Measuring State and Local Indebtedness: How Much is too Much?

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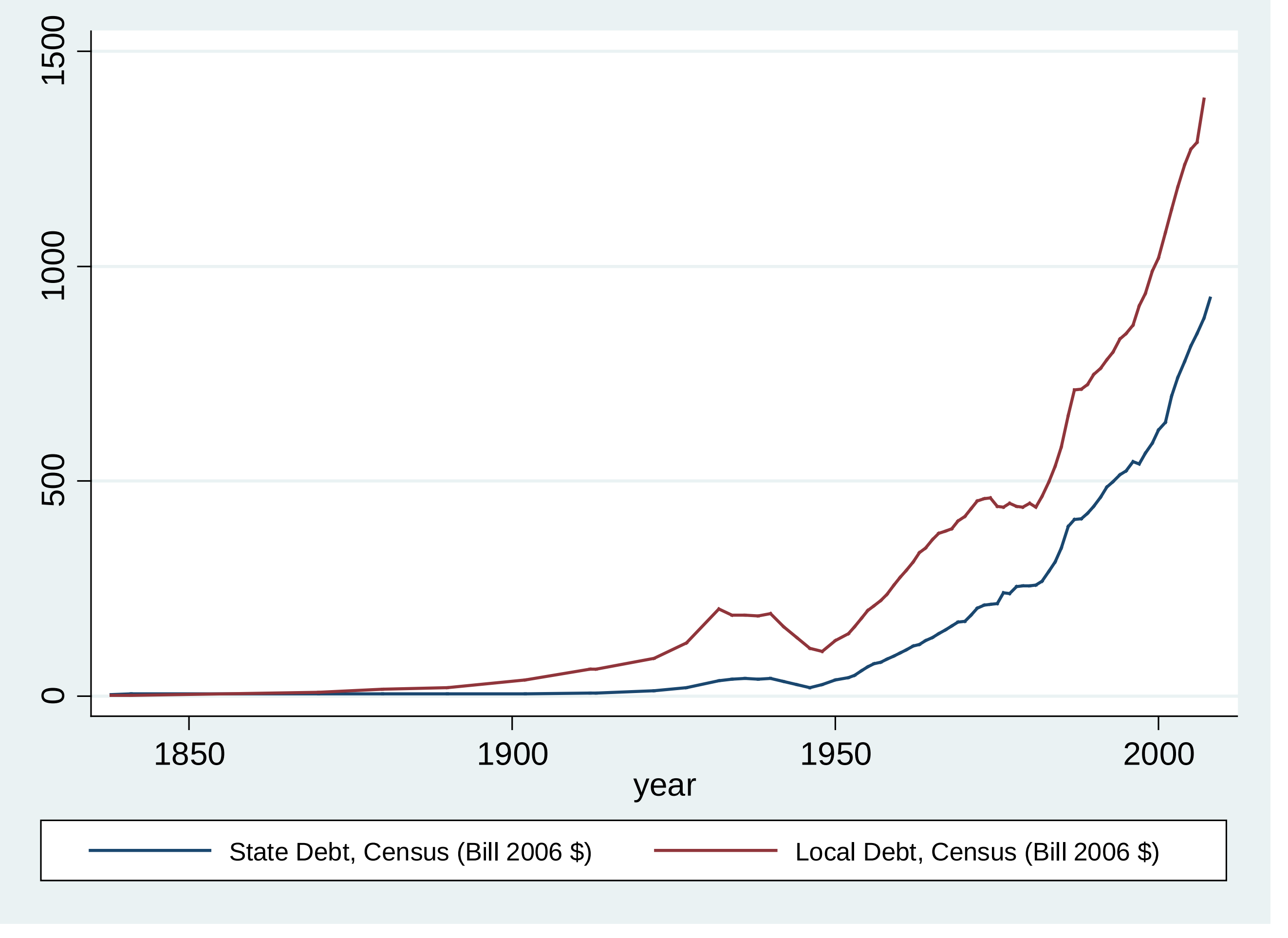
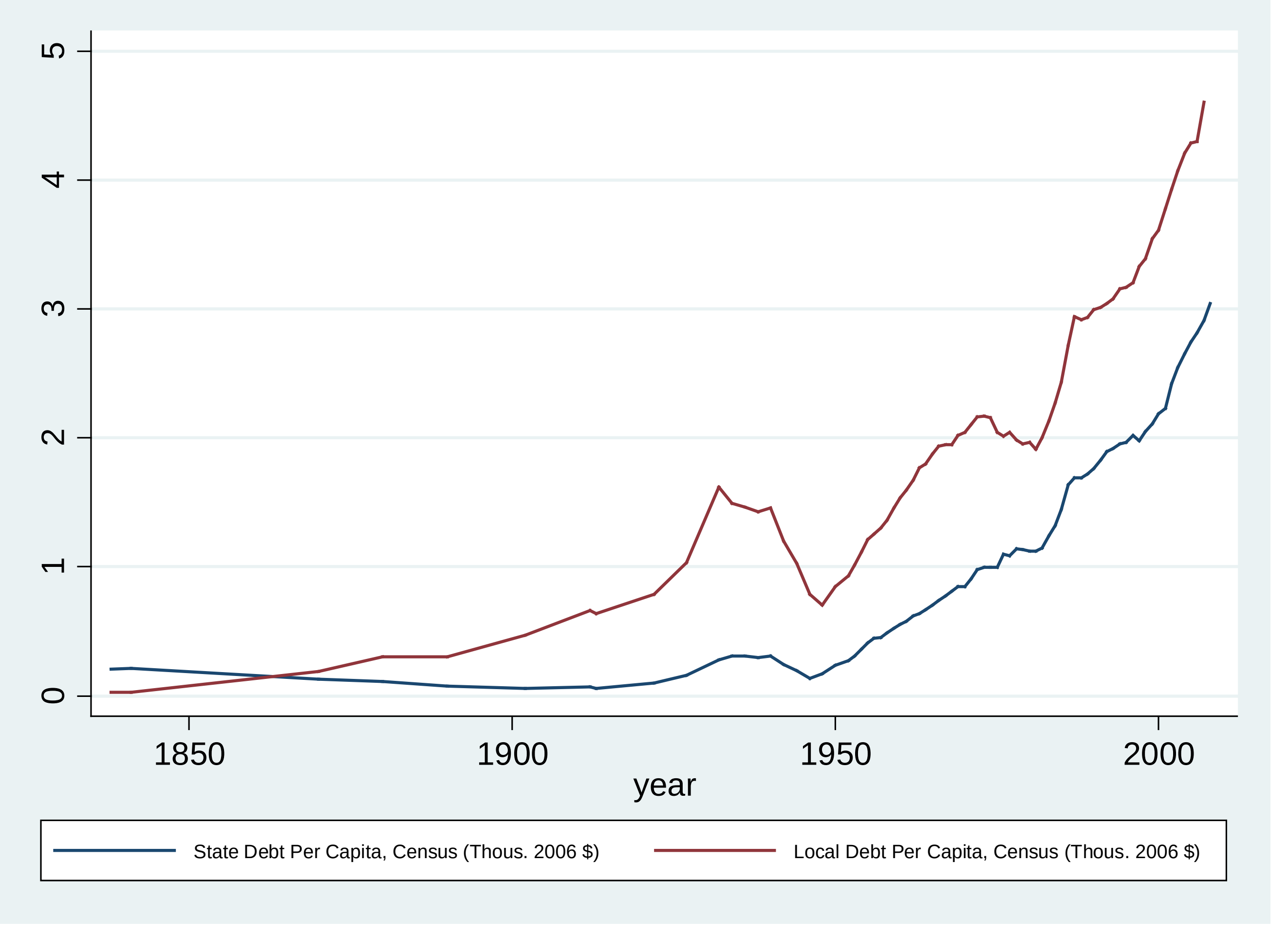
Current State Government Debt in Historical Perspective

Debt Levels

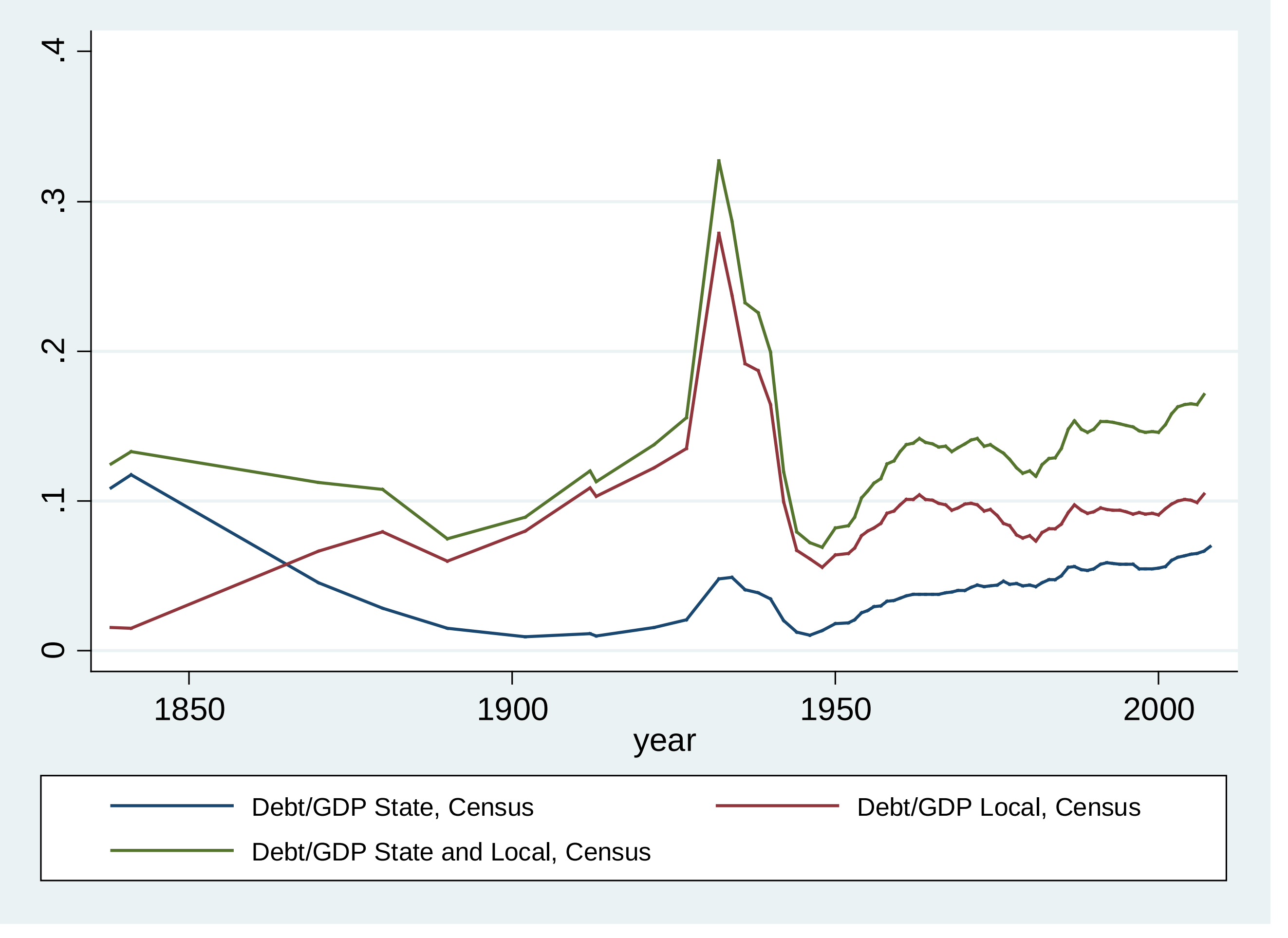


0
500
1000
1500
1850
1900
1950
2000
year
State Debt, Census (Bill 2006 $)
Local Debt, Census (Bill 2006 $)

Debt Per Capita

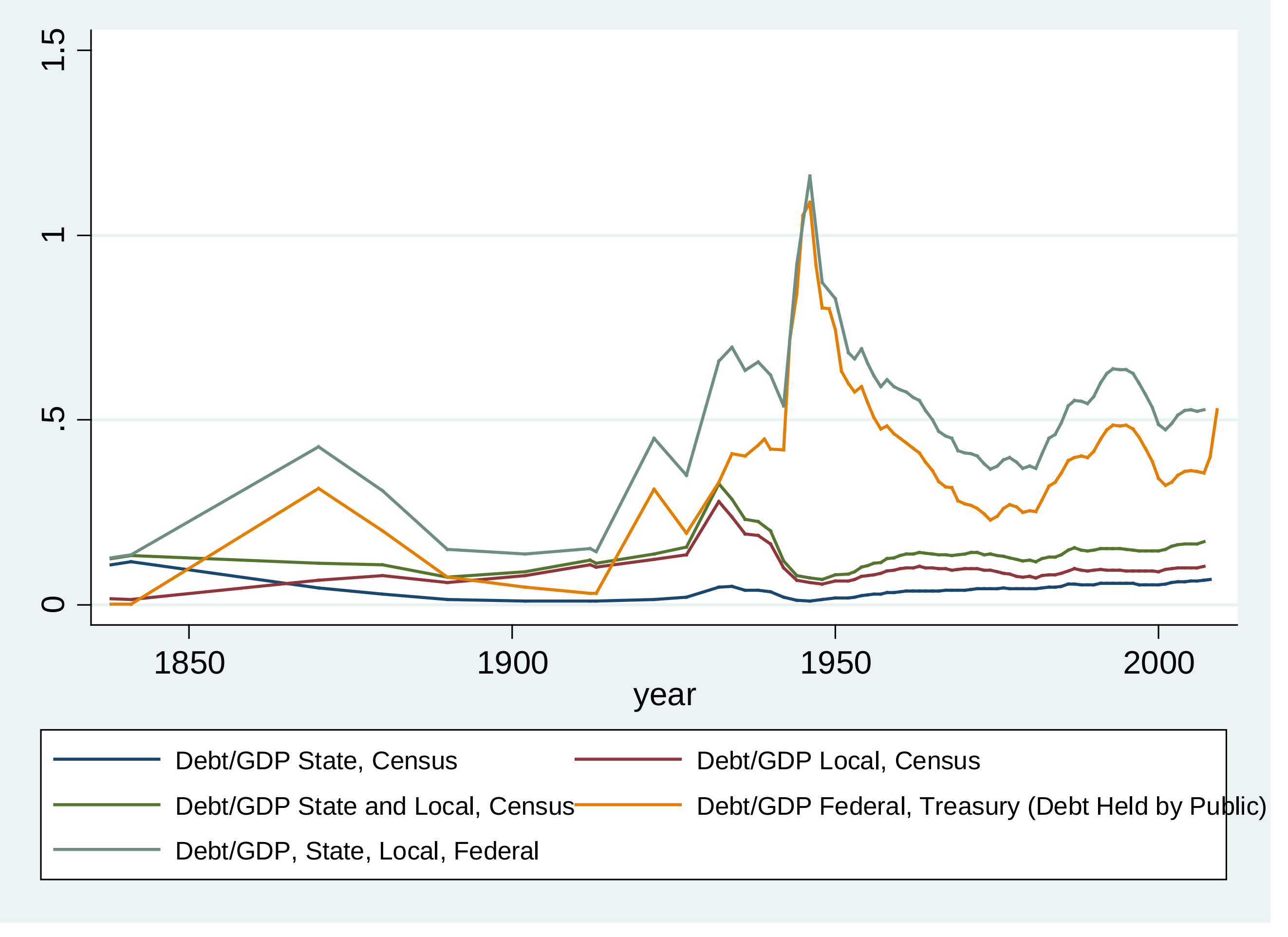


Debt/GDP

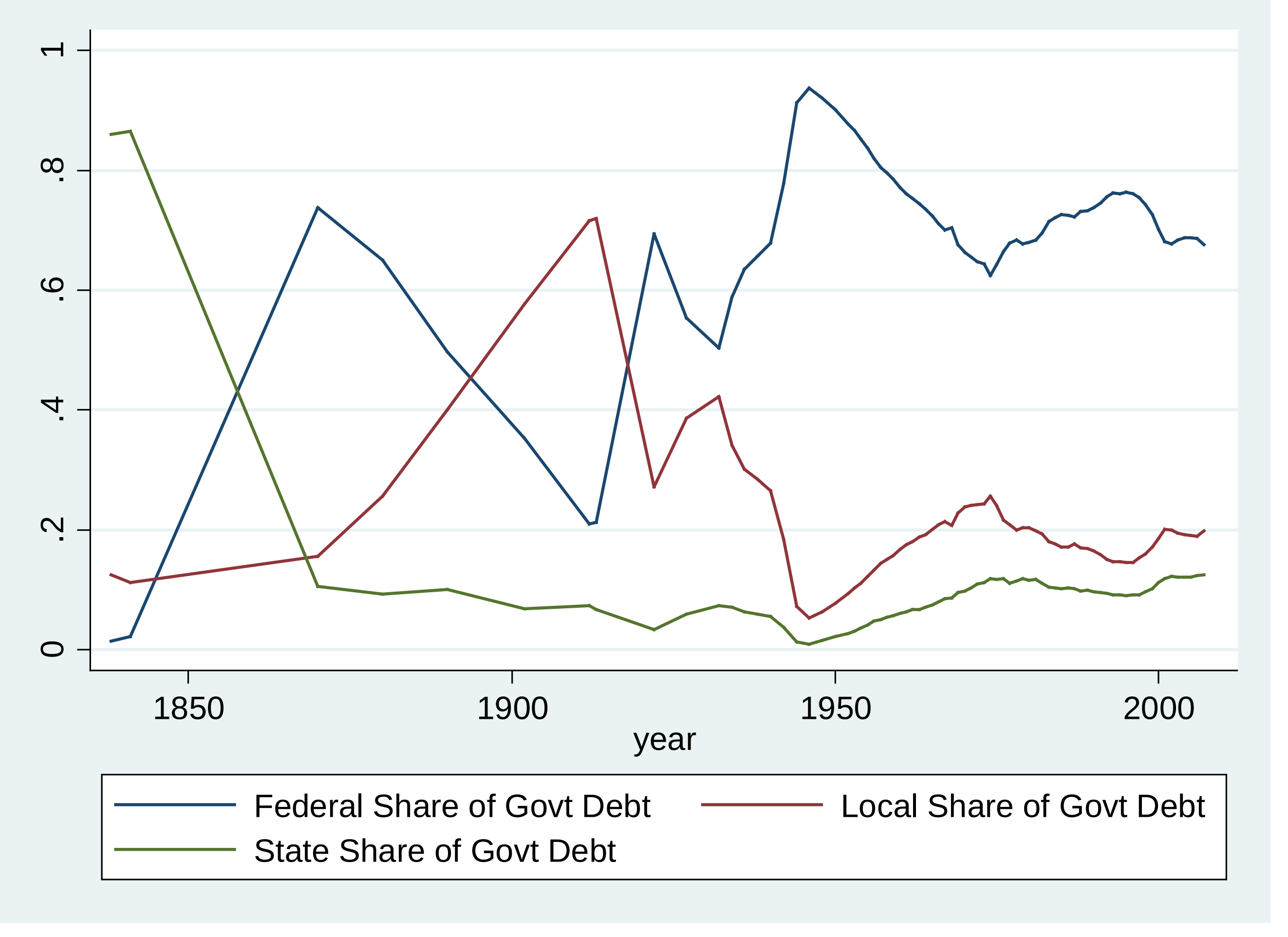


0
.1
.2
.3
.4
1850
1900
1950
2000
year
Debt/GDP State, Census
Debt/GDP Local, Census
Debt/GDP State and Local, Census

Debt/GDP With Federal

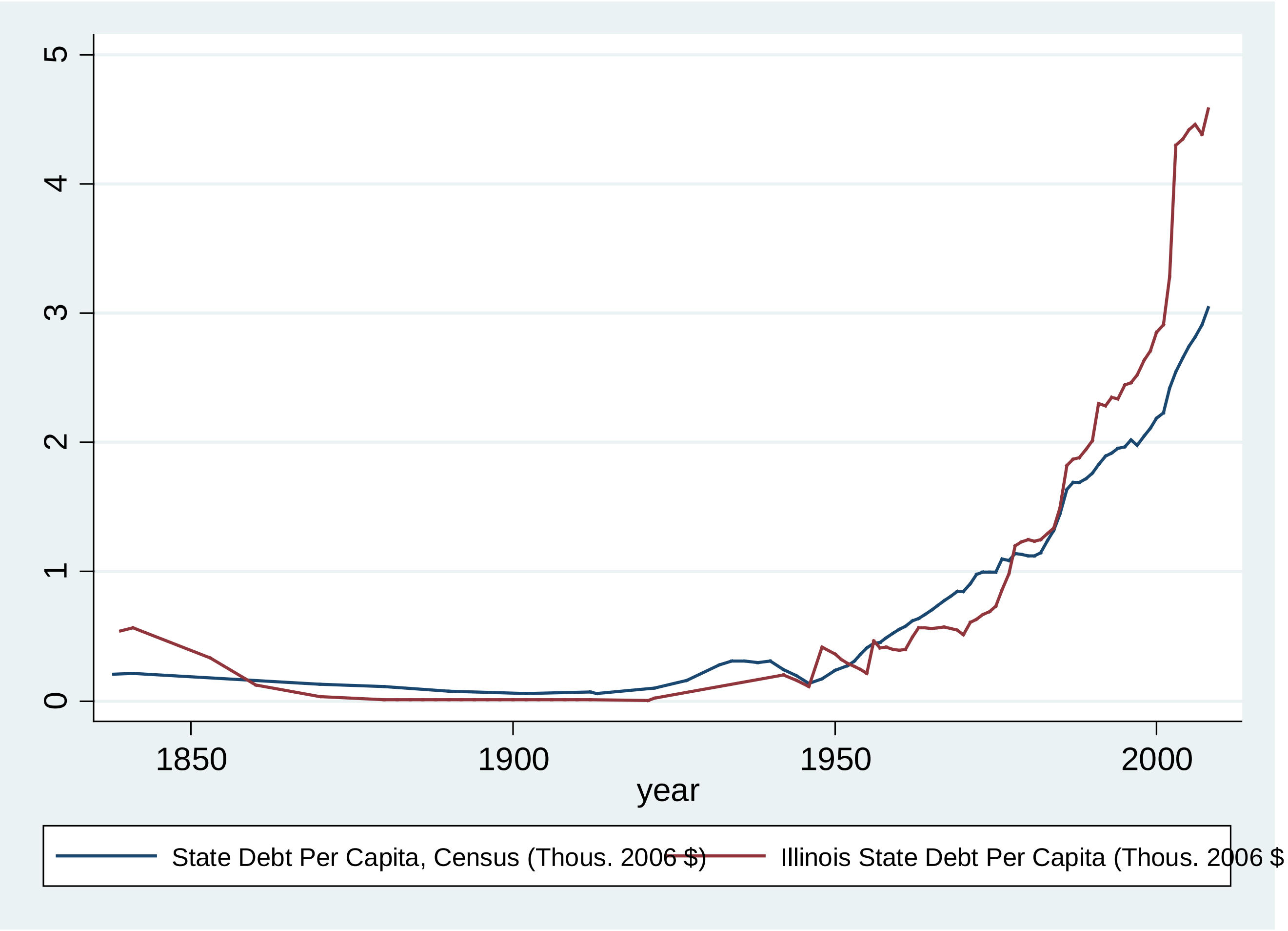


Debt Shares

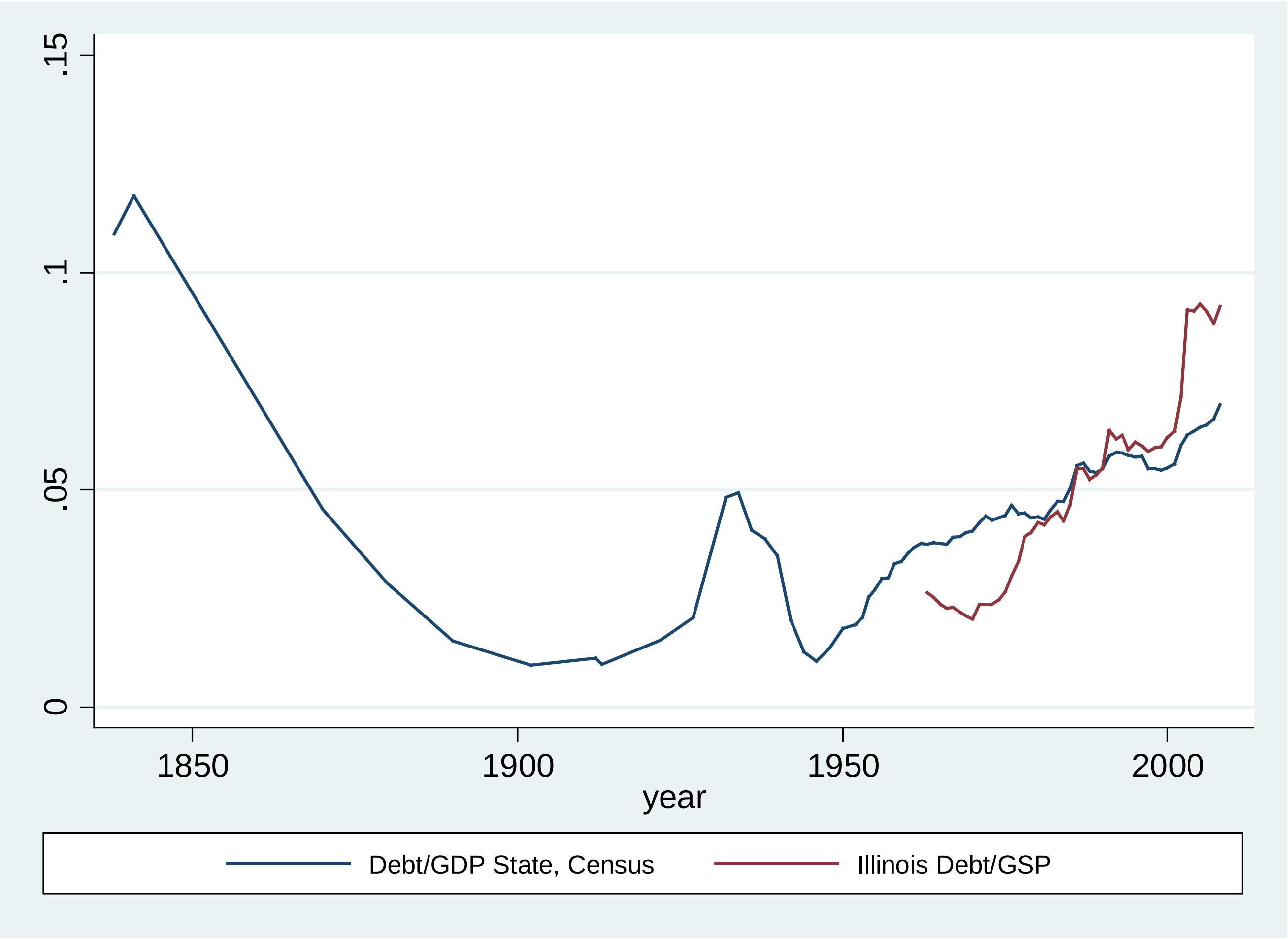


0
.2
.4
.6
.8
1
1850
1900
1950
2000
year
Federal Share of Govt Debt
Local Share of Govt Debt
State Share of Govt Debt

Illinois vs. National Average, Debt per Capita



Debt to GDP vs. Debt to GSP



State Debt Crisis of the 1830s & 1840s

- In 1841, state government debt/GDP 12%, as compared to 7% in 2008
- States took on debts for internal improvements (canals and railroads) and banking.
  - Jacksonian era of little Federal government meets Manifest destiny
- As of 1838, 18 of the then 26 states had debts totaling $171 M
  - "Of all the states that launched out upon the sea of internal improvements prior to 1840, Indiana, Illinois, and Michigan had the most canvas spread and the least ballast; and of these three Illinois drew the least water." (Canvas to spread – larger sails; ballast – materials to stabilize the ship)

State Debt Crisis of the 1830s & 1840s

- Panic of 1837
  - Led to deflation. Bad for debt issuers.
  - Projects were unable to earn anticipated returns
    - Some were left unfinished. Also, due to a decline in demand.
  - Banks were unable to pay interest on the bonds that were issued for their benefit.
  - Nine states defaulted (1841-2), five of these repudiated all or most (MS, FL, AR, MI, LA), two renegotiated (IN, IL), two ultimately paid (MD and PA). Several other states barely avoided it.

State Debt Crisis of the 1830s & 1840s

- Creditors argued for federal government assumption of debts
  - Actually got very little traction
- Similarities and differences vs. today
  - Ownership
    - Debt was primarily owned abroad
      - Defaulting on the British and Dutch
    - Debt today primarily owned by domestic individuals directly or through funds.
      - Tax Deduction. BABs may change this.
  - State revenue sources
    - Pretty limited at the time. Almost no direct taxation.
    - Income tax, sales tax.
  - Federal government debt situation
    - Federal government had almost no debt of its own
    - Now Federal government has lots of debt
  - Federal government was weak
    - Union not a given
    - Union now a given
  - Federal government had not figured out how to satisfy loser and winner states
    - "Let the States, in the management of their State policy and local concerns, look to and rely upon their own resources, and never from any temporary consideration or embarrassment, be induced to supplicate this Government for pecuniary aid, which will result in impairing that lofty spirit of self-reliance and independence which is absolutely necessary to high self-respect" (Senator Lumpkin, D-GA, 1839)
    - Federal government now transfers to states all the time – Medicaid, highway funds.

Legacy of the State Debt Crisis of the 1830s & 1840s

- Restrictions on issuance in state constitutions
  - Rhode Island in 1843: “The general assembly shall have no power, hereafter, without the express consent of the people, to incur state debts to an amount exceeding fifty thousand dollars, except in time of war, or in case of insurrection or invasion; nor shall they in any case, without consent, pledge the faith of the state for the payment of the obligations of others.”
  - Prior to this, no mention of debt other than treatment of debtors.
- 1896 only 10 of 45 states had no limit on how much debt the legislature could issue without consent of the people.
- Illinois
  - 1848 & 1870: “no other debt .. shall be contracted, unless the law authorizing the same shall, at a general election, have been submitted to the people and have received a majority of the votes cast for members of the general assembly at such election.”
  - 1970: “State debt for specific purposes may be incurred or the payment of State or other debt guaranteed in such amounts as may be provided either in a law passed by the vote of three-fifths of the members elected to each house of the General Assembly or in a law approved by a majority of the electors voting on the question at the next general election following passage.”
- Did these restrictions matter? Do these restrictions matter? (Preliminary results)
  - Modest effect on debt levels 1913-1950
  - Substantial effect on debt levels 1950-1970
  - Large effect on GO debt 1970+