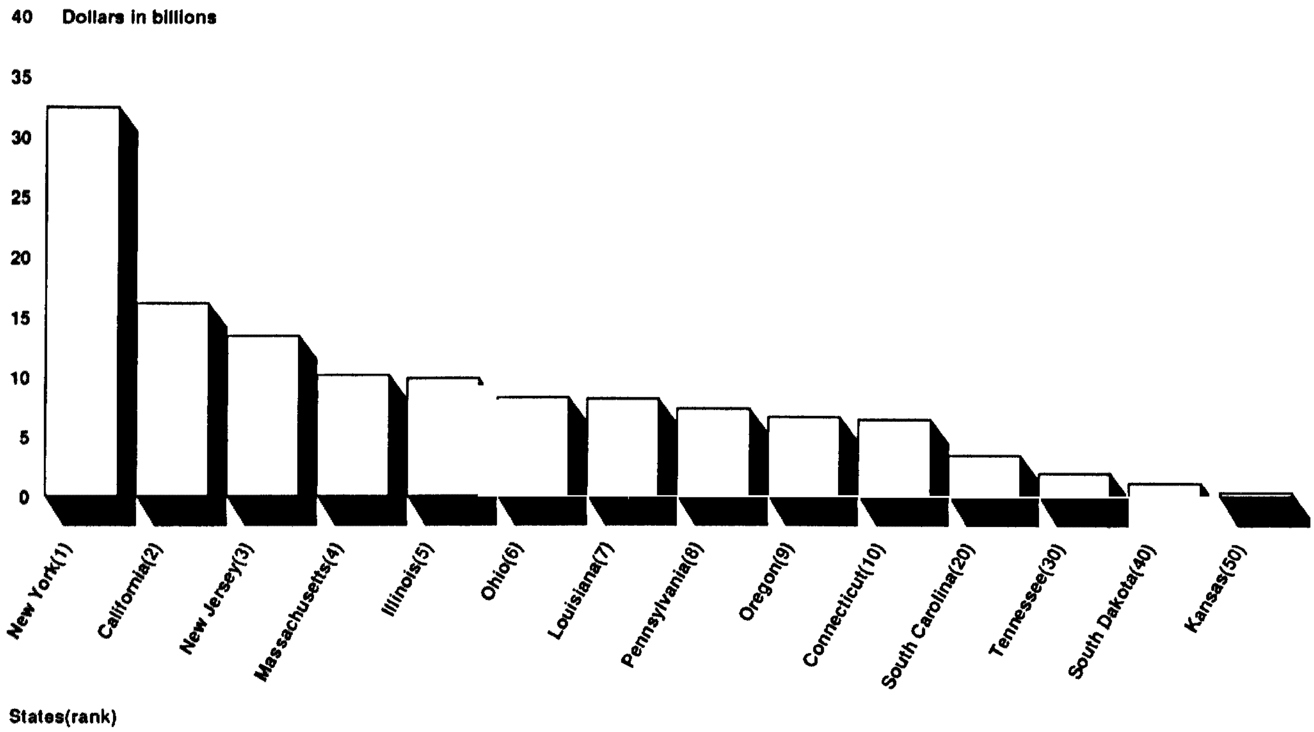
- **-- TOTAL DOLLARS**
- **-- PER CAPITA DEBT**
- **-- AVERAGE ANNUAL GROWTH RATES**

ANALYSIS OF INDIVIDUAL STATE DEBT

We analyzed individual state debt data in order to contrast them with the aggregate analyses and to identify the range of state debt experiences. We focused on data for the years 1981 through 1985, and ranked the states using three basic measures: outstanding debt, per capita debt, and growth rates.

In addition, we examined individual state debt in current dollars only, because inflation-adjusted dollars are not required to illustrate state variations.

Figure III.1: <u>Selected States' 1985 Year-End Debt</u>



TOTAL 1985 FISCAL YEAR-END DEBT OF THE INDIVIDUAL STATES

We ranked the states by the amount of debt carried at the end of fiscal year 1985 to show differences in the debt of individual states. Data from selected states are shown in figure III.1 to provide an overview of the range of individual state debt. Data on all the states are contained in table VI.1 in appendix VI.

Examination of the individual state debt data shows that

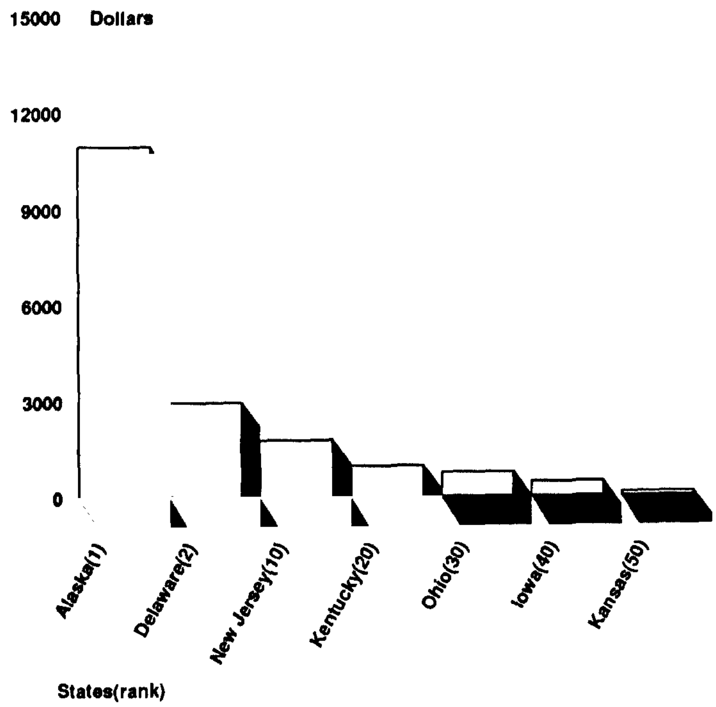
-- ten states carried 56 percent of the total state debt;

-- the range among the 10 states with the most debt was from $6 billion to $32 billion, while the 10 states with the least debt each carried about $1 billion or less; and

-- New York, ranked first with debt of $32 billion, carried 100 times more debt than Kansas, ranked last with $319 million.

APPENDIX III

Figure III.2: Selected States' 1985 Per Capita Debt



PER CAPITA DEBT OF THE INDIVIDUAL STATES

One might expect there to be a relationship between the size of a state's population and its debt--states with larger populations presumably have more needs for capital projects and debt financing for those projects. Our study found that there was a general relationship. When we ranked the states according to the size of their debt, we found that the 10 states with the most debt accounted for 56 percent of all state debt and 43 percent of the total U.S. population. The 10 states with the least debt accounted for 4 percent of total state debt and 7 percent of the U.S. population.

However, there was a wide variation of debt-to-population relationships within the overall pattern. We saw this when we ranked the states by per capita debt, comparing each state's debt to its population. Figure III.2 illustrates the range of per capita debt--Alaska was highest with $10,925, while Kansas was lowest with $130. Alaska's 1985 per capita debt was considerably higher than any other state's; Delaware had the next highest per capita debt with $2,945. Alaska's per capita debt was even higher than the federal government's per capita debt of $7,655. Per capita debt data on all the states are provided in table VI.1 in appendix VI.

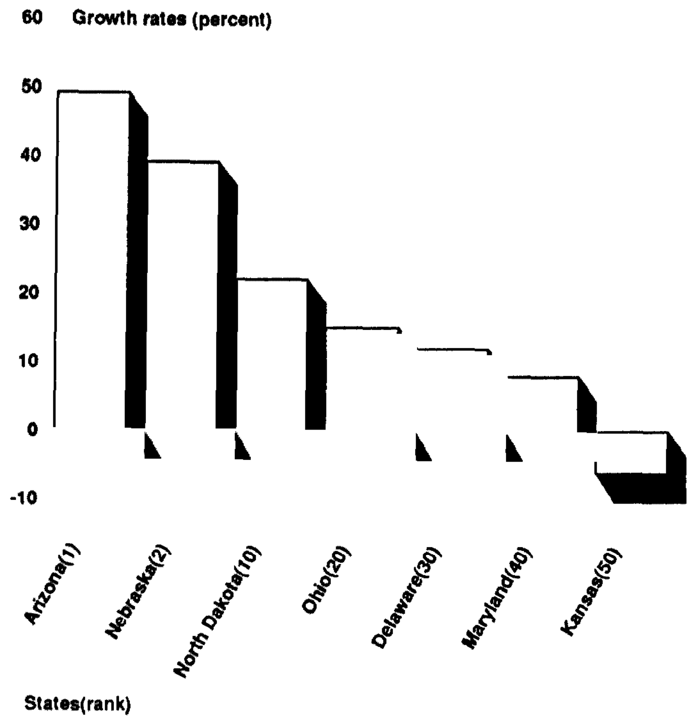
Table III.1 compares selected states' total debt and per capita debt rankings. This provides a perspective on a state's debt which is missing when either total debt or per capita debt alone is examined. For example, California had the second highest state debt but ranked thirty-seventh when its debt was related to its population. Montana ranked forty-sixth in total debt, but ranked twenty-second in per capita debt.

Table III.1: Comparison of Total Debt and Per Capita Debt Rankings

State	Total debt rank	Per capita debt rank
New York	1	8
California	2	37
New Jersey	3	10
Massachusetts	4	11
Illinois	5	25
Montana	46	22
Arizona	47	49
Idaho	48	35
North Dakota	49	24
Kansas	50	50

APPENDIX III

Figure III.3: Selected States' Average Annual Growth Rates--1981 to 1985



AVERAGE ANNUAL DEBT GROWTH RATES OF THE INDIVIDUAL STATES

We computed the average annual debt growth rate of each state for the period 1981 through 1985 to compare it with the aggregate state and federal rates. Selected states' growth rates are shown in figure III.3 to provide an overview of the state range. Individual state data on all the states are contained in table VI.1 in appendix VI.

The wide range in debt growth rates among the individual states, from a positive 49 percent (Arizona) to a negative 6 percent (Kansas), is of note. A majority of the states exceeded the aggregate state growth rate of 12 percent, and 18 states exceeded the federal growth rate of 15 percent.

Table III.2 identifies selected states' growth rates, accompanied by the related dollar increases to show that a high growth rate does not necessarily reflect a large growth in the amount of debt. For example, while both Idaho and California had the same average annual growth rate of 14 percent, California's debt growth in dollars was more than 25 times larger than Idaho's. In addition, Arizona's 49-percent growth rate only resulted in an increase of $288 million more debt than Idaho's 14-percent growth rate. Thus, growth rates alone can provide an incomplete picture unless the related dollar increases are also identified.

Table III.2: Selected States' Debt Growth Rates Compared to Increases in the Amount of Debt--1981 to 1985

	Average annual increase in debt	
State	Percent	Dollar growth (millions)
Arizona	49	$ 590
Alaska	30	4,138
Idaho	14	302
California	14	7,695
New York	6	8,715

OVERVIEW OF INDIVIDUAL STATE ANALYSIS

Table III.3 compares the results of three measures of individual states' debt to illustrate the usefulness of examining debt from a number of perspectives. For example, Arizona's average annual debt growth rate of 49 percent ranked first, although Arizona was among the lowest in total debt and per capita debt. This shows the usefulness of examining various measures of debt.

Table III.3: Comparison of Selected States' Rankings in Three Measures

State	Total debt (billions)	Per capita (dollars)	Growth rate (percent)
	---------------	(rank)	---------------
New York	$ 32 (1)	$ 1,819 (8)	6 (42)
California	$ 16 (2)	$ 609 (37)	14 (24)
New Hampshire	$ 2 (29)	$ 1,983 (7)	17 (15)
Alaska	$ 6 (12)	$10,925 (1)	30 (3)
Arizona	$ .7 (47)	$ 215 (49)	49 (1)

APPENDIX III

ANALYSIS OF STATE DEBT BY TYPE

ANALYSIS OF THE TYPES OF STATE DEBT PROVIDES A DIFFERENT PERSPECTIVE ON STATE DEBT GROWTH

- **FULL FAITH DEBT REPRESENTED 29 PERCENT OF STATE LONG-TERM DEBT**

- **NONGUARANTEED DEBT WAS USUALLY REPAID FROM NONTAX REVENUES**

- **STATE NONGUARANTEED DEBT GREW IN MOST YEARS AT A FASTER RATE THAN STATE FULL FAITH DEBT**

- **A RECENT FEDERAL TAX LAW CHANGE MAY SLOW THE GROWTH OF NONGUARANTEED DEBT**

ANALYSIS OF STATE DEBT BY TYPE

State long-term debt is comprised of full faith and nonguaranteed debt. The principal distinction between the two types of debt is that they differ in their financing sources and legal liability in case of default. However, both types are used mainly for capital investments. This differs from the federal practice of incurring debt for both operating expenses and capital investments. We examined the two types of state debt in order to provide another perspective of state and federal debt which is not apparent in the aggregate analysis.

FULL FAITH DEBT

When incurring full faith debt, a state promises to repay the debt and, if necessary, use its taxing power to raise the needed funds. The bonds issued by states for this kind of debt are often referred to as general obligation bonds. As of the end of fiscal year 1985, 29 percent of state long-term debt was full faith debt.

Table IV.1 shows the magnitude of state full faith debt in 1960 and 1985 in current and constant dollars. During the 25-year period from the end of 1960 through 1985, state full faith debt in current dollars grew from $9 billion to $60 billion, a 567-percent increase. In constant dollar terms, however, the percent growth was smaller--86 percent.

Table IV.1: Full Faith and Total State Debt in 1960 and 1985

	Current dollars		Constant dollars (1982 base year)	
	Full faith state debt	Total state debt	Full faith state debt	Total state debt
	(dollars in billions)			
1960	$ 9	$ 19	$29	$ 60
1985	60	212	54	190
Growth	$51	$193	$25	$130
Percent change	567	1,016	86	217

NONGUARANTEED DEBT

Nonguaranteed debt is financed primarily through revenue bonds which can be classified into three broad categories--enterprise bonds, public bonds for private purpose, and government lessee bonds. Nonguaranteed debt, which in 1985 comprised 71 percent of state long-term debt, is usually repaid from revenues generated by the activities being financed, rather than from tax revenues.

Enterprise bonds, the traditional category of revenue debt, typically have been used to borrow funds for constructing or improving utilities, airports, and bridges. In such instances, utility bills, landing fees, and bridge tolls provide revenues to fund the debt service.

The significant growth in nonguaranteed debt, however, has been attributed to a newer type of revenue bond--that is, bonds for private purposes. These bonds are issued to support private companies or organizations engaged in housing, economic development, construction, industry pollution control, student loans, and other activities. The private beneficiaries of the bonds' proceeds repay the debt through lease payments or other kinds of periodic payments which cover debt service over the life of the bonds. Because states do not specifically guarantee the bond interest or principal, potential purchasers of such bonds are advised to examine the credit rating of the private entities responsible for debt service payments.

The third category of revenue bonds, government lessee bonds, differs from the previous two types in that repayment is usually from taxes, not revenue-producing activities. In these cases, one state entity with borrowing authority issues bonds and uses the debt proceeds to acquire facilities for another state entity. The two entities enter a lease agreement calling for lease payments from the entity using the facility to the entity that issued the bond. The lease payments are usually funded by tax revenues and are used to liquidate the debt.

There appear to have been very few defaults on nonguaranteed bonds. If a default occurs, the state does not have a legal liability to pay the debt from general tax revenues. However, a state may in fact support repayment in these situations.

Table IV.2 shows the levels of state nonguaranteed debt in 1960 and 1985 in current and constant dollars. During this period, state nonguaranteed debt in current dollars grew from $9 billion to $149 billion, a 1,556-percent increase. In constant dollar terms, however, the growth rate was smaller--343 percent.

Table IV.2: Nonguaranteed and Total State Debt in 1960 and 1985

	Current dollars		Constant dollars (1982 base year)	
	Nonguaranteed state debt	Total state debt	Nonguaranteed state debt	Total state debt
	(dollars in billions)			
1960	$ 9	$ 19	$ 29	$ 60
1985	149	212	133	190
Growth	$140	$193	$103	$130
Percent change	1,556	1,016	343	217

Figure IV.1: Selected States' 1985 Long-Term Debt--Full Faith and Nonguaranteed

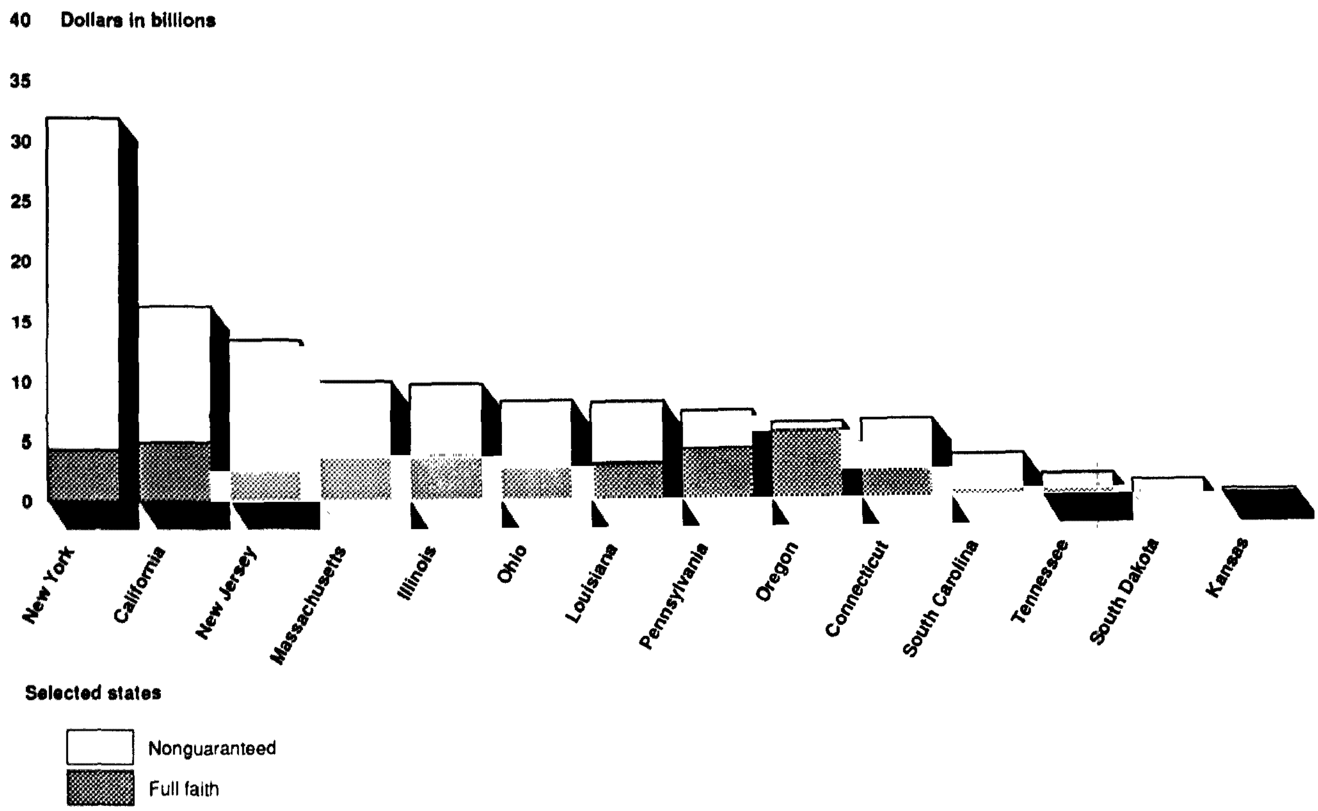
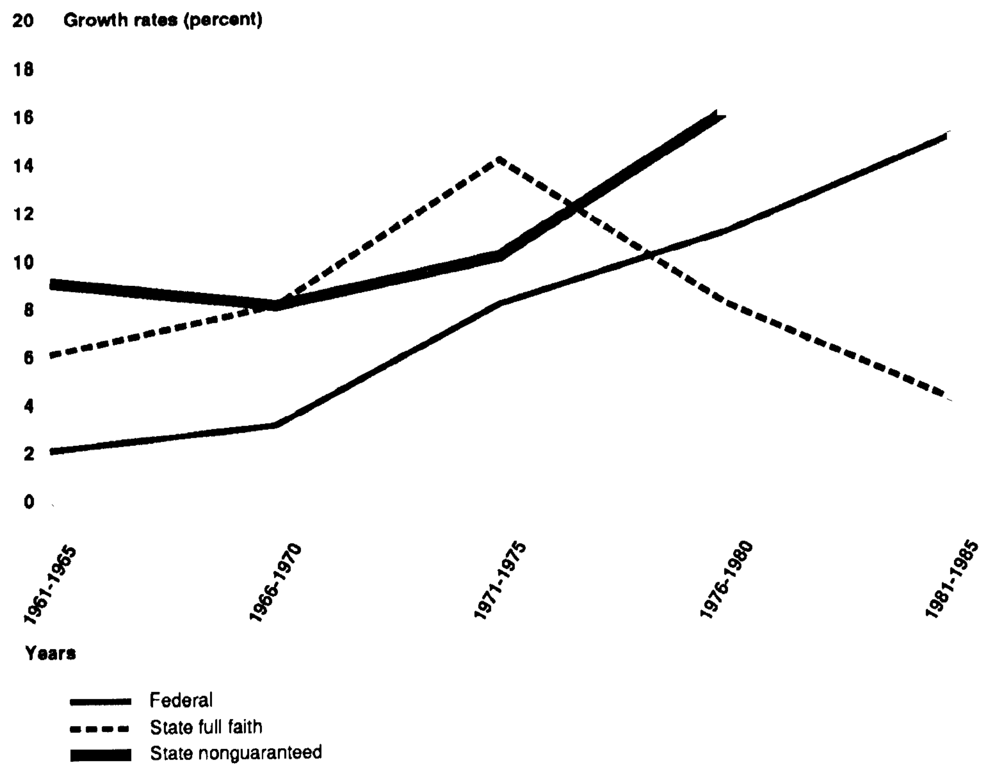


Figure IV.1 presents the full faith and nonguaranteed components of 1985 long-term debt using the same states presented in figure III.1 showing total year-end debt. The figure shows that the amount of full faith debt was generally much smaller than the amount of nonguaranteed debt. Comparable data on all of the states are found in table VI.1 in appendix VI.

As of the end of fiscal year 1985, the amount of full faith debt ranged from zero for nine states to $5.5 billion for Oregon. In contrast, the range in the amount of nonguaranteed debt was much wider, ranging from $319 million for Kansas to $28 billion for New York.

Although nonguaranteed debt was the type of debt most used by the states, the 1986 Tax Reform Act may limit its future use. The Act restricts the amount of tax-exempt bonds a state may issue to finance private trade or business. The general limit in 1987 for these private activity bonds is the greater of $75 per resident or $250 million a year. This limitation may make it less desirable for the states to issue some of their nonguaranteed debt. The law does not affect the states' ability to issue tax-exempt full faith debt.

Figure IV.2: Federal, State Full Faith, and State Nonguaranteed Debt Average Annual Growth Rates at 5-Year Intervals 1961 to 1985



AVERAGE ANNUAL GROWTH RATES OF STATE DEBT BY TYPE

Figure IV.2 illustrates the growth rates for federal debt and the full faith and nonguaranteed components of state debt. It shows that after 1975 the growth rate of state full faith debt fell below the growth rates of federal debt and state nonguaranteed debt. By the 1981 through 1985 period, the growth rate for state full faith debt had fallen to about 4 percent, while the growth rates for federal debt and state nonguaranteed debt had risen to 15 percent and 16 percent, respectively. This growth of nonguaranteed debt accounted for most of the overall state debt growth since 1975. In addition, figure IV.2 also reveals that the relative change during the period 1981 through 1985 in the state and federal debt growth rates observed in the aggregate analysis (figure II.3) resulted from higher growth rates in federal debt and a decline in the growth rates for state full faith debt.

ANALYSIS OF STATE LEGAL FISCAL CONSTRAINTS

SOME SAY THE FEDERAL GOVERNMENT SHOULD ADOPT LEGAL FISCAL RESTRAINTS SIMILAR TO THOSE USED BY STATES

THE TWO MAJOR TYPES OF LEGAL FISCAL CONSTRAINTS USED BY STATES ARE

-- DEBT RESTRICTIONS ON FULL FAITH DEBT

-- BALANCED BUDGET REQUIREMENTS

ANALYSIS OF STATE LEGAL FISCAL CONSTRAINTS

In the ongoing debate of how the federal government can reduce its deficits and debt, it is sometimes suggested that the federal government adopt legal fiscal constraints similar to those used by states. We examined how states use balanced budget requirements and debt restrictions to control their debt.

 APPENDIX V

NONGUARANTEED DEBT IS GENERALLY NOT SUBJECT TO THE FOLLOWING LEGAL FISCAL CONSTRAINTS

-- DEBT LIMITS

-- VOTER CONTROL

-- STATE BALANCED BUDGET REQUIREMENTS

NONGUARANTEED DEBT IS GENERALLY NOT SUBJECT TO LEGAL FISCAL CONSTRAINTS

Nonguaranteed debt, primarily in the form of revenue bonds, is generally excluded from state debt restrictions on the dollar amount of debt and the purposes for which debt may be incurred. Also, states may usually issue nonguaranteed debt without first obtaining voter approval.

In addition, nonguaranteed debt is generally not controlled by state balanced budget requirements. Nonguaranteed debt is generally issued by state entities whose debt service expenses (payments of principal plus interest) are not included in the state's operating budget. The operating budget and its component expenses, including debt service expenses, are normally the focus of state balanced budget requirements.

LEGAL FISCAL CONSTRAINTS ARE PLACED ON FULL FAITH DEBT

DEBT RESTRICTIONS DIRECTLY CONTROL FULL FAITH DEBT BY

-- LIMITING THE AMOUNT OF DEBT

-- SPECIFYING THE PURPOSE OF DEBT

-- REQUIRING VOTER APPROVAL

BALANCED BUDGET REQUIREMENTS INDIRECTLY CONTROL FULL FAITH DEBT

FULL FAITH DEBT IS GENERALLY SUBJECT TO LEGAL FISCAL CONSTRAINTS

Unlike nonguaranteed debt, full faith debt is usually subject to state debt restrictions and balanced budget requirements. The debt restrictions include dollar or percentage limits on the amount of debt or debt service, restrictions on the purposes for which the debt may be used, and/or requirements for voter approval.

For example, 25 states[2] have constitutional limits on the amount of debt that may be outstanding, while the federal government has a statutory debt limit. The state limits are usually expressed in dollar terms and can range from $50,000 to $2 million. In other states, the limit is variable because it is based on a percentage of property values.

The states generally restrict the use of most debt to capital projects. However, some states' debt restrictions permit the use of debt for noncapital purposes. When borrowing for noncapital expenses is permitted, a low dollar limit may be placed on such borrowings. For example, three states have limits of $100,000.

Some states also require voter approval for the issuance of debt. Some states require voter approval only for amounts above a certain dollar level, while others must obtain voter approval for all debt issuances. Statistics from The Bond Buyer 1985 Municipal Statbook on state and local debt show that the voters do not always approve proposed issuances of debt. Table V.1 shows that voter approval rates ranged from 29 percent to 85 percent over the 25-year period 1960 through 1985.

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[2]Limitations on State Deficits, National Association of Budget Officers, 1976, pages 8 and 9. A report issued subsequent to our audit work indicates that the number of states with constitutional debt limits has increased to 30. See Fiscal Discipline in the Federal System: National Reform and the Experience of the States, Advisory Commission on Intergovernmental Relations, 1987, page 38.

Table V.1: Voter Approval of State and Local Bond Elections

Year	Percent of bond elections approved (percentage)
1960	85
1965	73
1970	63
1975	29
1980	71
1985	83

Source: The Bond Buyer 1985 Municipal Statbook, page 24.

It is important to note that from 1961 through 1985, decreasing portions of state debt were subject to voter control. This is because the kind of state debt most often subject to voter control--full faith debt--decreased as a percent of total state debt.

As indicated previously, state full faith debt also is generally limited, albeit indirectly, by state balanced budget provisions. Forty-nine of the states have balanced budget requirements, usually written into state constitutions. This contrasts with the federal government which does not have a constitutional balanced budget requirement. While some states only require that the governor submit a balanced budget, 34 of the states require that their governments execute balanced budgets.[3]

State balanced budget provisions normally require that balanced operating budgets include, on the spending side, expenditures for debt service on full faith debt. By requiring that annual operating expenditures, including debt service, be

[3]Budget Issues: State Balanced Budget Practices, (GAO/AFMD-86-22BR, December 10, 1985).

covered by annual taxes and other nonborrowed revenues, the balanced budget provisions indirectly control the amount of full faith debt that may be issued for capital projects.

State officials often have a balanced budget "mind-set" that reinforces the formal balanced budget requirements. This is a predisposition by state officials to avoid operating deficits. Such deficits can lower a state's bond ratings and often run counter to the political culture of a state. The officials therefore begin with a balanced budget and try to keep the budget in balance throughout the year. Prior GAO and National Association of State Budget Officers' reports have noted that this "mind-set" has had much to do with keeping state budgets in balance.

In spite of this, operating deficits sometimes occur. Three states reported such deficits for 1985. When this happens, states rarely finance their operating deficits with long-term bonds. More often, short-term debt, which in 1985 represented only 1 percent of the states' total year-end debt, is used to cover an operating deficit.

In considering state and federal debt experiences, it must be recognized that these two levels of government have different roles and institutional procedures. The federal government has several major responsibilities not assumed by state governments. For example, the federal government provides for the national defense and promotes national economic growth, employment, and price stability. Some of these unique responsibilities may require the federal government at times to incur intentional budget deficits.

In addition, some of the debt control procedures employed by the states could not be adopted at the federal level without affecting the balance of power between the Congress and the President. For example, some states permit their governors to unilaterally reduce available funding to avoid a deficit. Such powers are not available to the President under existing law.

INDIVIDUAL STATE DATA

LISTS OF THE 50 STATES RANKED BY

- **-- TOTAL OUTSTANDING DEBT AT THE END OF FISCAL YEAR 1985**
- **-- PERCENT OF FULL FAITH AND NONGUARANTEED DEBT**
- **-- PER CAPITA DEBT AT THE END OF FISCAL YEAR 1985**
- **-- AVERAGE ANNUAL GROWTH RATES OF DEBT FOR FISCAL YEARS 1981 THROUGH 1985**

Table VI.I: Individual State Data

State	Total fiscal year 1985 debt: Total dollar Amount (Millions of dollars)	Total dollar Rank	Guaranteed (Percent)	Nonguaranteed (Percent)	Fiscal year 1985 per capita debt: Amount (Dollars)	Rank	Average annual debt growth 1981 through 1985: Amount (Millions of dollars)	Percent	Rank
Alabama	$ 3,240	23	21	79	$ 806	29	$2,208	26	7
Alaska	5,692	12	34	66	10,925	1	4,138	30	3
Arizona	684	47	0	100	215	49	590	49	1
Arkansas	825	44	0	100	350	45	462	18	14
California	16,057	2	30	70	609	37	7,695	14	24
Colorado	1,521	34	0	100	471	39	1,060	27	5
Connecticut	6,389	10	36	64	2,458	5	2,510	10	36
Delaware	1,832	31	31	69	2,945	2	787	12	30
Florida	5,015	15	31	69	441	41	2,388	14	25
Georgia	2,158	27	57	43	361	44	753	9	38
Hawaii	2,710	26	64	36	2,571	4	845	8	41
Idaho	629	48	0	100	626	35	302	14	23
Illinois	9,787	5	36	64	848	25	3,510	9	37
Indiana	1,730	32	0	100	315	48	1,123	23	8
Iowa	1,326	36	0	100	460	40	945	28	4
Kansas	319	50	0	100	130	50	(119)	-6	50
Kentucky	3,633	17	5	95	975	20	598	4	47
Louisiana	8,095	7	36	64	1,806	9	5,118	22	9
Maine	1,225	38	23	77	1,052	18	494	11	35
Maryland	5,091	14	44	56	1,159	16	1,589	8	40
Massachusetts	10,101	4	36	64	1,735	11	4,316	12	31
Michigan	5,904	11	11	89	650	33	2,988	15	21
Minnesota	3,503	19	33	67	835	27	1,433	11	34
Mississippi	1,007	42	53	47	385	43	192	4	46
Missouri	3,319	21	10	90	660	32	2,302	27	6
Montana	745	46	14	86	901	22	435	19	12
Nebraska	1,028	41	0	100	640	34	829	39	2
Nevada	1,109	39	24	76	1,184	15	581	16	17
New Hampshire	1,979	29	21	79	1,983	7	1,080	17	15
New Jersey	13,365	3	18	82	1,767	10	6,838	15	19
New Mexico	1,278	37	2	98	881	23	570	13	28
New York	32,355	1	13	87	1,819	8	8,715	6	42
North Carolina	2,157	28	39	61	345	46	891	11	33
North Dakota	586	49	1	99	855	24	367	22	10
Ohio	8,204	6	32	68	764	30	4,189	15	20
Oklahoma	3,581	18	3	97	1,085	17	2,056	19	13
Oregon	6,605	9	88	12	2,458	5	1,719	6	45
Pennsylvania	7,289	8	57	43	615	36	941	3	48
Rhode Island	2,814	25	11	89	2,907	3	1,351	14	22
South Carolina	3,403	20	19	81	1,017	19	1,466	12	29
South Dakota	1,086	40	0	100	1,535	13	372	9	39
Tennessee	1,913	30	35	65	402	42	508	6	43
Texas	5,193	13	33	67	317	47	2,724	16	16
Utah	1,333	35	17	83	811	28	796	20	11
Vermont	887	43	30	70	1,659	12	233	6	44
Virginia	3,317	22	13	87	581	38	1,391	11	32
Washington	3,030	24	82	18	687	31	1,430	14	26
West Virginia	1,628	33	44	56	841	26	(188)	-2	49
Wisconsin	4,473	16	52	48	937	21	2,027	13	27
Wyoming	757	45	0	100	1,487	14	394	16	18
Total	$211,907								

GLOSSARY

The following terms are used in this report.

AVERAGE ANNUAL GROWTH RATE - Average of the individual annual growth rates over a period of time. In this report, we examined average annual growth rates of outstanding debt over 5-year and 25-year periods.

BALANCED BUDGET REQUIREMENTS - A requirement legislated by 49 of the 50 states which requires that their budgets be balanced. This requirement varies by state but generally includes state operating budgets.

CONSTANT DOLLARS - A dollar value adjusted for changes in prices.

CURRENT DOLLARS - Dollars expressed in nominal values; i.e., unadjusted for inflation.

DEBT LIMIT - Various legal limits on state debt which may include dollar limits, restriction on use, and/or voter approval.

DEBT SERVICE - The amounts of money necessary to pay bond interest and principal requirements for a given year or series of years.

DEFAULT - Failure to pay principal or interest promptly when due.

ENTERPRISE DEBT - Revenue bonds which are to be retired primarily from the earnings of publicly owned and operated enterprises.

FISCAL CONSTRAINTS - For purposes of this report, fiscal constraints are state debt limits and balanced budget requirements. Most of these fiscal constraints are cited in statutory provisions or state constitutions.

FULL FAITH AND CREDIT BONDS - Bonds--typically general obligation bonds--backed by the issuing government with a guarantee of repayment based on its taxing powers. Voter approval is often required before these bonds can be issued.

FEDERAL GOVERNMENT SPONSORED ENTERPRISES - Five entities, now privately owned, established by the federal government to perform specific credit functions. Enterprises include the Farm Credit System and the Federal National Mortgage Association. The five enterprises are not part of the federal budget, and their debt is not included in gross federal debt.

GNP DEFLATOR - A weighted average of the price indexes used to deflate the components of current dollar GNP. This measure of prices is generated by the Bureau of Economic Analysis.

GOVERNMENT LESSEE BONDS - Bonds issued by one governmental agency retired primarily by lease payments from other governments or governmental agencies.

GROSS FEDERAL DEBT - Total outstanding federal debt which consists of all outstanding public and agency debt. Gross federal debt, strictly defined, does not include the debt of federally sponsored but privately owned enterprises.

LONG-TERM DEBT - Debt with a maturity of more than 1 year after the date of issuance.

MUNICIPAL BONDS - Securities, historically tax-exempt, issued by a state or local governmental unit. Recent federal tax laws have limited the amount of some types of municipal bonds which may be issued on a tax-exempt basis.

NONGUARANTEED DEBT - Long-term obligations, primarily revenue bonds, payable solely from pledged specific sources, such as earnings of plants or activities, which do not constitute obligations against other resources.

PUBLIC DEBT FOR PRIVATE PURPOSE - A type of revenue bond issued by states or localities which benefits private corporations and is retired by payments from the corporations. Also referred to as "nontraditional borrowing," "on behalf of debt," and "private activity bonds."

REVENUE BONDS - Limited obligation bonds that have no claim on the issuer's tax revenues. Instead, repayment is based on the revenues generated by the specific projects, financed by the bonds issued. Revenue bonds usually do not require voter approval.

SHORT-TERM DEBT - Debt with a maturity of 1 year or less after the date of issuance.

TAX-EXEMPT BONDS - Bonds with interest exempt from federal income taxes.

TOTAL STATE DEBT - Total outstanding long-term credit obligations and interest-bearing short-term debt of the states and their agencies.

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