TAX-SUPPORTED DEBT RISES IN STATE

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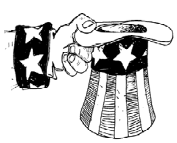
Mississippi's total bonded indebtedness tripled between FY1994 and FY2004, rising from $0.9 billion to $3.1 billion. As a result, per capita debt levels, which had been below the U.S. median at the start of this period, had jumped to twice that median by 2002, or $1,200 per capita. (This number has since fallen, to $1,116 in 2004.) In addition, $1.1 billion of additional debt has been authorized but not yet issued. Is this increasing debt a cause for concern? In brief, the answer is "Not necessarily", but increased focus on the questions of how much debt, and what kinds of debt, the state should take on is warranted.



The state typically borrows money by issuing bonds, thereby taking on the obligation to repay the value of those bonds including interest. This enables the state to finance projects over a period of time, rather than simply relying on current revenues In many cases, this debt finances infrastructure and facilities that are vital to the functioning of the state and its economic development.

However, it is necessary to monitor the issuance of debt to ensure that the increase in state revenues is keeping pace with the increased debt service obligations. The recent increased reliance on debt will likely necessitate some adjustment in the state budgetary process to ensure that this monitoring, and the appropriate responses to any findings, take place.

Debt by Purpose

General obligation bonds have traditionally been issued to provide funds for constructing and improving state-owned facilities, (including ports, university facilities, and roads), and these bonds have also been used to promote economic development in the state, particularly in recent years. Reports from the State Treasurer and the Department of Finance and Administration provide information and data on recent debt trends.

A breakdown of the state government's outstanding general obligation bonds in the Department of Finance and Administration's *2004 Annual Report* shows that, for the $1.6 billion in bonds for which a purpose was given, 28% were classified as Major Economic Impact, 26% Capital Improvements, 12% Gaming Highway Improvement, 5% Business Investment Act, 3% State Shipyard Improvements, and 26% Other. The Major Economic Impact category in 2004 was largely financial assistance for the Nissan project.

In addition, $1.4 billion of bonds were refunded and reissued, in order to reduce debt service payments. No breakdown of purpose was provided for these bonds.

Debt Service Taking Up More of Revenue Pie

The increase in debt means that an increasing percentage of the state budget must go to debt service. In FY2005, an estimated 6.8% of total general fund state appropriations ($244 million of $3,596 million) will go toward debt service, and $69 million in special fund transfers have also been appropriated for debt service. Another $32 million in debt service is also due, according to a 1/13/05 report by the State Treasurer, for a total of $345 million in debt service obligations due in FY2005. (By comparison, in FY1994 2.1% of general fund appropriations went to debt service versus the 6.8% in FY2005.)

Besides reducing the percentage of revenues available for other uses, high debt levels can potentially affect a state's bond rating. A lower bond rating means that the state would have to pay a higher interest rate to borrow funds. Long- and short-term trends in debt, however, are only one factor in determining a state's bond rating. The rating also depends on the strength of its economy, the state of its finances, and its management practices and capabilities.

Impact on State Credit Rating

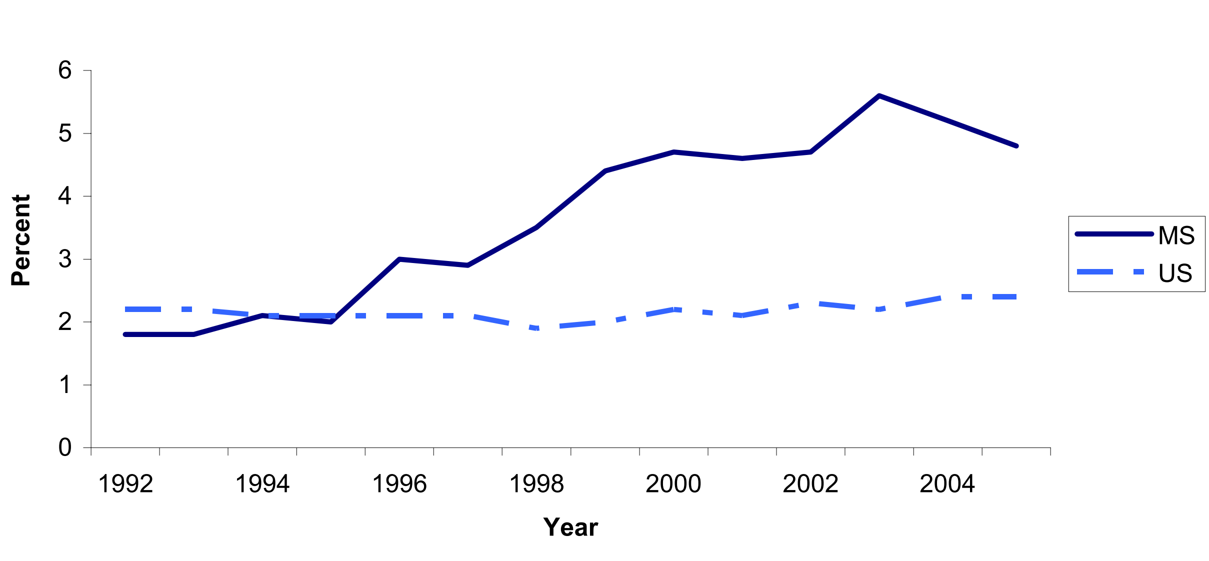
States in general receive high credit ratings, given their ability to require the payment of taxes and fees by their residents. Moody's top credit rating for a state is Aaa, the next highest is Aa1 followed by Aa2 and Aa3, then A1 to A3. Mississippi has received a Aa3 rating from Moody's since 1997, which places it in the bottom third of the states, along with such states as New York and California.[1] Standard & Poor's and Fitch, two other national investor services firms, rate Mississippi's bonds AA, which is the equivalent of Moody's Aa2 rating.

The recent increase in the debt level of the state does mark a change in one of the factors impacting the state's rating. Figure 1 shows the growth in net tax-supported debt as a percent of personal income in Mississippi and the U.S.[1] Only Kansas and Oregon had a more rapid increase in this variable from 1992 to 2003 than Mississippi among states whose debt ratio was above the 2.4% median for the U.S. as a whole. Mississippi was eighth in the nation in tax-supported debt as a percent of personal income in 2003, with debt equal to 5.2% of personal income. States with higher debt ratios included Hawaii, Massachusetts, Connecticut, New York, New Jersey, Illinois and Delaware. Two of these, Delaware and Hawaii, however, have high debt burdens in part because school district capital financing is fully funded by the state, not by local governments as is typically the case. Recently released figures for 2004 show that debt in the state dropped to 4.8% of personal income in 2004, but this percentage is likely to rise as debt that has been authorized within the past year is issued.

Other Debt Burdens Rising As Well

Mississippians are also liable for other forms of governmental debt. According to the U.S. Census Bureau, in FY2002, in addition to the $2.7 billion in long-term debt backed by "full faith and credit" of the state, the State of Mississippi owed another $1.4 billion in nonguaranteed debt.[1] (Data is not yet available

Figure 1. NET TAX-SUPPORTED DEBT AS A PERCENTAGE OF PERSONAL INCOME



SOURCE: Moody's Investors Service, "2005 State Debt Medians", May 2005 and "Moody's State Rating Methodology", November 2004.

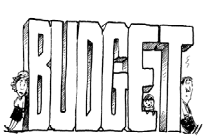
for FY2003.) This nonguaranteed debt includes, for example, claims and judgments against the state, mortgage notes and special and limited obligation bonds. Many of these non-bond debts are not included in figures on total bonded indebtedness issued by the State Treasury. In FY2002, for example, total bonded indebtedness was $2.9 billion, compared to the total state debt of $3.9 billion, as measured by the Census.

Local government debt, another obligation of Mississippi residents, exceeded that of the state, as of FY2002. Total debt outstanding for Mississippi's local governments was $5.77 billion, compared to the state debt of $4.16 billion. Again, FY2003 data is not yet available. Local debt has been growing more slowly than that of the state, however, increasing 27% from FY1997 to FY2002, compared to an increase of 70% in the state's total debt outstanding. Using these Census figures, per capita governmental debt obligations in the state rise to $3,464, as of FY2002.

The federal debt should also be mentioned, since this debt affects the state. The federal debt currently amounts to $26,793 per person in the country, with this number including an increase of $1,127 in 2005.[2]

Concluding Remarks

These figures indicate that the recent growth in debt levels has been significant. There are implications for the state. The shift in state expenditures towards debt service, and so away from other areas in the state budget, means in effect that the projects funded by state debt are competing with other items in the state budget. Rising interest rates may heighten this competition in the future by increasing debt service obligations. Growing debt burdens at the local and federal governmental levels, as well, add to the need for caution.[2] In brief, careful monitoring of developments with regard to the state's debt is required.



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Notes

[1]Tax-supported debt, as defined by Moody's, includes not only general obligation debt but also limited obligation bonds, such as four-lane highway refunding bonds ($132 million) and also lease-rental bonds ($160 million) in 2003. The U.S. Census Bureau includes several liabilities besides general obligation bonds and limited and special obligation bonds in its definition of state and local debt, such as industrial revenue/ development bonds, lease-rental bonds, and mortgage notes.

[2]Nationally, consumer credit outstanding has also been increasing, currently standing at $7,314 per person, and mortgage debt as well, now at $28,572 per capita. Although these numbers will be lower for Mississippi, the order of magnitude will be similar.

Sources

Mississippi Department of Finance and Administration, *Comprehensive Annual Financial Report, FY2004, FY2003, FY2002.*

Mississippi State Treasurer, *Legislative Fiscal Briefing*, January 13, 2005.

Moody's Investor Services, several reports at www.moodys.com, and data provided by Ted Hampton, Moody's Public Finance Group.

U.S. Census Bureau, *State Government Finances,* and can be accessed at the following site: www.census.gov/govs/state/0325msst.html.