



# State and Local Government Debt: An Analysis

**Steven Maguire**  
Specialist in Public Finance

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## Summary

The financial consequences of the recession that spanned from December 2007 through June 2009 have increased congressional interest in the fiscal health of state and local governments. State and local tax revenues declined, expenditures climbed, and debt increased. Even though tax revenue has begun to rebound, expenditures for unemployment benefits and other social programs remain elevated. Also, federal aid to states, which had increased as part of the American Recovery and Reinvestment Act, has receded. Federal outlays for grants in aid to state and local governments rose from \$538 billion in FY2009 to \$608.4 billion in FY2010 and are estimated to be \$625.2 billion in FY2011. The FY2012 budget provides \$584.3 billion in outlays for aid to state and local governments in 2012.

In response to these state and local government fiscal headwinds, several hearings were held in the first session of the 112<sup>th</sup> Congress to examine the health of state and local government finances and the potential effects on the economic recovery. The hearings focused on a range of issues important to state and local governments as well as federal policy makers. The role of state and local government debt was one of these issues. The federal government has a significant stake in this debt market, as the tax expenditure for tax-exempt bonds issued by state and local governments was recently estimated to be \$161.6 billion over the 2010 to 2014 budget window.

This report first provides a broad overview of state and local government finances and how these governments incorporate borrowing into their budgets. The second section reports data on state and local government debt and how that debt has changed over time. This section includes a comparative analysis of these debt parameters for each state. The third section discusses different economic perspectives on the use of debt by governments and if governments are intrinsically biased toward borrowing more than is considered economically optimal. The discussion provides background for Congress as it deliberates potential changes in the oversight of the primary and secondary markets for state and local government debt.

Issues related to state and local government finances, such as government pensions and health benefits, are also addressed. This report will be updated as legislative events warrant.

## Contents

State and Local Government Finances .....	1
State and Local Government Debt.....	1
Operating Budget and Capital Budget.....	2
The Unemployment Trust Fund and Pension Debt .....	3
Individuals Hold Most State and Local Government Debt.....	4
Measuring State and Local Government Debt.....	5
Relative Measures of State and Local Government Debt.....	6
State and Local Government Finances: 2002 to 2009 .....	8
Why Has State and Local Government Debt Increased?.....	10
Fiscal Illusion and Debt Versus Taxes .....	10
Ricardian Equivalence and Debt Capitalization .....	11
Changes in State and Local Debt and Operating Budgets .....	12
Other Fiscal Strains: Pensions and Declining Federal Aid .....	14
Pension Obligation Bonds .....	14
Federal Aid .....	15
Debt and Pension Liabilities.....	15
Economics of State and Local Government Debt.....	16
Crowding Out of Domestic Investment and Net Exports.....	17
Economic Efficiency of Tax-Exempt Debt.....	17
Congressional Action.....	18

## Figures

Figure 1. Holders of State and Local Government Debt Outstanding .....	5
Figure 2. State and Local Government Debt Outstanding as Percentage of Own-Source Government Revenue in FY2009 .....	7
Figure 3. Level of State and Local Employees Retirement Fund Asset Value, Debt, Taxes, and General Revenue.....	9
Figure 4. Annual Change in Aggregate State and Local Government Debt and Operating Budgets from FY2003 to FY2009 .....	12
Figure 5. State and Local Government Debt as Percentage of Personal Income.....	13
Figure 6. State and Local Government Debt and Pension Liabilities as Percentage of State GDP .....	16

## Tables

Table A-1. Relative Measure of State and Local Government Debt Outstanding in FY2009.....	20
Table A-2. Change in State and Local Government Debt and Interest Expense from FY2002 to FY2009 .....	22

Table A-3. State and Local Government Debt and Pension Obligations ..... 24

**Appendixes**

Appendix..... 20

**Contacts**

Author Contact Information..... 25

## State and Local Government Finances

The fiscal health of many states has been severely strained by the prolonged economic slowdown following the recent recession, even after the official end of the recession in June 2009. State and local tax revenues have declined, expenditures for social insurance programs have increased, and federal assistance has begun to recede as federal aid related to the American Recovery and Reinvestment Act (ARRA) expires. Further, state and local governments are required to balance current operating budgets either annually or biennially. State and local governments have used a combination of rainy day fund withdrawals, tax increases, spending reductions, and in some instances, borrowing to meet these balanced budget requirements.<sup>1</sup>

Congress has become increasingly concerned that financial difficulties may lead state and local governments to take actions that could have an adverse impact on the economic recovery and that they may need additional federal government assistance. Part of this concern has focused on debt issued by state and local governments. This report will describe state and local government debt and analyze how debt is incorporated into state and local budgets. The report will also analyze the role the federal government has in state and local government debt structure.

Other issues of interest to Congress include bond default risk and public pension underfunding. Bond default risk and underfunding public pensions are both integral parts of state and local finance, though somewhat beyond the scope of this report. Clearly, during economic downturns, the risk of bond default rises. In particular, those bonds secured by specific revenue streams and not the general obligation of the issuing jurisdiction are at greatest risk. Even so, municipal default has been relatively rare, only 54 defaults from 1970 to 2009, and has yet to become a significant issue in municipal finance.<sup>2</sup> As for public pensions, debt is rarely used to finance future obligations and is generally discouraged by public finance professionals. Nonetheless, some states have used debt to fund pensions.<sup>3</sup>

## State and Local Government Debt

As noted earlier, the level of state and local government debt and purported growth of this debt during the recession has generated congressional interest.<sup>4</sup> Some observers have suggested that

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<sup>1</sup> An overview of some techniques used to “manage” state budget constraints can be found in the following: Eileen Norcross, *Fiscal Evasion in State Budgeting*, Mercatus Center, George Mason University, Working Paper no. 10-39, July 2010.

<sup>2</sup> For more on the history, see Moody’s Investor Service, “U.S. Municipal Bond Defaults and Recoveries, 1970-2009,” February 2010. As for future defaults, though difficult to predict, the Bond Dealers of America reports that “in the last four years and during the height of the recession, only seven municipal governments filed for bankruptcy.” See Mike Nicholas, Chief Executive Officer, Bond Dealers of America, as reported in *The Bond Buyer*, February 28, 2011. Also, Kroll Bond Ratings issued a report where they summarized that “...we do not foresee a material increase in municipal defaults over the medium term. Moreover, our findings support the view that any resulting investor losses are likely to be small.” From Kroll Bond Ratings, “An analysis of Historical Municipal Bond Defaults,” November 14, 2011, p. 3; available at <http://www.krollbondratings.com/ratings/publicfinance>.

<sup>3</sup> James B. Burnham, “Risky Business?: Evaluating the Use of Pension Obligations Bonds,” *Government Finance Review*, June 2003, p. 12-17.

<sup>4</sup> For more on state and local government debt, see CRS Report RL30638, *Tax-Exempt Bonds: A Description of State and Local Government Debt*, by Steven Maguire.

the pressure to provide additional federal assistance has increased as states are purportedly relying more on debt to finance operations. For example, H.R. 344, the Fiscal Responsibility Effective Enforcement Act, would prohibit the Federal Reserve Board (the Fed) from buying short-term municipal securities, thus reducing the probability that the Fed would be asked to “bail-out” state and local governments. And, with regard to pensions, H.R. 567 and its Senate companion, S. 347, would require non-federal government entities to provide more information about pension funding and require more conservative accounting rules for pension finances.

More generally, Congress has also held several hearings on policies addressing the fiscal health of state and local governments.<sup>5</sup> This section will describe the type of state and local government debt analyzed here and who holds this debt.

## **Operating Budget and Capital Budget**

In contrast to the federal government, most state and local governments maintain two budgets, an operating budget and a capital budget. The operating budget funds current expenditures such as employee salaries, payment for services, and interest payments on debt. Current revenues, such as taxes, fees, user charges, and intergovernmental aid, finance these expenditures. When observers refer to state and local government budget deficits, they are almost always referring to the operating budget.

The timing of state and local revenue collection, however, typically does not match spending. Thus, most governments issue short-term debt to finance current spending then use future revenue to repay this debt. These notes are called revenue anticipation notes or tax anticipation notes. It is important to note that almost every state and local government is required to maintain a balanced operating budget from fiscal year to fiscal year, so only in rare circumstances is short-term debt carried over into the next fiscal year.<sup>6</sup>

The capital budget is typically used to finance infrastructure (or public capital) investment. The capital budget looks forward as far as 10 years for some states.<sup>7</sup> The role of debt differs in the operating and capital budgets. Long-term debt is almost always intended for capital projects and as such is included in the capital budget. However, the interest expense on debt issued for the capital budget is included in the operating budget.

No uniform definition of a “capital” expenditure exists, though most lean toward a common principle. The National Association of State Budget Officers (NASBO) provides the following brief explanation of how states identify spending for inclusion in the capital budget:

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<sup>5</sup> U.S. Congress, Senate Committee on the Budget, *Challenges for the U.S. Economy*, 112<sup>th</sup> Cong., 1<sup>st</sup> sess., February 3, 2011; U.S. Congress, House Committee on Oversight and Government Reform, Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs, *State and Municipal Debt: The Coming Crisis?*, 112<sup>th</sup> Cong., 1<sup>st</sup> sess., February 9, 2011; and U.S. Congress, House Committee on Oversight and Government Reform, Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs, *State and Municipal Debt: The Coming Crisis? Part II*, 112<sup>th</sup> Cong., 1<sup>st</sup> sess., March 15, 2011. U.S. Congress, House Committee on Oversight and Government Reform, *State and Municipal Debt: Tough Choices Ahead*, 112<sup>th</sup> Cong., 1<sup>st</sup> sess., April 14, 2011.

<sup>6</sup> National Association of State Budget Officers (NASBO), “Budget Processes in the States,” Washington, DC, Summer 2008, available at <http://www.nasbo.org/LinkClick.aspx?fileticket=AaAKTnjgucg%3d&tabid=38>.

<sup>7</sup> NASBO, “Capital Budgeting in the States,” Washington, DC, November 1999, available at <http://www.nasbo.org/LinkClick.aspx?fileticket=yfDocTSXHU4=&tabid=84>.

States define the types of expenditures allowed in capital budgets to include such items as construction, improvements, land acquisition, site improvements, major renovations, and equipment. Definitions may also specify the anticipated useful life of a project and a minimum level of expenditure, with \$25,000 being the most frequent minimum for capital budget expenditures.<sup>8</sup>

The ambiguity in some facets of this explanation is readily apparent. For example, the difference between a “major renovation” and a “minor renovation” may be arbitrary.

Nevertheless, the use of capital budgets and balanced budget rules makes it relatively difficult for state and local governments to issue debt to fund current operating expenses. Some states, however, do have some flexibility to shift spending between the operating and capital budgets, from fiscal year to fiscal year, and from account to account. This flexibility diminishes the seemingly disciplined treatment of debt. In addition, many states create and use special purpose authorities for debt issuance. These special authorities, though part of state government, are typically not constrained by the budget discipline tools described above.<sup>9</sup>

### **The Unemployment Trust Fund and Pension Debt**

State and local governments also incur future liabilities that are not bonds. For example, many states borrow directly from the federal government to finance current expenditures for unemployment compensation (UC).<sup>10</sup> During recessions, the balance of these funds often falls to a point where states borrow to pay benefits. States can borrow from outside sources or from the federal government. As of December 29, 2011, 26 states and the U.S. Virgin Islands owed a combined \$36.4 billion through trust fund loans from the federal government.<sup>11</sup> These debts will be repaid through higher taxes on employers in most cases. A thorough examination of this type of debt and accompanying interest costs, though significant in some states, is beyond the scope of this report (for example, California owes almost \$10 billion to the federal government or 27% of the total outstanding).

Pension funds—in particular, defined benefit retirement funds—are also a significant liability or debt incurred by states and local governments. Recent studies have estimated that many state pensions are underfunded; one set the underfunding at \$1 trillion.<sup>12</sup> As with UC programs, a thorough examination of this type of debt is beyond the scope of this report.

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<sup>8</sup> NASBO, “Capital Budgeting in the States,” 1999, p. 8.

<sup>9</sup> An overview of some techniques used to “manage” state budget constraints can be found in the following: Eileen Norcross, *Fiscal Evasion in State Budgeting*, Mercatus Center, George Mason University, Working Paper no. 10-39, July 2010.

<sup>10</sup> CRS Report RS22954, *The Unemployment Trust Fund (UTF): State Insolvency and Federal Loans to States*, by Julie M. Whittaker.

<sup>11</sup> United States Department of Labor, Employment and Training Administration, “Trust Fund Loans,” Washington, DC, available <http://www.workforsecurity.doleta.gov/unemploy/budget.asp#tloans>, visited January 3, 2012.

<sup>12</sup> Pew Center for the States, “The Trillion Dollar Gap: Underfunded State Retirement Systems and the Road to Reform,” Washington, DC, February 2010, available at [http://downloads.pewcenteronthestates.org/The\\_Trillion\\_Dollar\\_Gap\\_final.pdf](http://downloads.pewcenteronthestates.org/The_Trillion_Dollar_Gap_final.pdf).

## Individuals Hold Most State and Local Government Debt

In addition to the discipline of budgetary rules, state and local government debt issuance is also constrained by the financial markets. As with any borrower, state and local governments need willing creditors to incur debt. The relative safety of state and local government debt and the federal income tax exclusion on interest payments on state and local bonds has created a strong demand for state and local government debt. What is also important to note is that entities that are otherwise non-taxable (or nontaxable foreign entities) have little interest in tax-exempt state and local debt.

Individuals are the primary holders of state and local government debt. **Figure 1** shows the holders of all outstanding municipal debt as of the third quarter of 2011.<sup>13</sup> Households, mutual funds, and money market funds represent holdings of individuals and compose almost three-quarters (73%) of all debt outstanding (shades of blue in **Figure 1**). In past years, the rest of the world (ROW) held considerably less municipal debt. The recent increase in tax-exempt bond holdings by the ROW can be attributed to the change in the more favorable tax treatment of corporate-held tax-exempt debt and Build America Bonds (BABs).<sup>14</sup> BABs are taxable and offer higher interest rates than tax-exempt bonds thus making them more attractive to non-taxable entities, such as pension funds and international investors.

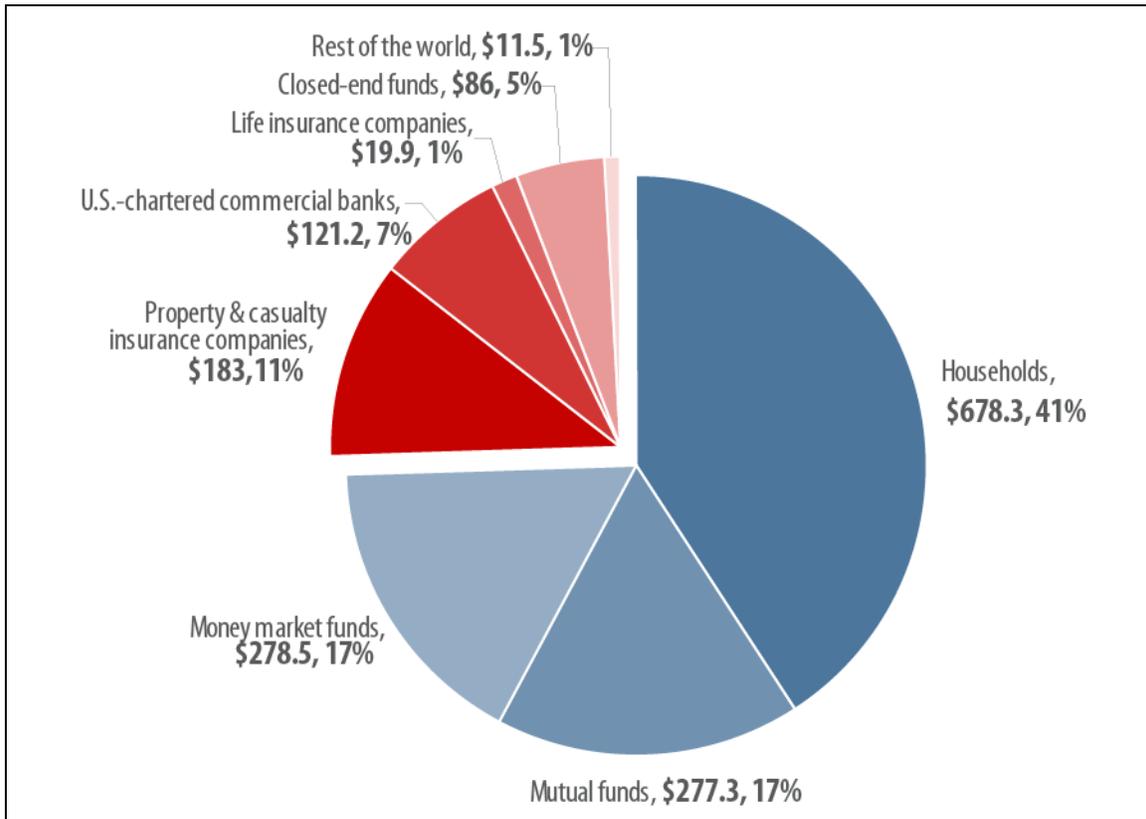
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<sup>13</sup> This total includes roughly \$746 billion of debt issued by nonprofit organizations and nonfinancial businesses.

<sup>14</sup> For further analysis of Build America Bonds, see CRS Report R40523, *Tax Credit Bonds: Overview and Analysis*, by Steven Maguire.

**Figure I. Holders of State and Local Government Debt Outstanding**

As of the Third Quarter of 2011 in Billions of Dollars



**Source:** CRS presentation of data from Federal Reserve Board, Flow of Funds Accounts, Flows and Outstandings, Third Quarter 2011.

**Note:** The blue parts are chiefly owned by individuals directly or indirectly through the specified type of investment vehicle.

The next section provides more detail on the level of state and local government debt. The discussion relies on data provided publicly by the Federal Reserve Board and U.S. Bureau of the Census and attempts to establish the current debt position of state and local governments and how it has changed over time.

## Measuring State and Local Government Debt

The Fed and the United States Census Bureau (Census) publish information on state and local government debt outstanding. Both sources exhibit the relative importance of long-term debt. The Fed data are more current whereas the Census reports detailed data for both state and local government debt, albeit less current.

The Fed reports that, as of the third quarter of 2011, \$2.99 trillion of state and local government debt was outstanding. Of this total, long-term debt composed 98.4%.<sup>15</sup> The Census reports that

<sup>15</sup> Federal Reserve Board, "Flow of Funds Accounts, Flows and Outstandings, Third Quarter 2011, Table L. 211" (continued...)

for FY2009, the latest year available, total state and local government outstanding debt was \$2.68 trillion (\$1.05 trillion in state debt and \$1.64 trillion in local debt).<sup>16</sup> The Census further reports that in FY2009 *state* long-term debt was 99.3% of state total outstanding debt and *local* long-term debt was 98.3% of local total outstanding debt.

The amount of state and local government debt outstanding provides an indication of the relative magnitude of government borrowing. The government issuer, however, is not obligated to repay all of this debt; much of this debt is issued through debt vehicles called revenue bonds. Revenue bonds commit (or are secured by) a specified revenue stream, not the full faith and credit of the issuer. From 1996 through November 2011, roughly one-third of state and local government debt issued was general obligation debt and two-thirds was specific revenue-secured debt.<sup>17</sup>

By comparison, total corporate and foreign bonds held by U.S. residents was \$11.4 trillion at the close of the third quarter of 2010, and U.S. Treasury debt just recently reached \$14.1 trillion.<sup>18</sup> Most corporate debt and all federal debt is backed by the full faith and credit of the issuer.

## Relative Measures of State and Local Government Debt

The level of debt outstanding is best understood in the context of capacity to service that debt. One common measure of capacity to service debt is a jurisdiction's own-source revenue, excluding transfers from the federal government. This metric includes revenue from taxes (e.g., sales, income, and property) and revenue from fees and charges (e.g., public college tuition and recreation fees). It could be argued that own-source revenue may be the best metric to gauge capacity to service debt because state and local governments have a great deal of control over these revenue sources.

A narrower measure of capacity to service debt is using current tax revenue alone. Using tax revenue alone would make the local government situation look relatively more precarious as they rely less on current taxes and more on user charges and fees than state governments. **Table A-1** in the Appendix presents ratios measuring (1) debt to own-source revenue (OSR; exhibited in **Figure 2**) and (2) debt to current tax revenue for (a) state and local governments combined, (b) state governments alone, and (c) local governments alone for FY2009 (the latest available).<sup>19</sup> In states where local governments have less responsibility for government service provision, state level revenue and spending is a larger share of the total state and local government combined budget. In such states, the debt burden would lean more heavily on the state. With this in mind,

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(...continued)

available at <http://www.federalreserve.gov/releases/z1/>. This total does not include the amounts issued by nonprofit organizations and nonfinancial corporate businesses.

<sup>16</sup> United States Census Bureau, *State and Local Government Finances FY2009*, released October 31, 2011. The Fed reports \$2.99 trillion outstanding for 2009.

<sup>17</sup> Thomson-Reuters as provided by the Securities Industry and Financial Markets Association (SIFMA). Data available at <http://www.sifma.org/research/statistics.aspx>.

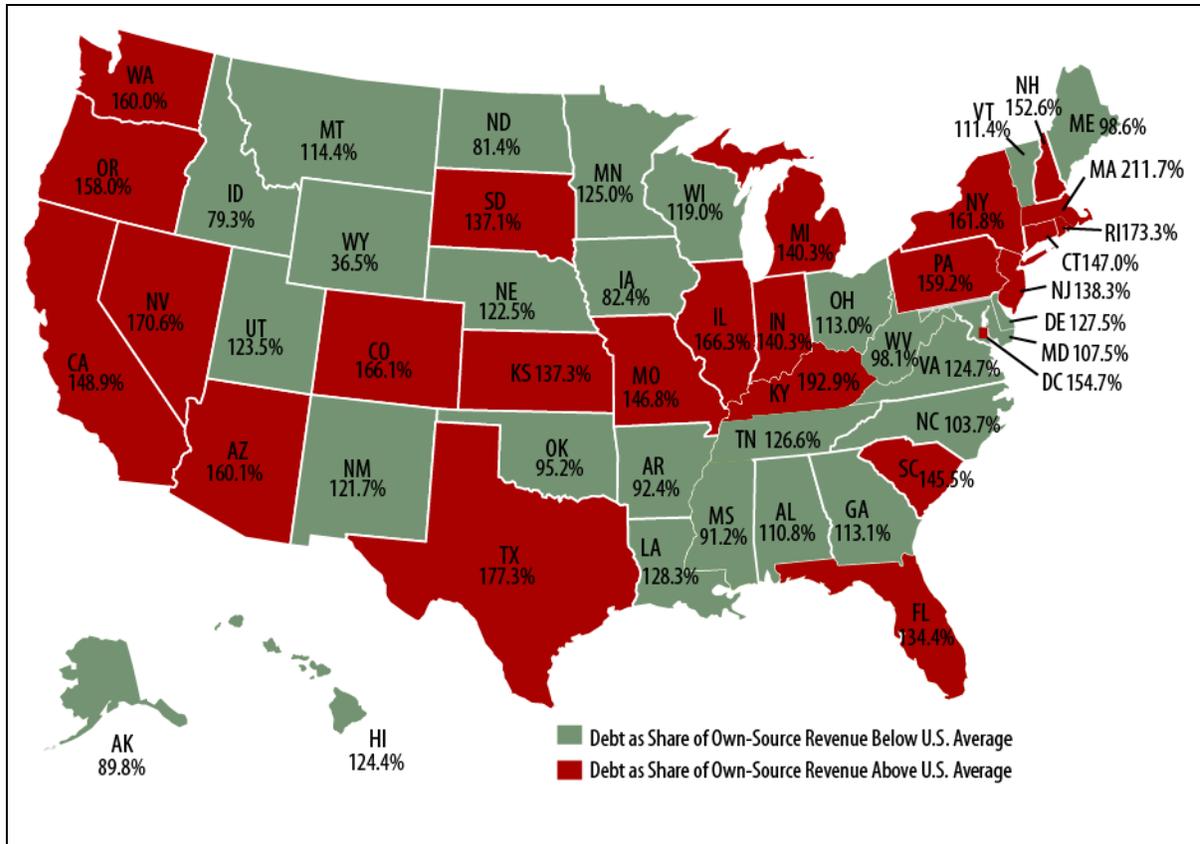
<sup>18</sup> For more on Treasury debt outstanding, see CRS Report RL31967, *The Debt Limit: History and Recent Increases*, by D. Andrew Austin and Mindy R. Levit.

<sup>19</sup> The FY2008 data, though somewhat dated, are still informative for comparative analysis. Debt outstanding does not fluctuate drastically from year to year as most of the underlying debt is long term. The drop in revenues corresponding with the 2007 to 2009 recession, however, is not reflected in the percentages.

the combined state and local government debt burden may be the best comparative measure across states.

**Figure 2** identifies the states with debt to OSR above the national average of 130.2% in red. The state with the highest aggregate debt load is Massachusetts with debt representing 211.7%, or more than double, OSR. In contrast, Wyoming has very little debt, just 36.5% of OSR.

**Figure 2. State and Local Government Debt Outstanding as Percentage of Own-Source Government Revenue in FY2009**



**Source:** United States Census Bureau, *State and Local Government Finances FY2009*, released October 31 2011.

**Note:** See **Table A-I** in the Appendix.

The total state and local debt to OSR percentages, however, should be viewed with caution, as they may mask fundamental differences among states in how debt finance is shared between the state government and local governments. For example, total state and local government debt to OSR in New Hampshire and Tennessee is 152.6% and 126.6%, respectively. From this, one might conclude that, from a risk perspective, Tennessee’s debt policies are relatively more sound than New Hampshire’s. The *state* of New Hampshire does have the third-highest debt burden of all *states* (state debt was 223.2% of OSR in FY2009) yet *local* governments in New Hampshire have the third-lowest debt burden (*local* debt was 75.6% of OSR). Whereas in Tennessee, the state had the lowest debt to OSR percentage of just 32.0%, but local governments in Tennessee had a debt to taxes percentage of 230.3%. Only eight states had local governments with a higher debt-to-OSR percentage than Tennessee.

The difference between New Hampshire and Tennessee highlights how examining measures of state debt alone may understate potential debt strain at the sub-state government level. And, to the extent states may be indirectly responsible for the finances of sub-state governments, risk could be transferred from the local governments to state governments. Following is a discussion of how state and local government finances, including employee retirement assets, have changed since 2002.

## **State and Local Government Finances: 2002 to 2009**

The recession that began in December 2007 and ended June 2009 created significant fiscal strain on state and local governments.<sup>20</sup> The economy was in recession for over half of FY2008 and all of FY2009. Over this period, revenues declined and elevated spending intended to counter the effects of a slowed economy created what the National Association of State Budget Officers called “one of the worst periods in State fiscal conditions since the great depression.”<sup>21</sup> In addition, federal assistance provided by the American Recovery and Reinvestment Act of 2009 is scheduled to expire and future pension obligations, for both retirement and health benefits, have created unease among many financial analysts and policymakers.

This section examines how state and local finances have changed over the FY2002 to FY2009 period. These years were selected for comparison because they are fairly representative of recent changing economic conditions. Both the beginning and end are considered economic troughs corresponding with the two most recent recessions. The recession of 2001 spanned from March 2001 to November 2001, which includes the beginning of FY2002 (for most states that would have been July 1, 2001). The data endpoint, FY2009, corresponds with the end of the most recent recession in June 2009.

**Figure 3** shows the level of state and local general revenue, tax revenue, total state debt outstanding, and interest expense. The average annual growth rate for debt outstanding over the period was 6.9% and total revenue, including intergovernmental aid, grew at an annual average rate of 5.3%. If intergovernmental aid were excluded, the average annual growth rate of state and local own-source revenue was 5.1% from 2002 to 2009.

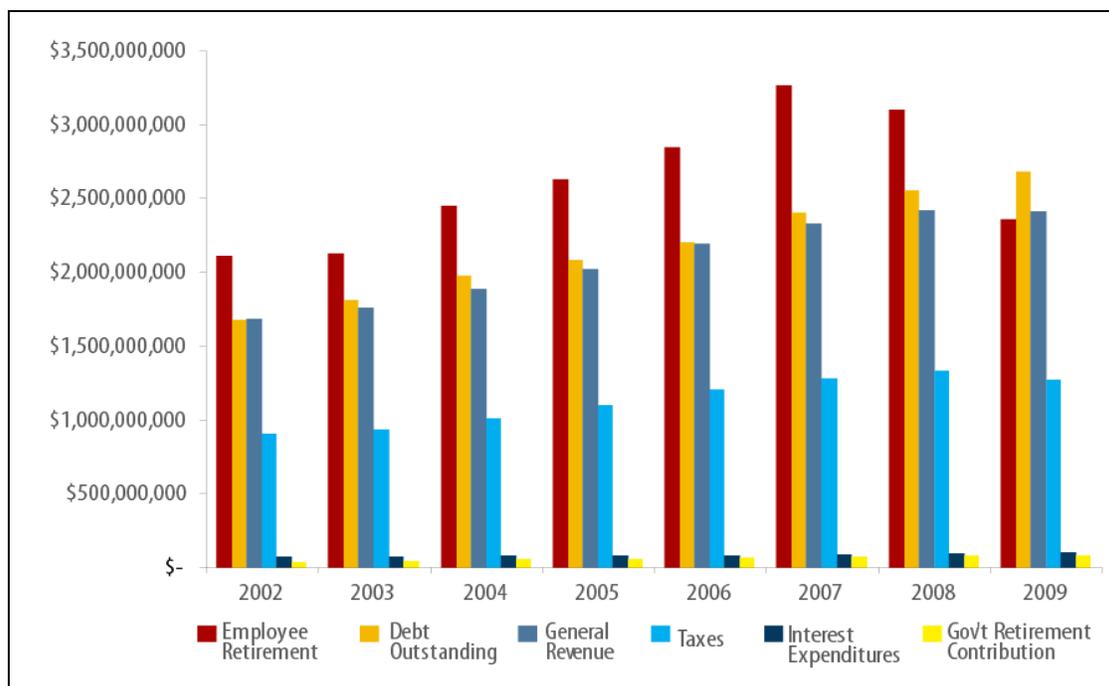
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<sup>20</sup> National Bureau of Economic Research, “U.S. Business Cycle Expansions and Contractions,” available at <http://www.nber.org/cycles/cyclesmain.html>, visited January 31, 2011.

<sup>21</sup> NASBO, “The Fiscal Survey of States: Fall 2010,” Washington, DC, p. vii., available at <http://www.nasbo.org/LinkClick.aspx?fileticket=EQnlICsAJD8%3d&tabid=38>.

**Figure 3. Level of State and Local Employees Retirement Fund Asset Value, Debt, Taxes, and General Revenue**

FY2002 to FY2009 in Current Dollars



**Source:** CRS calculations based on United States Census Bureau, *State and Local Government Finances FY2009*, released October 31 2011; and United States Census Bureau, *2009 Annual Survey of Public-Employee Retirement Systems*, Released September 29, 2011.

The relatively continuous rise and drop in state general revenues and taxes in FY2009 is likely a key contributor to the current stress on state and local government operating budgets. State and local government operating budgets, which as a general rule must be balanced from fiscal year to fiscal year, do not include *levels* of debt outstanding or value of employee retirement trust funds. The operating budget, however, does include interest payments on level of debt outstanding and annual contributions to the retirement fund. These interest payments outpaced state GDP growth over the same period, yet, as a portion of debt outstanding, declined from 4.5% to 3.9% from FY2002 to FY2009. Government employee retirement contributions grew at an average annual rate of 11.8% from FY2002 to FY2009, yet was still just an average of 3.7% of operating expenditures.

The lower (relative to state GDP) interest payments likely reflect falling interest rates over the past 20 years. In 1992, the average municipal bond rate was 6.41%, falling to 5.05% in 2002, and then to 4.16% in 2010.<sup>22</sup> As interest rates drop, governments replace (or current refund) outstanding high interest rate bonds with lower interest rate bonds.<sup>23</sup> Also, any “new money” debt issuances carry a lower interest cost.

<sup>22</sup> Office of Management and Budget, “Economic Report of the President,” Table B-73, February 2011. The interest rate dropped further in 2010 to 4.16%.

<sup>23</sup> Municipal bonds typically include a 10-year call provision where the issuer can buy back outstanding debt.

## Why Has State and Local Government Debt Increased?

Some policymakers have suggested that the level of state and local government debt may grow faster given the need to close current operating budget gaps. These gaps may be closed with an increased reliance on debt.<sup>24</sup> The budget gaps are relatively large from a historical perspective, though state definitions of “deficit” vary considerably. The National Conference of State Legislatures (NCSL) reported that states successfully closed a “cumulative budget gap of \$91 billion” for FY2012.<sup>25</sup> They also report that for the first time in many years, states are beginning work on the FY2013 budget (which for most states begins on July 1, 2012) without having to spend time closing gaps in the current fiscal year.

States are generally reluctant to address gaps in the operating budget by reducing general fund spending that could be included in state capital budgets, which are financed primarily with debt. There is evidence at the state level, however, to suggest that some states may have used this budget for financial flexibility. For example, despite the economic slowdown, state capital spending increased 4.7% in FY2009, and was estimated to have grown 5.5% in FY2010.<sup>26</sup> This additional spending was financed with additional debt and federal funds.

In addition, the NASBO reports that 32.5% of spending on state capital projects in FY2009 was financed with bonds. Other non-general fund sources, such as dedicated fees and fund surpluses, composed another 35.1% of capital spending. General fund financing of capital projects represented 5.9% and federal funds the remaining 26.5%. These levels reflect a change in the mix of funding sources. General fund financing of capital projects *decreased* by 35.9%, whereas federal fund financing *increased* 15.3% and bond-financed spending *increased* 10.6%. The implication is that in recent years states may have relied more on debt financing of capital projects that in the past were paid with general fund revenues.

Many states, some researchers contend, may suffer from a so-called “fiscal illusion” that makes debt (or federal grants) appear to be “cheaper” than using general fund revenues. As a result, they argue, states spend more than they otherwise would if the spending were financed exclusively with general fund revenues. In times of budget stress, the incentives for using debt are even greater. Following is a brief discussion of research that has examined the tradeoff between financing spending with debt, federal aid, or current general fund revenues.

### Fiscal Illusion and Debt Versus Taxes

The fundamental question of how to finance expenditures settles on the choice between selling bonds or using current tax revenues. Fiscal illusion, as it applies to state and local government debt, refers to the perception of current taxpayers that public goods financed with debt are

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<sup>24</sup> For a discussion, see U.S. Congress, House Committee on Oversight and Government Reform, Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs, *State and Municipal Debt: The Coming Crisis*, 112<sup>th</sup> Cong., 1<sup>st</sup> sess., February 19, 2011.

<sup>25</sup> National Conference of State Legislatures, “State Budget Update: Fall 2011,” December 1, 2011, p. 1.

<sup>26</sup> All expenditure data are from the National Association of State Budget Officers, “Fiscal Year 2009 State Expenditure Report,” Fall 2010. The report is available at <http://www.nasbo.org/>.

cheaper than using current taxes because payment is shifted to the future.<sup>27</sup> In theory, this illusion encourages more public spending than would otherwise be the case. This choice is principally a tradeoff between using taxes collected today versus taxes collected in the future.

Nevertheless, debt finance accomplishes two principal objectives of public finance. First, for debt issued for capital projects, the users of public infrastructure are repaying the debt through tax payments. This is typically called “pay-as-you-use” (payuse) financing and is considered more equitable, as the taxpayers receiving the benefit are paying the taxes needed to repay the bond. Second, the use of debt smoothens spending on (often) large and expensive infrastructure projects. Without a bond issue, the jurisdiction would be required to make periodic lump sum payments for infrastructure. Accordingly, taxes would fluctuate as the payments are made.

Some jurisdictions, however, use a pay-as-you-go (paygo) system and “save” tax revenue and plan spending to match the saving and revenue structure. This requires a disciplined system of maintaining taxes and accurately anticipating future spending needs. One study concluded that ideally, a mix of the two financing mechanisms, depending on economic conditions, could maximize efficiency.<sup>28</sup> According to the study, during times of economic growth and budget surpluses, jurisdictions should use paygo and during economic downturns, payuse would be preferred. Stated differently, debt financed capital spending is more efficient during times of economic stress, and in time of surplus, using current revenue to finance capital spending is more efficient. This appears to reflect the recent experience.

## Ricardian Equivalence and Debt Capitalization

One response to the fiscal illusion theory that suggests governments will borrow and spend “too much,” is that the current generation will save more today in anticipation of the future taxes needed to repay the debt.<sup>29</sup> The theory presumes the current generation is interested in maintaining the consumption patterns of the next generation. To achieve this, the current generation saves and then transfers at death to the next generation an amount needed to retire debt incurred by the current generation. The net amount of debt would be unchanged. The list of restrictive assumptions needed to achieve the balance of planned saving to match debt repayment has led some to question the robustness of the so-called Ricardian Equivalence Model (REM).

A second response to the “over borrowing” critique relies on a model similar in principle to the REM. The debt capitalization model posits that future debt payments are “capitalized” into the value of property at the state and local government level.<sup>30</sup> In this theory, higher debt translates into lower property values as the market “capitalizes” or incorporates the requirement to repay

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<sup>27</sup> A singular definition of “fiscal illusion” does not exist. J. Buchanan, *Public Finance in Democratic Process*, University of North Carolina Press, 1967.

<sup>28</sup> Wen Wang and Yilin Hou, “Pay-as-You-Go Financing and Capital Outlay Volatility: Evidence from the States over Two Recent Economic Cycles,” *Public Budgeting and Finance*, vol. 29, no. 4, 2009, pp. 90-107.

<sup>29</sup> Barro, R.J., “Are Government Bonds Net Wealth?,” *Journal of Political Economy*, vol. 82, no. 6, 1974, pp. 1095-1117.

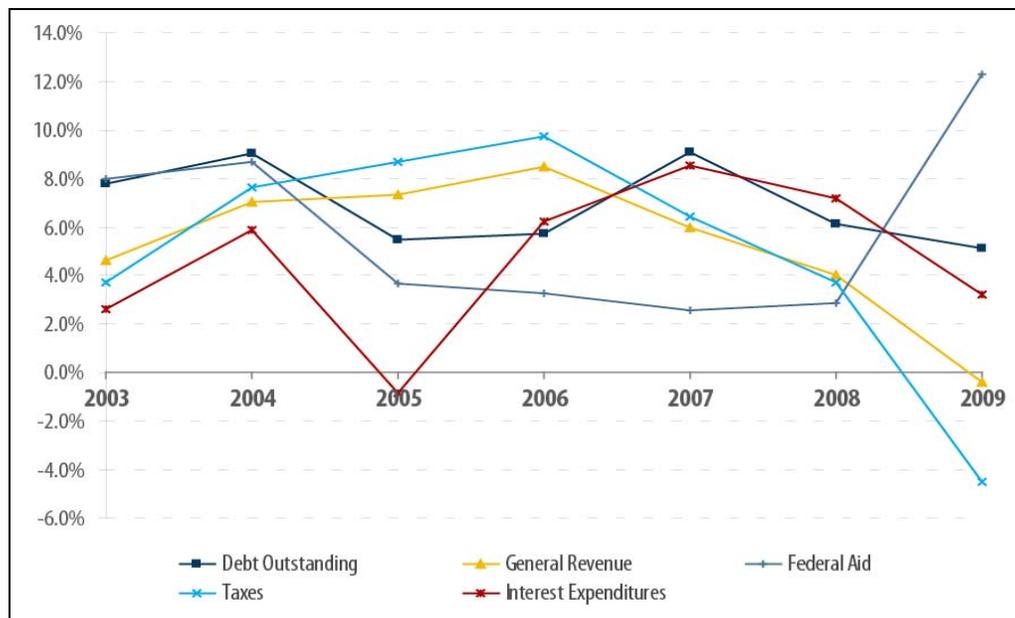
<sup>30</sup> These applications are relevant for state and local governments more so than federal level governments. For more, see Eichenberger, Reiner, and David Stadelman, “How Federalism Protects Future Generations from Today’s Public Debts,” *Review of Law and Economics*, vol. 6, no. 3, 2010; and Banzhaf, H.S., and W.E. Oates, “On Ricardian Equivalence in Local Public Finance,” June 2008, available at <http://ssrn.com/abstract=1248002>.

future debt into the value of property today. As a result, the current generation “pays” for debt through lower property values today.

## Changes in State and Local Debt and Operating Budgets

As noted earlier, the last two recessions mark the beginning and end of the era examined. The level of aggregate debt outstanding has increased from 127.0% of own-source revenue in FY2002 to 130.2% of own-source revenue in FY2009, and may increase further as the pace of the economic recovery and lagging housing market may continue to depress state (and local) revenue for FY2011 and FY2012. **Figure 4** shows that revenue declined in FY2009. The recession ended just before the beginning of FY2010, and the lag between economic decline and corresponding drop in revenues suggests that FY2010 data, when released, may also exhibit a decline. State *tax* revenue, however, has shown recent improvement and may help alleviate some fiscal strain in FY2012.<sup>31</sup> Nevertheless, the growth in debt outstanding did slow, though it still exceeded general revenue growth the past three fiscal years.

**Figure 4. Annual Change in Aggregate State and Local Government Debt and Operating Budgets from FY2003 to FY2009**



**Source:** CRS calculations based on United States Census Bureau, *State Government Finances: 2009*.

**Note:** The data point for the year listed represents the change from the preceding fiscal year.

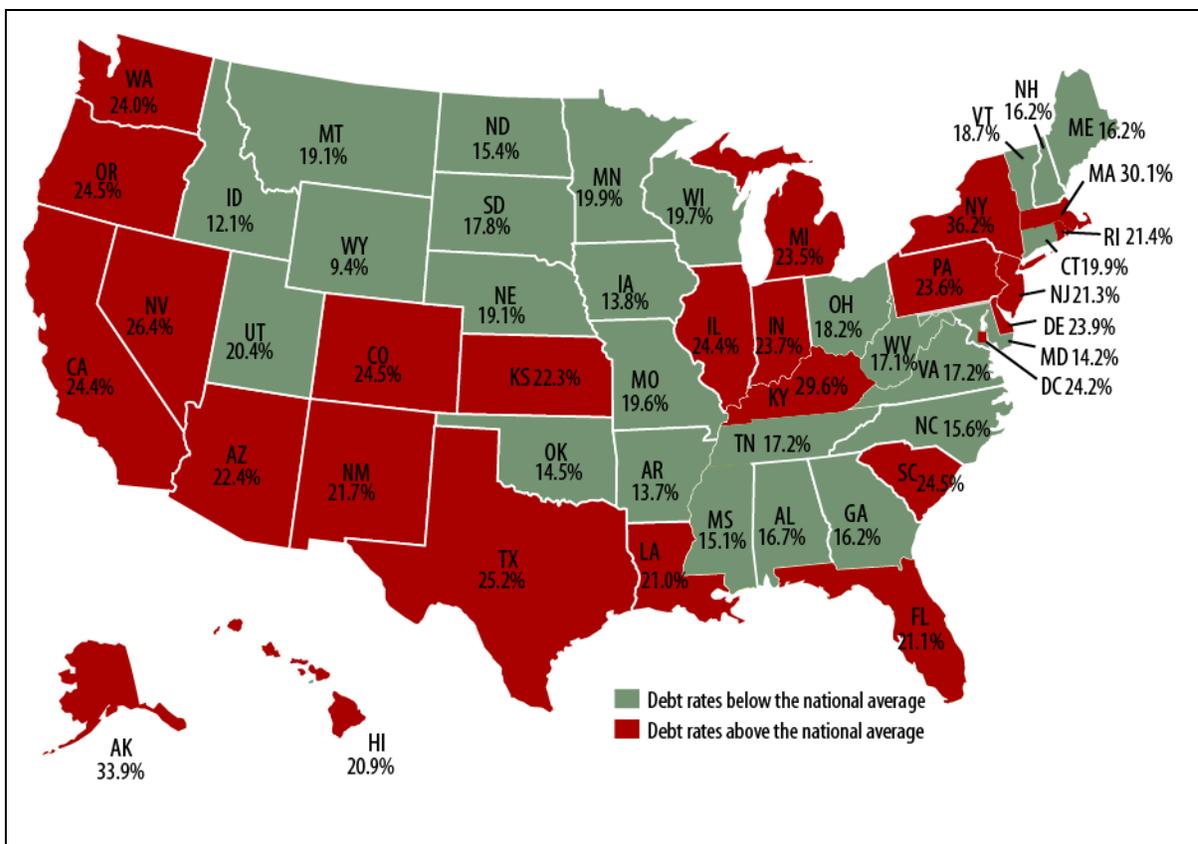
The composite data for all states do not reflect significant differences among states. The variation in debt position across states can be measured as it relates to a common measure, such as personal income or general fund revenue or expenditures. For this report, both personal income and

<sup>31</sup> Tax revenue is obviously the most important component of general revenue, yet composed just 48% of the total. Dadayan, Lucy and Donald Boyd, “State Tax Revenues Rebound Further, Growing For Third Straight Quarter,” The Nelson A. Rockefeller Institute of Government, *State Revenue Report*, October 2011. The report does note that *local* property tax revenue declined for a third straight quarter in the April-June Quarter of 2011. Available at [http://www.rockinst.org/pdf/government\\_finance/state\\_revenue\\_report/2011-10-26-SRR\\_85.pdf](http://www.rockinst.org/pdf/government_finance/state_revenue_report/2011-10-26-SRR_85.pdf).

general fund expenditures are used to represent the “budget” capacity of the state. Even though a state may have the capacity as measured by personal income, the tax (and budget) structure is the mechanism through which the capacity is accessed. The interest expenditures of a state as a share of total expenditures provides a measure of a state’s capacity to service debt out of the current operating budget.

**Figure 5** shows total state and local government debt to personal income for each state for FY2009. **Table A-2** in the Appendix exhibits two relative measures for FY2002 and FY2009 for each state. In FY2009, aggregate state and local debt as a share of personal income was 22.5%, up from 18.6% in FY2002. The increase likely reflects more debt as well as a decline in personal income in FY2009 given the severity of the recession. There is significant variation among states. State and local debt as a share of personal income was over 30% in three states: Massachusetts, New York, and Alaska. In contrast, aggregate state and local debt in Iowa, Arkansas, Idaho, and Wyoming was below 14% of personal income. In addition, seven states reduced debt as a share of personal income from FY2002 to FY2009. Overall, state and local debt outstanding has increased, though the overall debt position has been relatively stable through FY2009.

**Figure 5. State and Local Government Debt as Percentage of Personal Income**  
FY2009



**Source:** CRS calculations based on U.S. Census Bureau Data, available at <http://www.census.gov/govs/state/>.

**Note:** See **Table A-2** in the Appendix.

The second set of data in **Table A-2** shows the relative importance of interest expense in state expenditures (excluding intergovernmental expenditures).<sup>32</sup> These data could be used as an indicator of the “affordability” of the debt load discussed above. Debt is typically incurred for large capital projects and most (48) states use a separate capital budget to account for this debt. Government operating budgets incorporate the capital budget through the interest expense, which appears as an expenditure in the operating budget. Aggregate state and local interest expense declined from 4.2% of general fund expenditures in FY2002 to 3.5% in FY2009. Generally, as debt load has increased, the affordability has improved.

## Other Fiscal Strains: Pensions and Declining Federal Aid

Some have suggested that post-employment pensions for government workers are underfunded and compelling states to devote more revenue to shoring up pension funds. Recent reports have suggested that the amount needed to fully fund promised benefits could be as high as \$1 trillion. For example, an analysis by the Pew Center on the States found that “at the end of fiscal year 2008, there was a \$1 trillion gap between the \$2.35 trillion states and participating localities had set aside to pay for employees’ retirement benefits and the \$3.35 trillion price tag of those promises.”<sup>33</sup> In an update to that report, Pew estimated that the underfunding grew to \$1.26 trillion in 2009.<sup>34</sup>

Future pension obligations, however, impact current operating deficits only to the extent that annual contributions will need to rise to fully fund pensions. Data for state and local governments for FY2009 show that government pension expenditures account for just under 4% of total expenditures or \$86 billion for all state and local government pensions.<sup>35</sup> These contributions are for future retirees. Payments for already retired or separated workers are a significantly larger expense (\$191 billion in FY2009). These payments are typically funded with employee retirement trust funds, not from general fund revenue.

### Pension Obligation Bonds

Some governments have issued bonds to finance annual pension payments as a means to alleviate some fiscal strain. These bonds, called “pension obligation bonds” (POBs), are taxable, and the issuing governments invest the proceeds of the POBs in the pension fund. The intent is for the return of the invested proceeds to exceed the interest cost on the bonds. The portion of pension assets funded with POBs is very small.<sup>36</sup> A recent study found that the “amount of POBs issued

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<sup>32</sup> These expenditures are sometimes referred to as “general fund” expenditures.

<sup>33</sup> The Pew Center on the States, “The Trillion Dollar Gap: Underfunded State Retirement Systems and the Roads to Reform,” February 2010, available at [http://downloads.pewcenteronthestates.org/The\\_Trillion\\_Dollar\\_Gap\\_final.pdf](http://downloads.pewcenteronthestates.org/The_Trillion_Dollar_Gap_final.pdf).

<sup>34</sup> The Pew Center on the States, “The Widening Gap: The Great Recession’s Impact on State Pension and Retirement Healthcare costs,” April 2011.

<sup>35</sup> United States Census Bureau, *2009 Annual Survey of Public-Employee Retirement Systems*, Released September 29, 2011.

<sup>36</sup> Illinois, however, offered \$3.7 billion of pension obligation bonds on March 10, 2011.

any one year has never been more than 1% of total assets in public pensions.”<sup>37</sup> The same researchers concluded that

Nevertheless, it appears that POBs have the potential to be useful tools in the hands of the right governments at the right time. Issuing a POB may allow well-heeled governments to gamble on the spread between interest rate costs and asset returns or to avoid raising taxes during a recession. Unfortunately, most often POB issuers are fiscally stressed and in a poor position to shoulder the investment risk. As such, most POBs appear to be issued by the wrong governments at the wrong time.<sup>38</sup>

## Federal Aid

According to the U.S. Census Bureau, the federal government provided the state and local governments \$536.8 billion in FY2009, or roughly 22.4% of general revenue.<sup>39</sup> NASBO reports that federal funds financed 29.5% of state expenditures (\$457.0 billion) in FY2009, rising to 34.7% (\$563.7 billion) in FY2010.<sup>40</sup> As federal assistance contained in the American Recovery and Reinvestment Act (ARRA) gradually expires, the FY2011 federal share will likely decline somewhat. Currently, states are preparing the FY2012 budgets and are anticipating the need to increase revenue and reduce expenditures to replace the lost federal aid.

## Debt and Pension Liabilities

The amount of debt outstanding varies across states. The Census data presented in **Table A-3** and **Figure 6** do not differentiate among the types of debt that states issue. As noted above, some governments include liabilities for future pension obligations while others do not.<sup>41</sup> As of the end of FY2009, state and local governments had more than \$2.7 trillion of debt compared with \$2.4 trillion in general revenue.<sup>42</sup> As shown in **Figure 6** (and **Table A-3**), state and local debt ranged from \$2.4 billion in Wyoming to \$373.7 billion in California. The national average was \$53.5 billion.

According to the Pew Center on the States, at the end of FY2009, total pension liabilities were \$2.94 trillion and post-employment health benefits liabilities were \$637.8 billion. Pew estimates, however, that these liabilities are not fully funded. The total unfunded pension liabilities were an

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<sup>37</sup> Munnell, Alicia, Thad Calabrese, Ashby Monk, and Jean-Peirre Aubry, “Pension Obligation Bonds: Financial Crisis Exposes Risks,” Center for State and Local Government Excellence, January 2010, p. 7. Available at <http://www.slge.org/vertical/Sites/%7BA260E1DF-5AEE-459D-84C4-876EFE1E4032%7D/uploads/%7BD84F0CBF-78F0-41C1-93ED-84ACA92DE48%7D.PDF>.

<sup>38</sup> Ibid.

<sup>39</sup> U.S. Census Bureau, “State and Local Government Finances: 2009,” October 24, 2011.

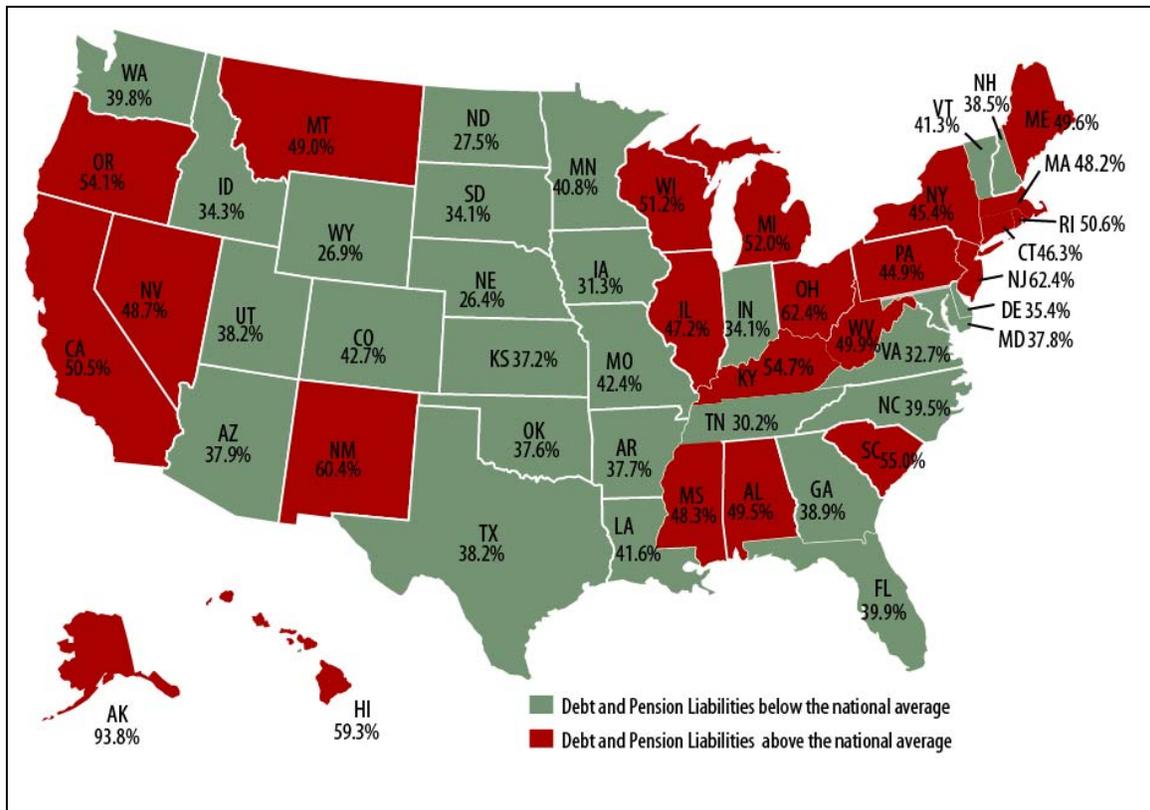
<sup>40</sup> National Association of State Budget Officers, “Fiscal Year 2009 State Expenditure Report,” Fall 2010. The report is available at <http://www.nasbo.org/>.

<sup>41</sup> The Government Finance Officers Association (GFOA) recommends that issuers only include the following types of debt in a debt management policy: direct debt which is payable from general revenues, including capital leases; revenue debt which is payable from a specific pledged revenue source; conduit debt, which is payable by third parties for which the government does not provide credit or security, state revolving loan funds and pools; other types of hybrid debt, which is payable from special revenues or containing other unique security pledges; and interfund borrowing, which are loans for short-term cash flow needs.

<sup>42</sup> General revenue does not include state pension net revenue, state owned utility company revenue, and state owned liquor store revenue.

estimated \$660 billion and unfunded health benefits were \$607 billion. **Table A-3** sums the pension and health liabilities for each state and is presented as a portion of state gross domestic product (GDP) in **Figure 6**. Alaska, Ohio, and New Jersey, with debt and unfunded pension obligations of 93.8%, 62.4%, and 62.4% of state GDP respectively, significantly exceed the national average of 44.3%. In contrast, North Dakota, Wyoming, and Nebraska had debt and unfunded obligations under 28% of GDP. Recall, however, (see **Table A-1**) that local governments in Tennessee carry a relatively large share of the debt burden in that state.

**Figure 6. State and Local Government Debt and Pension Liabilities as Percentage of State GDP**



**Source:** CRS Calculations based on U.S. Census Bureau, *State and Local Government Finances 2009*; and The Pew Center on the States, “The Widening Gap: The Great Recession’s Impact on State Pension and Retirement Healthcare costs,” April 2011.

**Notes:** The bond debt is at the end of FY2009. The pension data are for Hawaii is for FY2008 and for Ohio, the 2009 estimate is a projection. See **Table A-3** in the Appendix.

## Economics of State and Local Government Debt

The use of public debt has important economic consequences that extend beyond the comparative metrics presented in this report. Economists examine broader issues surrounding government debt and its impact on the financial markets and the economy. These issues, which are not mutually exclusive, include (1) the degree to which government debt crowds out domestic investment and net exports and (2) the economic efficiency of using tax-exempt debt to subsidize public capital formation. The two chiefly negative consequences may seem to justify greater oversight of state

and local government debt and the implicit federal subsidy. Designing a federal oversight role, however, would need to address the underlying constitutional issues governing the federal-state relationship.

## Crowding Out of Domestic Investment and Net Exports

In a typical economic model, the level of savings in the economy is equal to investment and is fixed over time. Under this model, when governments borrow, those savings are not available for private domestic investment, raising interest rates and making private borrowing more expensive. The higher interest rate also leads to net inflows of foreign capital as investors look to invest in the United States. The dollar would strengthen resulting in a drop in net exports as dollar-denominated goods become more expensive.

State and local government debt, thus, is often seen as having a significant impact on the macroeconomy, and some economists argue that if state government borrowing becomes “excessive” that borrowing could have a negative impact on private domestic investment and net exports.<sup>43</sup> As such, the economic impact of state and local government debt issuance is generally perceived as of congressional interest as is the role of the federal government in either promoting or impeding the issuance of state debt.<sup>44</sup>

## Economic Efficiency of Tax-Exempt Debt

The federal government currently provides a tax preference for state and local government debt.<sup>45</sup> The latest estimate of the federal tax expenditure for tax-exempt state and local government debt is \$177.6 billion over the 2011 to 2015 forecast window.<sup>46</sup> This tax expenditure is the direct cost to the federal government of the exclusion of interest paid on state and local government debt from individual and corporate income taxes.

The tax preference provided through tax-exempt bonds, however, has been criticized as “not a cost-effective means of transferring resources from the federal government to state and local governments.”<sup>47</sup> Congress may act to more fully explore alternatives to tax-exempt financing considering the volume of tax-exempt financing and the economic inefficiency. Following is a brief discussion of why tax-exempt bonds are seen as an economically inefficient means of federal assistance to state and local governments.

Consider a 35% marginal tax rate investor who purchases a 5% tax-exempt bond with principal amount of \$1 million to be repaid over 20 years. Each year for 20 years this taxpayer receives \$50,000 in tax-exempt interest income. Each year the federal government forgoes collecting

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<sup>43</sup> This holds for all government debt, not just state and local government debt.

<sup>44</sup> Aizenman, Joshua, and Gurnail Kaur Pasricha, “Net Fiscal Stimulus During the Great Recession,” *National Bureau of Economic Research*, no. 16779, February 2011.

<sup>45</sup> CRS Report RL30638, *Tax-Exempt Bonds: A Description of State and Local Government Debt*, by Steven Maguire.

<sup>46</sup> U.S. Congress, Joint Committee on Taxation, “Estimates of Federal Tax Expenditures for Fiscal Years 2011 to 2015,” JCS-1-12, January 17, 2012.

<sup>47</sup> Donald B. Marron, Acting Director of the U.S. Congressional Budget Office, *Economic Issues in the Use of Tax-Preferred Financing*, Testimony before the Committee on Ways and Means, Subcommittee on Select Revenue Measures, March 16, 2006.

\$24,500 (investor tax rate multiplied by what the taxable interest would have been) of revenue because the revenue loss is based upon the yield the taxpayer forgoes (the taxable yield) and the taxes that would have been collected on that interest income. For example, if the investor had purchased a taxable bond carrying a 7% interest rate, he would have received \$70,000 in interest income and paid \$24,500 in income taxes on that income (35% times \$70,000).<sup>48</sup>

The previous example presents the fundamental economic inefficiency of tax-exempt bonds. The after-tax rate of return for the tax-exempt bond is the full 5% (\$50,000 divided by \$1 million). The after-tax rate of return for the taxable bond is 4.55% (\$45,500 divided by \$1 million). Theoretically, the federal government is providing an additional \$4,500 to this investor for purchasing the tax-exempt bond.

Also, consider that the issuer is receiving a subsidy through lower interest costs. In this example, the issuer receives a two-percentage-point (the difference between a taxable rate of 7% and a tax-exempt rate of 5%) discount on debt or \$20,000, which is less than the \$24,500 tax expenditure. In theory, the federal government could provide the issuer with a direct subsidy of up to \$24,500 to the issuer yielding a smaller revenue loss.

Over time, the size of the federal subsidy for state and local government debt issuance has varied along with macroeconomic factors and more directly with the marginal income tax rates. The historical average interest rate on high-grade corporate bonds from 1939 to 2010 was 6.26% and for high-grade municipal debt, 4.89%. In 2010, the average was 4.94% for corporate debt and 4.16% for municipal debt.<sup>49</sup> The relatively high municipal bond rate in 2010, 0.84 of the taxable rate, confers a significant tax preference to higher tax rate investors.

## Congressional Action

This report examines the complexities of state and local government finance and how the magnitude of state fiscal stress varies considerably from state to state. Congress has recently held hearings examining the fiscal health of state and local governments and has offered legislation in two areas related to state and local fiscal health analyzed in this report: government debt and government pensions.

State and local debt, although growing, has not reached the point where widespread default seems likely. To date, few defaults have occurred and interest costs for debt outstanding represented a relatively modest 3.5% of total state and local government expenditures. More recent government budget data may show that for selected local government issuers, such as governmental authorities that rely on specialized revenue streams, interest costs have risen and default—and possible state government intervention—may be more likely than in the past. Prolonged weakness in the economy would certainly raise this probability.

Some policymakers are concerned that state and local governments are issuing too much debt, increasing the risk of potential default. In response, Congress may seek to increase oversight of

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<sup>48</sup> The decision about preferred alternatives is critical to estimates of the revenue loss from tax-exempt bonds. An entire range of financial and real assets exists with different yields, risk, and degree of preferential taxation. It is not true that the municipal bond purchaser's preferred alternative is always a taxable bond though it is a sound approximation.

<sup>49</sup> Office of Management and Budget, *Economic Report of the President 2011*, Washington, DC, February 2011.

the municipal bond market. Historically, the federal government has not actively engaged in regulating how state and local governments finance activities.<sup>50</sup> Congress has limited authority as the Tower Amendment to the Securities and Exchange Act of 1934 explicitly prohibits the federal government from requiring

any issuer of municipal securities, directly or indirectly through a purchaser or prospective purchaser of securities from the issuer, to file with the [Securities and Exchange] Commission or the [Municipal Securities Rulemaking] Board prior to the sale of such securities by the issuer any application, report, or document in connection with the issuance, sale, or distribution of such securities.<sup>51</sup>

Congress does confer a tax preference to state and local government bond issuers and could modify this tax preference to induce changes in bond disclosure requirements. Also, the Internal Revenue Service (IRS) currently audits selected outstanding tax-exempt bond issues to determine if the bonds comply with tax law. Expanding these audits may help ensure that the tax-exemption and associated federal revenue loss is merited.

Congress may also examine alternatives to tax-exempt bonds for subsidizing state and local government capital investment. In the 112<sup>th</sup> Congress, several bills have been introduced to extend and expand a modified version of Build America Bonds (BABs) including H.R. 11, H.R. 736, H.R. 747, and H.R. 992. BABs are viewed by many observers as a more efficient alternative to tax-exempt bonds.

Congress may also take a more active role in the oversight of state and local government pensions. Legislation has been introduced to address state pension issues. H.R. 567 and S. 347 would require greater transparency of state and local government pension systems. Recently, Moody's, one of the primary bond rating agencies, announced that it would begin integrating tax-supported debt and unfunded pension liabilities when evaluating state bond ratings.<sup>52</sup>

In the near term, however, annual pension contributions represent roughly 4% of state and local government operating expenditures (\$86.1 billion in FY2009).<sup>53</sup> As such, the underfunded pension systems are a longer-term concern and, for most states, have a marginal impact on short-term operating deficits.

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<sup>50</sup> For example, S. 251 in the 112<sup>th</sup> Congress would explicitly prohibit the Fed from assisting state and local governments and authorities through purchasing their debt or offering guarantees.

<sup>51</sup> Securities Exchange Act of 1934, Section 15B(d)(1).

<sup>52</sup> Albano, Christine, "Moody's to Weigh Tax-Backed Debt, Pension Liabilities Together," *The Bond Buyer*, January 28, 2011.

<sup>53</sup> U.S. Census Bureau, *Annual Summary of the of State and Local Public-Employee Retirement Systems: 2009*, October 2011.

## Appendix.

**Table A-1. Relative Measure of State and Local Government Debt Outstanding in FY2009**

State	Debt Outstanding as Percentage of Own Source Revenue, FY2009			Debt Outstanding as Percentage of Tax Revenues, FY2009		
	State and Local	State	Local	State and Local	State	Local
United States Average	130.2%	101.0%	169.5%	197.0%	149.7%	278.8%
Alabama	110.8%	61.0%	177.0%	194.5%	98.2%	353.2%
Alaska	89.8%	72.1%	160.9%	161.2%	133.0%	261.1%
Arizona	160.1%	81.4%	239.3%	234.1%	110.7%	378.6%
Arkansas	92.4%	40.3%	246.6%	134.6%	55.4%	436.7%
California	148.9%	107.0%	191.1%	220.3%	133.2%	348.6%
Colorado	166.1%	125.3%	199.7%	268.9%	198.1%	330.0%
Connecticut	147.0%	182.5%	93.6%	180.4%	233.5%	108.2%
Delaware	127.5%	116.8%	168.6%	229.0%	213.3%	285.2%
District of Columbia	154.7%	n/a	154.7%	193.9%	n/a	193.9%
Florida	134.4%	85.4%	169.3%	214.5%	121.3%	296.4%
Georgia	113.1%	62.5%	156.2%	168.1%	83.7%	256.1%
Hawaii	124.4%	99.2%	201.4%	179.6%	146.0%	274.0%
Idaho	79.3%	82.3%	75.3%	129.6%	110.4%	174.7%
Illinois	166.3%	148.6%	183.9%	225.6%	194.0%	259.6%
Indiana	140.3%	115.3%	172.6%	213.9%	159.1%	305.0%
Iowa	82.4%	60.1%	111.2%	130.0%	91.0%	185.7%
Kansas	137.3%	60.0%	233.5%	210.8%	87.5%	383.5%
Kentucky	192.9%	95.6%	382.0%	294.7%	137.2%	667.2%
Louisiana	128.3%	119.2%	139.6%	195.4%	171.6%	228.9%
Maine	98.6%	105.0%	87.2%	137.4%	151.8%	114.1%
Maryland	107.5%	112.3%	100.9%	143.6%	153.6%	130.7%
Massachusetts	211.7%	253.4%	138.1%	302.5%	378.7%	183.1%
Michigan	140.3%	89.4%	215.3%	217.1%	130.0%	367.8%
Minnesota	125.0%	50.0%	240.0%	180.8%	61.3%	479.4%
Mississippi	91.2%	72.1%	118.0%	149.4%	95.9%	286.1%
Missouri	146.8%	129.6%	165.0%	220.3%	186.5%	259.4%
Montana	114.4%	130.7%	83.8%	181.7%	196.2%	149.4%
Nebraska	122.5%	44.7%	205.4%	181.9%	62.9%	324.0%
Nevada	170.6%	64.2%	259.8%	255.6%	79.2%	474.6%

State	Debt Outstanding as Percentage of Own Source Revenue, FY2009			Debt Outstanding as Percentage of Tax Revenues, FY2009		
	State and Local	State	Local	State and Local	State	Local
New Hampshire	152.6%	223.2%	75.6%	221.0%	395.7%	91.3%
New Jersey	138.3%	154.8%	118.1%	181.9%	209.3%	150.5%
New Mexico	121.7%	95.1%	188.5%	204.8%	165.7%	291.7%
New York	161.8%	142.8%	178.8%	216.6%	189.4%	241.5%
North Carolina	103.7%	72.8%	143.8%	158.5%	97.0%	271.9%
North Dakota	81.4%	53.0%	152.1%	122.8%	78.2%	242.6%
Ohio	113.0%	79.5%	152.1%	168.2%	116.7%	230.0%
Oklahoma	95.2%	81.2%	119.1%	150.0%	120.4%	210.0%
Oregon	158.0%	106.7%	224.5%	266.6%	178.2%	383.9%
Pennsylvania	159.2%	98.9%	240.4%	226.7%	139.4%	346.8%
Rhode Island	173.3%	223.5%	95.9%	246.3%	355.0%	117.3%
South Carolina	145.5%	114.0%	184.2%	271.6%	200.5%	371.3%
South Dakota	137.1%	164.6%	103.5%	215.0%	271.8%	153.0%
Tennessee	126.6%	32.0%	230.3%	204.9%	46.5%	426.8%
Texas	177.3%	50.2%	290.5%	264.7%	72.9%	445.1%
Utah	123.5%	69.8%	213.4%	203.2%	115.6%	347.0%
Vermont	111.4%	100.7%	166.1%	156.1%	136.8%	277.7%
Virginia	124.7%	90.1%	170.5%	187.6%	146.3%	233.7%
Washington	160.0%	108.4%	221.5%	247.4%	150.0%	398.7%
West Virginia	98.1%	88.6%	124.0%	153.4%	135.8%	205.2%
Wisconsin	119.0%	101.1%	145.4%	170.8%	144.8%	209.7%
Wyoming	36.5%	35.6%	37.7%	56.7%	47.8%	76.0%

**Source:** United States Census Bureau, *State and Local Government Finances FY2009*, released October 31 2011.

**Note:** The data released debt in Wyoming did not meet the Total Quantity Response Rates for the Census Bureau's 70% standard.

**Table A-2. Change in State and Local Government Debt and Interest Expense from FY2002 to FY2009**

Debt as Share of Personal Income and Interest as Share of Expenditures

State	Debt to Personal Income			Interest Cost as Share of Expenditures		
	FY2002	FY2009	Change	FY2002	FY2009	Change
United States	18.6%	22.5%	4.0%	4.2%	3.5%	-0.7%
Alabama	16.5%	16.7%	0.2%	3.2%	2.6%	-0.6%
Alaska	40.6%	33.9%	-6.6%	4.9%	2.9%	-2.0%
Arizona	18.0%	22.4%	4.5%	4.4%	3.4%	-1.0%
Arkansas	13.3%	13.7%	0.4%	3.1%	2.3%	-0.9%
California	17.7%	24.4%	6.8%	3.7%	3.3%	-0.4%
Colorado	18.0%	24.5%	6.5%	4.5%	4.3%	-0.2%
Connecticut	18.6%	19.9%	1.4%	5.3%	4.7%	-0.6%
Delaware	20.7%	23.9%	3.2%	5.6%	3.8%	-1.8%
District of Columbia	20.5%	24.2%	3.8%	3.2%	3.3%	0.1%
Florida	17.8%	21.1%	3.3%	5.0%	3.2%	-1.8%
Georgia	13.7%	16.2%	2.5%	3.2%	1.9%	-1.3%
Hawaii	22.5%	20.9%	-1.6%	6.1%	4.3%	-1.8%
Idaho	11.4%	12.1%	0.7%	2.9%	2.4%	-0.5%
Illinois	19.1%	24.4%	5.3%	4.8%	4.6%	-0.2%
Indiana	13.7%	23.7%	10.0%	3.4%	3.5%	0.1%
Iowa	11.2%	13.8%	2.5%	2.1%	2.0%	-0.1%
Kansas	15.4%	22.3%	6.9%	4.0%	4.0%	0.0%
Kentucky	25.7%	29.6%	3.9%	6.3%	4.8%	-1.5%
Louisiana	18.1%	21.0%	2.9%	4.0%	3.6%	-0.4%
Maine	17.0%	16.2%	-0.8%	3.9%	3.1%	-0.9%
Maryland	12.7%	14.2%	1.5%	4.0%	3.1%	-0.9%
Massachusetts	25.7%	30.1%	4.4%	7.0%	6.0%	-1.1%
Michigan	17.9%	23.5%	5.6%	3.6%	3.4%	-0.2%
Minnesota	18.7%	19.9%	1.2%	3.9%	3.2%	-0.7%
Mississippi	15.0%	15.1%	0.1%	3.1%	1.8%	-1.3%
Missouri	14.6%	19.6%	5.0%	3.4%	3.5%	0.1%
Montana	17.0%	19.1%	2.2%	3.9%	2.6%	-1.2%
Nebraska	15.1%	19.1%	4.0%	3.2%	1.8%	-1.4%
Nevada	23.3%	26.4%	3.2%	5.9%	3.9%	-1.9%
New Hampshire	16.2%	19.7%	3.6%	5.9%	4.7%	-1.2%
New Jersey	16.9%	21.3%	4.5%	3.8%	3.8%	0.0%

State	Debt to Personal Income			Interest Cost as Share of Expenditures		
	FY2002	FY2009	Change	FY2002	FY2009	Change
New Mexico	18.6%	21.7%	3.2%	3.2%	2.3%	-0.9%
New York	28.8%	32.6%	3.8%	5.1%	3.9%	-1.2%
North Carolina	14.1%	15.6%	1.4%	3.4%	2.6%	-0.8%
North Dakota	16.8%	15.4%	-1.3%	3.7%	3.8%	0.0%
Ohio	15.1%	18.2%	3.2%	3.5%	3.1%	-0.4%
Oklahoma	13.7%	14.5%	0.8%	3.2%	2.3%	-0.9%
Oregon	18.0%	24.5%	6.6%	3.0%	3.1%	0.2%
Pennsylvania	21.6%	23.6%	1.9%	5.0%	4.0%	-1.1%
Rhode Island	21.4%	27.4%	5.9%	4.2%	5.1%	1.0%
South Carolina	21.3%	24.5%	3.1%	5.1%	3.0%	-2.1%
South Dakota	16.2%	17.8%	1.6%	4.2%	3.1%	-1.1%
Tennessee	12.9%	17.2%	4.3%	3.0%	2.3%	-0.7%
Texas	19.0%	25.2%	6.3%	4.7%	4.2%	-0.5%
Utah	22.1%	20.4%	-1.7%	4.2%	2.1%	-2.2%
Vermont	17.4%	18.7%	1.3%	4.2%	3.1%	-1.1%
Virginia	14.4%	17.2%	2.8%	4.2%	3.2%	-1.0%
Washington	22.7%	24.0%	1.2%	4.4%	3.2%	-1.2%
West Virginia	18.5%	17.1%	-1.4%	3.9%	2.6%	-1.3%
Wisconsin	18.1%	19.7%	1.6%	3.9%	3.9%	0.0%
Wyoming	15.0%	9.4%	-5.6%	3.2%	1.1%	-2.1%

**Source:** CRS calculations based on U.S. Census Bureau Data.

**Note:** The general fund expenditures do not include contributions to insurance funds on behalf of employees.

**Table A-3. State and Local Government Debt and Pension Obligations**

Amounts in Thousands of Dollars

State	Debt at End of FY2009	Pension Obligation FY2009 <sup>a</sup>	Healthcare and Non-Obligation FY2009 <sup>a</sup>	Total Debt and Pension Obligations FY2009	Total Debt as Portion of State GDP
United States	2,673,947,962	2,938,772,715	637,761,015	5,252,475,107	44.3%
Alabama	25,965,595	41,634,554	14,919,073	75,610,622	49.5%
Alaska	10,253,149	15,347,768	17,407,621	41,400,951	93.8%
Arizona	48,332,569	44,078,394	2,219,542	72,904,337	37.9%
Arkansas	12,684,306	22,698,906	1,865,809	33,318,638	37.7%
California	373,693,799	490,585,000	69,351,300	769,607,822	50.5%
Colorado	50,415,448	54,536,549	2,043,914	85,046,500	42.7%
Connecticut	38,058,246	41,311,400	26,018,800	95,097,447	46.3%
Delaware	8,232,006	7,615,166	5,636,000	18,783,888	35.4%
Florida	147,177,578	141,485,280	3,742,846	235,544,300	39.9%
Georgia	52,977,125	79,898,410	20,284,637	134,483,647	38.9%
Hawaii	11,473,985	16,549,069	10,791,300	35,788,641	59.3%
Idaho	5,858,168	12,057,500	493,746	16,536,556	34.3%
Illinois	128,100,116	126,435,510	43,949,729	251,321,377	47.2%
Indiana	51,080,741	36,924,845	524,859	61,520,561	34.1%
Iowa	15,465,299	26,602,516	538,200	36,635,044	31.3%
Kansas	24,175,833	21,138,206	236,910	33,825,398	37.2%
Kentucky	40,843,263	35,686,737	8,754,555	71,578,377	54.7%
Louisiana	34,159,598	39,657,924	11,512,100	72,155,691	41.6%
Maine	7,764,734	14,410,000	2,625,963	23,382,212	49.6%
Maryland	38,750,929	53,054,565	16,098,602	94,818,172	37.8%
Massachusetts	97,611,812	61,140,335	15,166,300	141,628,977	48.2%
Michigan	77,975,975	72,911,900	41,419,600	168,631,690	52.0%
Minnesota	43,426,309	60,835,351	1,136,601	93,982,077	40.8%
Mississippi	13,444,459	31,386,747	727,711	42,048,083	48.3%
Missouri	42,346,384	55,314,996	3,321,637	82,880,870	42.4%
Montana	6,337,682	10,271,027	540,894	14,774,805	49.0%
Nebraska	13,373,255	9,427,370	NA	17,333,360	26.4%
Nevada	25,900,929	33,148,347	1,874,005	50,795,175	48.7%
New Hampshire	11,024,643	8,475,062	3,226,105	18,922,425	38.5%
New Jersey	92,624,389	134,928,225	66,792,900	259,311,561	62.4%
New Mexico	14,329,827	29,003,362	3,116,916	40,723,556	60.4%
New York	293,509,712	146,733,000	56,286,000	398,336,691	45.4%

State	Debt at End of FY2009	Pension Obligation FY2009 <sup>a</sup>	Healthcare and Non- Obligation FY2009 <sup>a</sup>	Total Debt and Pension Obligations FY2009	Total Debt as Portion of State GDP
North Carolina	50,178,067	76,976,542	33,814,515	144,251,598	39.5%
North Dakota	4,070,601	4,475,800	161,376	7,542,168	27.5%
Ohio	73,942,689	171,194,371	43,360,893	265,898,877	62.4%
Oklahoma	18,356,615	34,815,244	359,800	47,683,204	37.6%
Oregon	33,249,153	56,810,600	555,047	76,192,760	54.1%
Pennsylvania	117,683,748	111,317,700	16,303,617	211,430,366	44.9%
Rhode Island	11,738,423	11,500,425	788,189	19,633,503	50.6%
South Carolina	35,550,348	42,050,701	9,667,187	74,559,700	55.0%
South Dakota	5,493,795	7,494,895	67,100	11,012,748	34.1%
Tennessee	36,657,040	35,198,741	1,746,879	58,073,666	30.2%
Texas	228,282,439	155,679,204	53,890,544	328,795,490	38.2%
Utah	17,738,523	24,299,183	480,752	38,029,557	38.2%
Vermont	4,533,538	4,012,955	1,628,934	8,851,639	41.3%
Virginia	59,017,508	69,135,000	5,830,000	110,387,294	32.7%
Washington	66,757,056	57,754,700	7,618,372	110,933,622	39.8%
West Virginia	9,824,414	14,266,419	6,362,640	28,746,972	49.9%
Wisconsin	41,211,575	79,104,600	2,326,834	111,758,722	51.2%
Wyoming	2,294,567	7,401,614	174,161	9,963,770	26.9%

**Source:** CRS Calculations based on U.S. Census Bureau, *State and Local Government Finances 2009*; and The Pew Center on the States, "The Widening Gap: The Great Recession's Impact on State Pension and Retirement Healthcare costs," April 2011.

**Notes:** As most pensions are heavily invested in equities (stocks), the data do not reflect the sharp decline in assets value in 2009. Thus, the underfunding should be viewed as a conservative estimate. The data for Nebraska healthcare obligations were not provided.

a. Data are estimates from *Pew Center on the States*, 2011.

## Author Contact Information

Steven Maguire  
Specialist in Public Finance  
smaguire@crs.loc.gov, 7-7841