New England Fiscal Facts

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Are State Government Debt Levels Too High?

by Daniel G. Swaine and Robert Tannenwald

According to some critics, New England's state governments are carrying too much debt. To support this contention, they note that New England's state debt ratios (state debt as a percent of state personal income) are relatively high. In FY94, the latest year for which comparable data are available, this ratio was about 6 percent in Maine, New Hampshire, and Vermont; about 10 percent in Connecticut, Massachusetts, and Rhode Island; and only about 4 percent for the nation as a whole (Chart 1).

For at least three reasons, this comparison provides little insight into whether New England's states have borrowed too much:

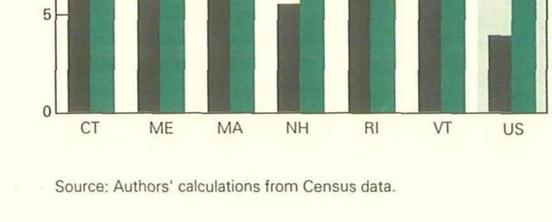
• The region's state governments finance a relatively large portion of the capital investment of their municipal governments. Since the population of a typical New England municipality is small, it would have difficulty obtaining favorable terms in nationwide credit markets. It makes sense, therefore, for the region's state governments to acquire debt on their local governments' behalf.[1] As a result, for each New England state, the ratio of state and local debt to personal income is closer to the national average than is the ratio for state debt alone (Chart 1).

• Debt ratios fail to take into account the long-run costs and benefits of investment in public infrastructure. For example, a state with a low debt ratio today may have a high ratio in the future if it has been postponing repair and renovation of its capital stock. Furthermore, debt ratio comparisons fail to take into account differences among states in public investment preferences. State governments acquire debt to finance capital projects projected to yield a stream of social benefits flowing over many years, just as house-

Chart 1

New England State and Local Debt Ratios

Expressed as a Percent of Personal Income, FY94



Source: Authors' calculations from Census data.

1 State borrowing figures importantly even in the investment of the region's largest cities. For example, Massachusetts is currently debating whether and how to finance a new convention center for Boston. According to a proposal currently before the state legislature, the Commonwealth would issue bonds covering 77 percent of the project's cost, even though its benefits would redound primarily to the City.

New England
Fiscal Facts

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State Budget Timetable

Annual Budgets
Massachusetts
Rhode Island
Vermont
FY97: July 1, 1996 to June 30, 1997
FY98: July 1, 1997 to June 30, 1998

Biennial Budgets
Connecticut
Maine
New Hampshire
FY96-97: July 1, 1995 to June 30, 1997
FY98-99: July 1, 1997 to June 30, 1999

holds acquire mortgages to purchase homes and manufacturers borrow to finance the construction of new factories. If a state or municipality chooses to renovate a major airport, rebuild a major highway, or modernize its school buildings, it may quite properly acquire a large amount of debt relative to the personal income of its residents, provided, of course, that its tax effort is also relatively high or the investment projects will generate revenues to pay for the added debt service.

• A more pertinent issue than whether a state's debt ratio is relatively high is whether, given its preferences, priorities, and fiscal responsibilities, it can afford to service its debt, that is, to make scheduled payments of interest and repayments of principal. Interstate comparisons of debt ratios are of little help in making this determination. A state with a low ratio may nonetheless have difficulty carrying its debt load if interest rates have been high and its tax effort is relatively low. A more useful and frequently cited indicator of debt affordability is debt-service payments as a percent of revenues, termed the debt-service ratio.[2] The debt-service ratios of the New England states in FY94 (the most recent year for which comparable data are available) are presented in Chart 2. The current debt-service ratio is the first bar for each state.

Debt-Service Ratios

Debt-service ratios can help policymakers resolve two salient policy questions:

(1) To what extent are the burdens of financing past borrowing crowding out spending for other purposes?

(2) What is the likelihood that the "quality" of a state's debt instruments will be downgraded by credit-rating agencies, thereby raising the interest rates it faces on newly issued debt?

The first question reflects current dissatisfaction with costs imposed by past decisions to borrow long term and invest (primarily) in long-run capital projects. Future generations reap the benefits of these long-lived assets, but also incur the costs of paying interest on the debt acquired to finance the initial capital outlays. Policymakers do not always share the priorities imposed on them by these past investment decisions. As a result of newer priorities, they may scale back current capital spending, freeing up funds for other uses.

The second question concerns the cost of servicing each dollar of debt. This cost, which varies by government, is strongly influenced by the formal credit ratings assigned by credit-rating agencies. The debt-service ratio is one of several indicators that the agencies monitor to evaluate the riskiness of a state's debt. However, they do not disclose what debt-service levels, if any, they consider grounds for triggering changes in credit ratings. Attempts by academics to quantify the relationship between debt-service ratios and credit ratings have proven inconclusive.

While it is not possible to identify precisely what debt-service ratio is "too high" for a given state, credit rating agencies currently give the New England states decent marks for debt quality. Moody's has given the Aa rating to Connecticut, Maine, New Hampshire, and Vermont, signifying that their general obligation debt is "of high quality by all standards." Massachusetts' and Rhode Island's bonds are rated A1, indicating that they possess "many favorable investment attributes" and rank just below Aa status, but some factors may be present that suggest possible risk from future events.[3]

The state debt-service ratios of all six New England states have fallen since 1991, the trough of the last recession. This downward trend, which has eased some concern about debt levels, is attributable to falling interest rates, accelerating revenue growth generated by the recovering regional economy, and a diminished

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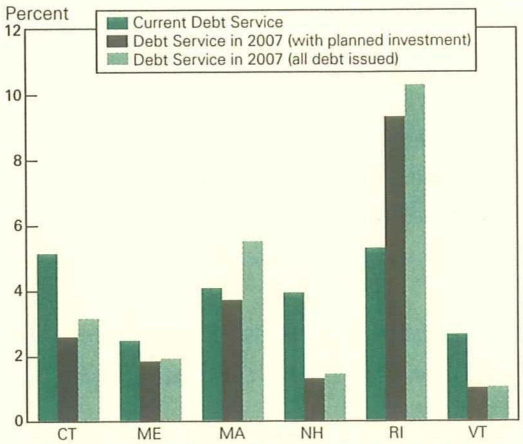
2 Debt-service payments are commonly defined as interest costs plus repayment of principal. However, in practice, although particular debt issues are redeemed, the outstanding debt is not actually paid down but is constantly refunded through the issuance of new debt. For this reason, we exclude principal repayments from debt service and include only interest costs.

3 Moody's ratings of Aaa, Aa, A, Baa are generally considered to be free of most risk. (A1-rated bonds are at the higher end of the A category.) The next lower rating below Baa is Ba, which is considered to be of lower medium quality, with the existence of some risky elements. With every rating step below Baa (Ba, B, Caa, Ca), the degree of riskiness increases to the point where a rating of Caa signifies a very high probability of default, and a rating of Ca signifies default status. See Moody's Investors Service World Wide Web site, http://www.moodys.com/ratings/ratdefs.htm#ltus.

Chart 2

Debt-Service Payments as a Percent of Revenues

Fiscal Year 1994



Source: Authors' calculations from Census and Budget documents.

need to issue short-term debt to make ends meet. Reduced reliance on short-term debt has been an especially encouraging development, as high levels of such debt are frequently viewed by credit-rating agencies as indicative of poor financial management. In most of the region's states, short-term debt is a minuscule percentage of total debt. In Massachusetts, it is 1.3 percent, the highest percentage in the region.

Absent unforeseen revenue shocks or a spike in interest rates, *Fiscal Facts* projects that the debt-service ratios of five of the region's states are likely to continue to fall gradually over time (Chart 2, the second bar for each state).[4] These projections reflect the fact that public capital, and therefore public debt, will grow more slowly than revenues from FY1998 through FY2002.[5] Even Massachusetts, which will exceed its self-imposed spending cap by $100 million from FY97 through FY99, should see its debt-service ratio drop from 4.0 to 3.7 percent. The one state projected to show a rising ratio, Rhode Island, has relatively ambitious capital spending plans and a low average historical rate of revenue growth. As a result, its debt-service ratio is projected to rise from its current value of 5.2 percent to over 9 percent by the year 2007. This increase is not necessarily a problem, provided that it reflects a public preference to pay for public investment over other forms of public spending or the investments that are planned bear fruit in the form of enhanced revenues.

Reasons for Caution

Several potential developments could cause the region's debt-service ratios to decline less rapidly than projected or perhaps even increase over time. One frequently cited concern is the backlog of authorized but unissued debt that exists in some states, especially Massachusetts. When a bond issue is approved, legislatures sometimes postpone issuance of the bonds if legislators believe that the delay is in the best financial interests of their state. If these delayed projects were all implemented over the short or intermediate run on top of planned future capital spending, debt-service ratios could swell. *Fiscal Facts* explored the potential for this problem by making new projections under the assumption that all authorized but unissued debt as of the end of FY97 would be issued uniformly over the five years from FY98 through FY2002. Under this assumption, the debt-service ratios of four New England states would still decline between now and 2007 (Chart 2, the third bar for each state). Massachusetts would join Rhode Island in seeing an increase in its debt-service ratio, although the Massachusetts increase would be much smaller than Rhode Island's. It is unlikely that all of Massachusetts' large stock of authorized but unissued debt would be issued over the next five years, however.

Another source of concern is a possible reduction in the share of federal transportation aid allocated to some states, as proposed in the federal transportation bill currently wending its way through Congress. While a decision on this legislation has been postponed for six months to allow Congress more time to study the issue, the current version of the proposed bill poses some problems for the Northeastern states. The federal government allocates a portion of federal fuel taxes back to the states for highway construction and maintenance. In the past, the Northeast has sometimes enjoyed what is arguably a disproportionately large share of these allocations. The formula contained in the proposed bill would decrease the share of funds allocated to the Northeastern states in favor of the Sunbelt. Funding levels in most New England states would not actually decrease, since the amount of funds to be allocated would increase substantially. Massachusetts is the exception to this rule. Should the current proposal be enacted, Massachusetts would lose between 35 and 50 percent of its transportation assistance.

Continued on back page

4 Although it is not intuitively obvious, economic growth theory and the fact that rates of capital investment have lagged rates of growth in revenues imply that debt-service ratios will tend toward a "steady-state" value. We calculate that, with the exception of Rhode Island, these steady-state values would be far below those projected for FY2007.

5 Growth in public capital is given by the capital-spending plans of the states as published in their budget documents. We use the average investment rate (as a percent of revenues) over the five-year capital-budgeting period 1998 to 2002 as our measure of planned investment trends. Revenue growth rate is measured as a regression of revenues against time for the period 1983 to 1995 (see *Fiscal Facts*, Spring 1997 issue).

Across *the* Region

The good times are continuing across the region. Despite the cooler than normal spring, which slowed growth in tourist-related tax revenues, FY97 revenues significantly exceeded revised projections in every state. All six New England states realized surpluses of 2 to 5 percent of spending. Even New Hampshire, which was expecting a large deficit earlier in the year, recovered as a result of a late surge in revenues.

The strong revenue growth led to some spending increases. New Hampshire, Rhode Island, and Vermont increased inflation-adjusted spending levels by about 2 percent, while Connecticut, Maine, and Massachusetts continued to hold spending increases beneath the inflation rate.

New Hampshire enacted a budget increase of nearly 2 percent in inflation-adjusted terms. The spending increase is funded partly by a tax hike, with most of the increase allocated to K-12 education in response to a court challenge to local property tax funding. Current conditions suggest that New Hampshire realized an FY97 budget surplus of approximately 2 percent of spending. However, previously accumulated deficits totaling $44 million will still leave a general fund deficit of about 1 percent of spending.

Vermont enacted a budget with modest real spending growth in FY98 along with no change in spending priorities. With no major budgetary initiatives, most of the legislative session was devoted to devising a new educational funding system in response to the Supreme Court's decision on the Brigham case, which ended local property tax financing. In June, an historic reform was enacted, increasing state funding for education from the current 32 percent to 79 percent.

Total State Appropriations for FY97 and Enacted Appropriations for FY98[a]

Excluding Federal Dollars

	FY97	FY98	Percent Change
	Millions of Dollars		
Connecticut	8,199.7	8,285.5	1.0
Maine	1,997.2	2,047.5	2.5
Massachusetts	14,801.0	15,112.8	2.1
New Hampshire[b]	1,137.1	1,188.1	4.5
Rhode Island[c]	2,417.2	2,536.5	4.9
Vermont	873.6	912.3	4.4

a Unless otherwise noted, includes general fund and transportation fund appropriations only. Excludes expenditure of federal grants and reimbursements.
b Includes budgeted income from sweepstakes earmarked for foundation aid and special education.
c Includes general revenue and other unrestricted funds.

Source: Official budget documents, state financial statements, and conversations with state budget officials.

Six-State Review

Connecticut

Connecticut finished FY97 with a surplus of $267 million, 3 percent of expenditures. General fund receipts, expected to grow 2.8 percent, totaled $7.5 billion, an increase of 4.6 percent over FY96. Personal income tax revenues grew 8.3 percent, exceeding projected growth of 5.3 percent. As a result of a scheduled rate decrease, corporate profits receipts fell 9.6 percent.

Future revenue flows could be significantly different. The $8.3 billion FY98 own-source revenue budget (see *Fiscal Facts*, Spring 1997), passed in early June, contains $394 million in tax cuts over two years, $34 million more than in Governor Rowland's proposed plan. Budget highlights include the following:

- The lowest personal income tax bracket will be expanded, lowering the tax rate for affected taxpayers from the current 4.5 percent rate to 3 percent, effective January 1, 1998, and for some taxpayers retroactive to January 1, 1997. This change is expected to cost the state $39 million in lost revenue for FY98 and $114 million in FY99.
- The 50 percent of Social Security benefits currently subject to the personal income tax will be excluded starting in the 1998 tax year. This provision is expected to cost the state $1 million in FY98 and $10 million in FY99.
- The property tax credit will be increased from a maximum of $100 to a maximum of $215, effective for income tax year 1997, and to a maximum of $285 for income tax year 1998. This change is expected to cost the state $46 million in FY98 and $56 million in FY99.
- The gasoline tax will be reduced from $0.39 per gallon to $0.36 per gallon effective July 1, 1997, and to $0.33 per gallon effective July 1, 1998. This tax change is expected to reduce revenue flows into the transportation fund by $38.8 million in FY98 and $78.1 million in FY99.

Own-source spending will increase 1 percent in FY98. The budget incorporates privatization of the state's computer system, for a cost saving of $50 million over two years. Also included are early retirement incentives for state employees 52 years of age and over, which are expected to save $115.1 million in FY98 and $92.2 million in FY99.

Christine Gagliardi

Maine

As reported by the Budget Office, the state of Maine ended FY97 with a surplus of $59.6 million, or 3 percent of general fund spending. Most of this surplus was allocated for tax relief. A provision in the approved FY98-99 biennium budget creates a new tax-relief fund that will contain 75 percent of FY97 surplus revenues, and, in the future, all unexpected income tax revenues. The remainder, nearly 25 percent of the FY97 surplus, will be allocated to a retirement allowance fund.

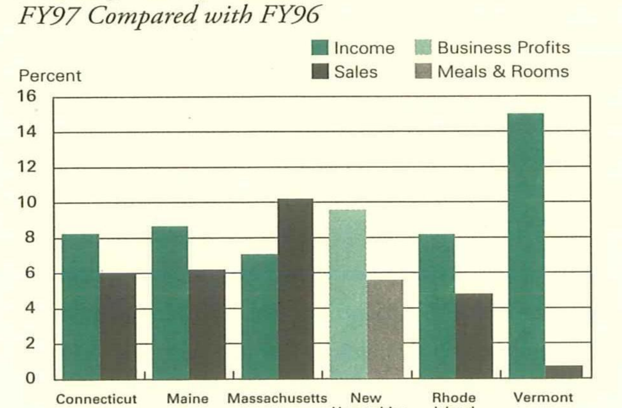
Strong corporate and personal income tax revenues contributed to the FY97 surplus, growing 37.8 and 8.7 percent, respectively, from FY96 levels. Sales tax receipts grew 6.2 percent over FY96 levels, falling short of projected growth of 9.3 percent. Total FY97 revenues of $1.9 billion were up 5.5 percent, exceeding projected growth of 2.1 percent.

In March, Governor King signed into law a $4.3 billion FY98-99 budget, with appropriations of $2.1 billion in own-source spending for FY98, an increase of 2.5 percent over FY97 levels, and $2.2 billion for FY99. The budget act repeals the income tax cap and includes a number of minor spending initiatives.

An issue of hot debate during the 1997 legislative session was Governor King's proposal to double the cigarette tax to 74 cents per pack. Although both the Governor and Democrats, the majority in the legislature, supported the

Revenues from the Two Largest Taxes in Each New England State

Percentage Rate of Growth
FY97 Compared with FY96



Source: Official budget documents, state financial statements, conversations with state budget officials, and U.S. Bureau of the Census.

increase, they differed on how to allocate the additional funds. While both agreed on allocating some funds for an anti-smoking campaign, the Governor wanted to use the remainder for tax relief, while the Democrats hoped to fund health insurance for poor children and prescription drugs for the elderly. The enacted bill will double the cigarette tax, effective November 1, 1997. Of the additional $31 million per year the tax increase is expected to generate, $3.5 million will be allocated for smoking prevention with the remainder going into a special fund to be used to lower taxes.

In May, the U.S. Supreme Court ruled against a Maine tax law that discriminates against nonprofit organizations within the state that serve primarily residents from outside the state. The law, which gives tax-exempt status to state nonprofits that serve primarily Maine residents, was found to violate the Commerce Clause of the U.S. Constitution.

Christine Gagliardi

Massachusetts

Massachusetts collected tax revenues of $12.8 billion for FY97, up 6.8 percent over a year earlier and significantly above both the early 2.2 percent growth projected by the administration (which was updated only in late May to 3.8 percent) and the more recent 4.7 percent growth forecasted by the Massachusetts Taxpayers Foundation (MTF). Based on the early administration forecast (for which spending increases would have been geared), the final numbers should show that the state ended the year with a surplus of about $500 million, or about 3 percent of spending.

Consistent with robust economic growth, collections were strong across the board. Income tax revenues were up 7.1 percent over a year earlier, to a level of $7.2 billion and significantly better than the 3 percent growth projected. Sales tax revenues were up a healthy 10.2 percent, to a level of $2.9 billion and only slightly below expectations. On a down note, excise tax revenues from all sources were down about 1 percent from a year earlier, as bank tax receipts came in much lower than expected, illustrating the uncertainties inherent in forecasting the effects of the recently enacted bank tax reform.

For FY98, an own-source revenue budget of $15.1 billion was enacted, an increase of $312 million, or 2.1 percent, over the adjusted FY97 spending level. In inflation-adjusted terms, spending would decline 0.6 percent. The enacted budget includes increases of $370 million (5.2 percent) in human service spending and $311 million (8.9 percent) in local aid. However, the human service increase is financed by a temporary (five-year) increase in federal funds, which will bring in an additional $330 million a year in federal funds. State-authorized human service funding will increase by $40 million, which will provide state welfare benefits to legal immigrants cut from the federal rolls. Of the $311 million increase in local aid, $255 million is earmarked for education as required by the 1993 Education Reform Act.

In addition, the enacted budget includes three tax cuts, estimated to cost $54 million in FY98. Of the tax cuts originally proposed by Governor Weld, the legislature passed only an increase of $600 per filer in the deduction for dependent children. The other two cuts are both tax credits:

(1) an earned income tax credit, at a rate of 10 percent of the existing federal credit, for families earning less than $9,500 per year, and

(2) a septic system tax credit of up to $6,000, intended to compensate households affected by the recent change in the state regulation concerning sewer systems.

Daniel G. Swaine

New Hampshire

New Hampshire ended FY97 with a $27 million surplus, due primarily to strong business profits tax receipts that exceeded FY96 levels by 9.5 percent. Total general fund receipts of $892.5 million were 9.0 percent over FY96 levels, beating the expected growth rate of 7.2 percent. Meals and rooms tax revenues grew 5.6 percent — 4.7 percentage points below projected growth of 10.3 percent.

Although revenue flows were healthy throughout the year, state legislators voted to extend the "temporary" tax rates of 8 percent on meals and rooms, 5.5 percent on telecommunications services, and 0.5 percent on real estate transfers through June 30, 1999. These rates were scheduled to drop to 7 percent, 3 percent, and 0.35 percent, respectively, on July 1, 1997.

State legislators also approved a 12-cents-per-pack increase in the cigarette tax, a change expected to raise approximately $40 million over two years.

The legislature approved a $2.4 billion FY98-99 own-source revenue budget, with spending of $1.19 billion allocated for FY98, a 4.5 percent increase over FY97 levels. Budget highlights include the following:

- $38.5 million to fund a kindergarten plan that allocates $750 for each child enrolled in either a public or a private program and authorizes $22.5 million in bonds over five years to cover three-quarters of building or renovating costs;

• an additional $10 million per year in education aid; and

• pay raises for 10,000 state workers.

Also included as part of the approved budget are a cut of $25 million in the health and human services budget beyond the Governor's initial proposed cut and the enactment of a 120-day hiring freeze on most state agencies before vacant positions may be filled. The state projects that the accumulated undesignated general fund deficit will be eliminated by the end of FY99, ending the biennium with a $3 million surplus.

Christine Gagliardi

Rhode Island

Through the end of May, Rhode Island was on track to collect FY97 tax revenues totaling $1,467.2 million, up 5.9 percent from a year earlier, and exactly in line with recently revised revenue projections. When the final numbers are in, the state should end FY97 with a surplus of $46.4 million, or about 2 percent of spending. Personal income tax collections were up 8.2 percent to $625.7 million, below revised projected growth of 9.6 percent. Sales tax collections totaled $523 million, up 4.8 percent and also below revised projected growth (6.4 percent). Corporate tax receipts, surprisingly stronger than projected growth of 4.4 percent, were up 7.2 percent to $81.1 million. Officials had anticipated that previously enacted tax cuts would preclude growth in this revenue source.

The budget enacted for FY98 entails own-source spending of $2,536.5 million, 4.9 percent higher than the adjusted figure for FY97. On an inflation-adjusted basis, this is an increase of 2.2 percent. Virtually all of Governor Almond's spending initiatives were enacted, including the renovation of state buildings, the establishment of technology assistance centers, and funding for transportation (including a partial substitution of $8.7 million in gas tax revenues for bond financing of capital projects in order to improve the state's credit rating). The unexpected surge in revenues allowed the legislature to add spending for three initiatives:

• $26.5 million in aid to local education along with a new formula to distribute education funds more equitably;

• $13.6 million in welfare aid to both the poor and legal immigrants to partially replace lost federal payments from the new welfare rules; and

• $6 million for higher education.

The budget also includes most of the Governor's tax initiatives, including an income tax cut and increases in two business tax credits. The income tax rate was cut from 27.5 percent to 25 percent of federal liability over a five-year period. This would reduce revenues by an estimated $6 million in FY98 and $60 million when fully implemented. The research and development (R&D) tax credit was increased from 5 percent to 22.5 percent, while the investment tax credit (ITC) was raised from 4 percent to 10 percent. Increasing these two tax credits was done to make Rhode Island more competitive with Connecticut, which has R&D and ITC rates of 20 percent and 10 percent, respectively. The two tax credit increases are expected to cost $4.5 million in FY98. Finally, the legislature added a tax increase on cigarettes, from 61 cents to 71 cents per pack, which is expected to raise $9 million in new revenues.

Daniel G. Swaine

Vermont

Vermont tax receipts for FY97 totaled $715.5 million, up 9.1 percent from a year earlier and above revised projected growth of 8.5 percent. When the final numbers are available, the state should end FY97 with a $43 million surplus, or about 5 percent of spending. Year-over-year growth of 15 percent in personal income tax receipts was especially surprising to forecasters. Sales and tourist tax receipts, which lagged all year, were up 1.5 percent, in line with recently revised projections. Corporate tax receipts, down 0.3 percent, beat an expected decline of 1.9 percent.

For FY98, an own-source revenue budget of $912.3 million, up 4.4 percent from FY97, was enacted in late June. The budget contains no significant change in spending priorities. In inflation-adjusted dollars, spending will be up by 1.7 percent. The budget is nearly 2 percent larger than that proposed by Governor Dean in January.

As a result of the landmark Brigham case (see *Fiscal Facts*, Spring 1997), an educational funding reform was enacted in late June, with a five-year phase-in period. The bill commits the state to raise its share of educational funding from the current $221 million, (or 32 percent of total educational expenditures) to $550 million (or 79 percent), with the total amount spent on education remaining at about $700 million per year. Localities can raise the remaining $143 million (or 21 percent) through certain local option taxes.

The state will levy a new statewide property tax at a rate of 1.1 percent on all taxable property, raising $492 million in revenues. The remaining $58 million will be raised through increases in the rooms and meals tax (from 7 to 9 percent), the gasoline tax (from 15 to 19 cents), and the corporate income tax (by 1.5 percentage points). In addition, a scheduled rate reduction in the sales tax (from 5 to 4 percent) was canceled, while the sales tax base was broadened to include telecommunications services. The $550 million raised will be used to fund a minimum "guarantee" of $5,000 per student in local educational aid.

While the court decision forced the elimination of local property taxes as the primary funding source for education, the reform act allows for a local tax option that includes an add-on to the state property tax at an average rate of 0.3 percent. Other local tax options include a 1 percent sales tax (excluding telecommunications services) and a 1 percent levy on meals and rooms. Wealthy communities must share a portion of their local-option tax revenues with poor communities, a requirement designed to allow localities some flexibility to spend more than the average, while at the same time satisfying the court decision that requires equalized funding across communities.

Daniel G. Swaine

Are State Government Debt Levels Too High?

Continued from page 3.

Fiscal Facts has projected the impact for Massachusetts of a loss of 43 percent of its federal transportation funding. It is assumed that the Commonwealth would replace all of its lost federal funds by issuing new debt — a reasonable assumption given the difficulty of scaling back the so-called "Big Dig" project. Under this scenario, the Commonwealth's debt-service ratio would increase from 4 to 4.8 percent.

Summary and Conclusions

The New England states do not currently appear to be carrying overly burdensome levels of debt. The often-quoted debt ratios of the New England states are inflated by the fact that state governments in the region shoulder a large part of local responsibilities. After taking this into account, the debt levels of the region's states are much closer to the national average.

More important, this statistic is not necessarily an accurate indicator of a state's debt-servicing capacity. The debt-service ratio may be a somewhat more accurate measure. An analysis of debt-service trends suggests that most New England states have adequate debt-bearing capacity. Rhode Island, the principal exception, may be investing at a rate that eventually pushes against its debt-servicing capacity, unless its economic development policies generate additional revenues.

A potential concern for the Commonwealth of Massachusetts is a proposed reduction in its level of federal transportation assistance. This would most likely result in public resources being diverted from other uses, or require that additional state revenues be raised.

An additional development that would create serious debt-service problems for all the New England states would be the onset of a deep and prolonged recession. The resulting drop in revenues and bulge in short-term debt would cause debt-service ratios to rise sharply.

In view of these various uncertainties, whatever their preferences for public investment, states should continue to manage their finances prudently to minimize debt-service costs. They should closely monitor trends in public investment and revenue growth to ensure that their capital spending does not outstrip the revenue base that supports it. **FF**

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