Debt Limits

How States Restrict Borrowing

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states had limits on authorized debt in 2015.

Debt limits are provisions that limit a state's ability to take on new debt or debt service. Debt limits cap total debt at a certain dollar amount or limit outstanding debt to a certain percentage of revenues. Some historical limits have been set at very low levels. In some states, constitutional debt limits also require voter approval to issue new debt. Debt limits can reduce general obligation debt effectively, but they can also squeeze capital budgets, and some states have circumvented limits by borrowing in other ways or setting up dependent governments to issue debt.[1]

Debt Limit Design

States structure their debt limits very differently and report variation in

- whether provisions are constitutional or statutory;
- the level of the cap and whether it is tied to a dollar amount or a percentage of forecasted revenues;
- the type of debt subject to the limit, such as short- or long-term debt; and
- whether or not the state caps debt, debt service, or both.

WHEN DEBT LIMITS MEET TAX CUTS

Some states, such as Lousiana, tie their debt limit to forecasted revenues. Louisiana limits its debt to 6 percent of estimated revenues. This means that when the state enacts a tax cut, less funding is available to finance capital projects. In 2018, the state will see $1 billion in temporary sales tax revenues expire, which will not only create a hole in the state's operating budget but could squeeze its capital projects budget as well.

Do Debt Limits Work?

Several studies in the 1990s found that debt limits are associated with lower levels of general obligation debt. For example, states requiring a voter referendum on new long-term debt tend to take on less debt.

However, research also finds that debt limits can have broader effects, including

- reduced capital investment rather than a reduction in general spending;
- higher levels of unrestricted debt, such as revenue bonds and other forms of debt not always guaranteed by the full faith and credit of the state;
- more debt issued through public authorities and local governments; and
- higher borrowing costs caused by reduced flexibility to finance capital investment.

"The reality is that if we don't choose to do something next year because of the fiscal cliff and because of the limit on the debt, (Louisiana) is going to have to start slowing down [capital] projects."

Louisiana Commissioner of Administration Jay Dardenne, July 30, 2017 [2]

Taken together, these studies suggest that states may be able to circumvent strict debt limitations or they shift debt obligation to less desirable forms of public borrowing. For other budget institutions, such as balanced budget requirements, stringency produces higher levels of compliance; strictness in debt limitations, however, may only obscure other forms of state indebtedness and lead to less transparent budgets.

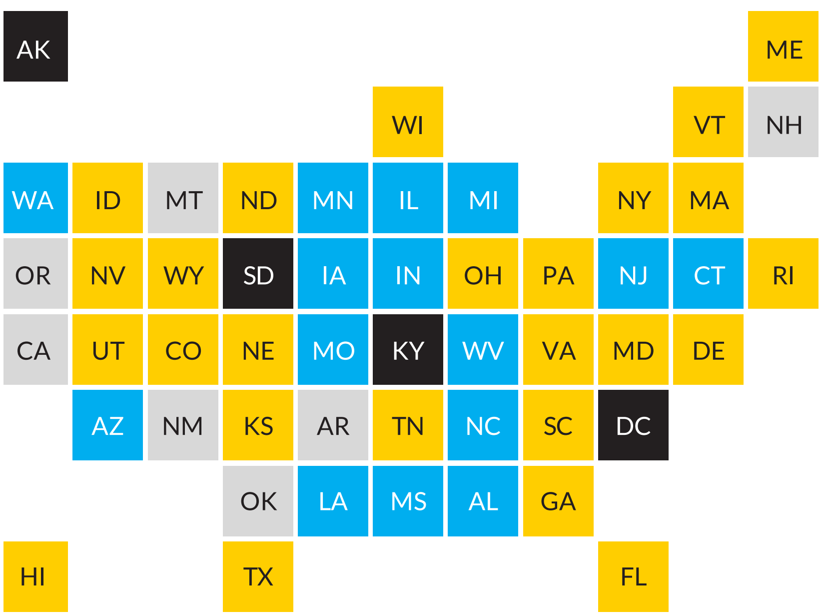
Moreover, states with debt limitations requiring a supermajority of the legislature (but not the public) to take on debt had more debt than states without any debt limitations at all. This suggests a "borrowing logroll" effect at the legislative level, wherein debt is used as a political bargaining chip to smooth the passage of legislation.

DEBT LIMIT VARIATION

In 2015, 40 states placed limits on authorized debt; 28 states and the District of Columbia placed limits on debt service.

Limits on Authorized Debt and Debt Service in the States, 2015

- Limits on authorized debt and debt service
- Limit on debt service
- Limit on authorized debt
- No debt limits



[1] For more information, see Megan Randall and Kim Rueben, *Sustainable Budgeting in the States: Evidence on State Budget Institutions and Practices* (Washington, DC: Urban Institute, 2017).

[2] Melinda Deslatte, "Louisiana Spotlight: Expiring Taxes Threaten to stall state Construction Work," *Advocate* (Baton Rouge, LA), July 30, 2017.

Source: National Association of State Budget Officers, *Budget Processes in the States* (Washington, DC: National Association of State Budget Officers, 2015).

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