

beginning in 2007 brought state budget shortfalls to crisis levels, but many states had faced systematic budget gaps for years.

The ARRA was politically popular when it passed, but public support for increased government spending is waning. Unfortunately for state budget makers, the worst is likely yet to come, because declining state revenues generally lag behind the economy as a whole during downturns. In the coming fiscal year when Congress will be more hesitant to allocate more aid, history suggests that state budget shortfalls will be even higher than in the last fiscal year. The economic downturn could have shined light on states' existing budget problems, but instead it has become an opportunity for state lawmakers to turn to their federal counterparts for help. Because this cash infusion was billed as a one-time occurrence, states theoretically cannot rely on it to close future budget gaps. However, now that state officials have seen that they can successfully petition for aid, Washington has effectively softened the so-called "hard budget constraint."

**Masking Structural Problems.** Federal bailouts cover up rather than ameliorate structural problems. The result is that state budgets no longer act as a hard budget constraint, and deficits become not a once-in-a-lifetime anomaly but the usual state of affairs. Citizens are left unable to count on the type, quality, and quantity of public services available to them as policymakers budget on a boom-and-bust cycle.

States should not undertake spending that they cannot sustain through their own revenues over the long term. Attempts to mask unsustainable spending reduces states' control over their own finances, passes costs to residents of other states who don't enjoy the benefits of the spending, or pushes debt off on future residents of the state. State reliance on more federal funds is like painting over cracks

*Continued at page 18*

# Why States Have Debt Limits

By Benjamin Barr

With the westward expansion of the 19th century came canals and railroads—two highly expensive forms of public transit. As states became eager to lure industry and trade, they borrowed to invest in capital construction. Many state legislatures borrowed irresponsibly. As public and legislative yearning for modern public infrastructure grew, states fell into financial distress, eventually defaulting on loans.

Nine states and several cities defaulted on bonds, sending them into bankruptcy or near insolvency. The defaulting states included Arkansas, Florida, Illinois, Indiana, Louisiana, Maryland, Michigan, Mississippi, and Pennsylvania.

In 1825, New York completed construction of the Erie Canal, pressuring other states to look to debt to finance major public infrastructure and works. In turn, Pennsylvania and Maryland both actively sought out debts to bring more traffic into their states. By 1836, nearly every state had used debt to build railroads or canals to further compete in bringing more traffic and revenue into their state.

With the banking collapse of 1837, the economic foundation of the nation was shaken, causing a severe depression. States hoped for federal assistance with their assumed debts, and continued debt financing pushed



many states into deeper financial problems, leading several to disclaim their debts.

Likewise, in the South, war-torn states borrowed heavily to recuperate from the Civil War. In 1865, Southern state assets leveled around \$33 million, while state debt hovered around \$112 million. With few other options, the affected states borrowed once again, using debt to pay off debt.

As financial problems worsened, states convened constitutional conventions to address the growing debt crisis. In New York, one legislator saw the inherent tension and risk between the operation of representative government and debt, noting, “[U]nless some check was placed upon this dangerous power to contract debt, representative government could not long endure.” And so it was realized: Permitting states to borrow money without limit is much like giving teenagers limitless credit cards—the result is fiscal disaster.

For most states, recovery meant raising excise and property taxes substantially. Citizens mindful of the tax strain created by public debt did not take well to increased debt obligations. Across the Union, voters amended state constitutions to prohibit exactly these sorts of boondoggles from happening again. As new territories became states, debt limits were routinely included.

Not a single state included debt limits in its constitution before 1840. By 1855, after the ravage of unchecked debt spending, 19 states had added debt limitations.

Today, more than three-quarters of state constitutions have some form of debt limit. Four states prohibit all debt. Eleven states, including Arizona, limit debt to a maximum amount. Three states limit the amount of debt but demand public referenda or legislative supermajorities, even for debt that does not exceed the named amount. Eight states permit any amount of debt, but always require a public referendum on the issue. Three states require both a legislative supermajority and a public referendum for any debt to be acquired. Likewise, three states demand only a legislative supermajority for the state to assume debt.

Debt limits have a simple purpose: to prevent the plunder of taxpayer resources. Legislatures should not have unrestrained power to incur debt guaranteed by the taxpaying public.

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