

State Debt Limit Debate Misses the Point

By Kim Justice and Andy Nicholas

Introduction

There's been much discussion in the Legislature around the state debt limit. That is, the amount of debt accrued from the loans used to fund building projects such as public schools and colleges, water and sewer plants, prisons and parks. Missing from this important debate has been a frank discussion about Washington's flawed revenue structure and its failure to meet the many needs of our state – from current demands for health care and education services to long-term investments in new schools and other public infrastructure.

Financing infrastructure is a core function of state government

It is important to draw a distinction between the ongoing debt ceiling debate in Washington, D.C. and the current debate in Olympia. At the national level, debt is issued to cover the gap between total revenues and total spending, including the ongoing costs of maintaining public services and benefits. In other words, we borrow in order to pay for the wars in Iraq and Afghanistan, to pay federal employee salaries, to issue benefit payments to families and seniors, and to cover the costs of everything else the federal government does.

By contrast, our State Constitution strictly limits state debt and what it can be issued for. Almost all of our state debt is issued in order to pay for large-scale infrastructure projects, such as the construction of new schools, roads, bridges, water treatment facilities, and other permanent public structures.

Issuing debt for these limited purposes is sound fiscal policy at the state-level for the following reasons:

- **Large infrastructure projects can benefit multiple generations:** Schools, roads, bridges, and other major infrastructure investments benefit our state over the course of many years or decades. Issuing debt to pay for these investments, which is repaid gradually over time, ensures that all who benefit from them share in their construction and maintenance costs.
- **Many large-scale projects wouldn't be possible without debt-financing:** Without the ability to issue debt, many essential state infrastructure projects would simply be too expensive to pay for up front. The ability to sell bonds (the major debt instrument for states) makes such projects affordable because their costs are incrementally paid over multiple years or decades.

- ***States can take advantage of low interest rates:***

As with many other types of debt, interest rates on state bonds rise and fall over time. States can take advantage of these interest rate fluctuations by undertaking major infrastructure improvements when interest rates are low, which reduces overall costs.

State infrastructure investments in schools, colleges, correctional facilities, and other buildings are paid out of the Capital budget while roads, bridges, and state highway infrastructure are paid out of the Transportation budget.

How debt impacts the state budget

Spending on the construction of state facilities takes place through the Capital budget, but it's out of the Operating budget that we pay the interest and principal of our loans, or bonds. This is referred to as our "debt service" and paying it is a constitutional requirement. In the coming biennium, the cost of our debt obligation is \$2 billion, or 6 percent of the total Operating budget. In the context of the \$5.1 billion recession-induced budget shortfall our state currently faces, that's a lot of money which could otherwise be used to maintain essential services for kids and vulnerable populations.

Current debate misses the point

Policymakers in Olympia are currently debating whether to lower our Constitutional debt limit, which is based on the amount we devote each biennium to making payments on existing debt.¹ Proponents of lowering the debt limit are rightfully concerned that growing state debt payments will hamper our ability to maintain public services like health care, education, and public safety. Opponents of lowering the limit are equally justified in their concern that lowering the limit will impair our ability to make needed long-term investments in schools, correctional facilities, water treatment facilities, and other important infrastructure.

However, both sides are ignoring the fundamental problem: this type of budget tug-of-war is one of the many consequences of not having an adequate revenue stream, which is essential for the state to carry out its necessary functions. Ideally, the state should have the resources it needs to pay the bills on our investments in needed infrastructure as well as invest in our shared values of economic security, healthy people and environment, thriving communities, and education and opportunity. Accordingly, policymakers' time would be better spent addressing the fundamental deficiencies of our revenue system.

Conclusion: Revenue system overhaul is long overdue

In order to address the many needs of our state it is essential that policymakers and the public consider reforming our inadequate revenue system. Coupled with other significant reforms, actions like – [modernizing our state sales tax to encompass a broader array of goods and services](#), [strengthening our state rainy day fund](#), and funding a [sales tax rebate program](#) for lower-income working families with children – would do much to improve the adequacy, equity, and long-term stability of our system of financing public services.

There hasn't been a serious discussion about reforming our broken revenue system during the current legislative session. However, a number of bills – such as [Senate Bill 5857](#), [Senate Bill 5944](#), and [House Bill 1889](#) – have been introduced that would reform how policymakers account for the ongoing costs of special tax breaks during the state budget process. If approved, these measures would provide policymakers and the public with more options when it comes to maintaining the investments we will need in order to recover and prosper in the coming years.

Check out our [Framework for Prosperity tool](#), which offers values-based solutions, grounded in sound research, to our short-and long-term needs as a state.

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Endnotes

1. The current state debt limit restricts debt service payments from exceeding nine percent of general state revenues, which are averaged over the previous three years and do not include state property taxes or other dedicated revenue sources. A proposal has been introduced that would lower this limit over time, but would average state revenues over the previous 10 years while expanding the definition of general state revenues to include property tax revenues. [Senate Joint Resolution 8215](#) would lower the limit to seven percent from nine percent of general state revenues. A recent amendment to that measure adopted by the House Capital Budget Committee would lower the limit to 8.5 percent beginning in fiscal year 2018.