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How States Stack Up Based On Their Fiscal Health

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WASHINGTON – Connecticut, Massachusetts, and Illinois are among the states with the worst fiscal health and provide examples of problematic strains on state and local finances, according to a report by researchers from George Mason University's Mercatus Center.

"These fiscal pressures point to areas for policymakers to direct their efforts," wrote the report's authors Eileen Norcross and Olivia Gonzalez. "They also highlight areas where improved financial reporting could give the public a clearer picture of states' fiscal health."

The report, which is based on data from the states' and Puerto Rico's comprehensive audited financial reports for fiscal year 2014, updates similar fiscal health studies from prior years. Norcross, a senior research fellow and the director of the State and Local Policy Project for the center, and Gonzalez, a research assistant on with the project, used a total of 14 metrics in their study that they then combined into five larger categories for rankings: cash solvency, budget solvency, long-run solvency, service-level solvency, and trust fund solvency.

Cash solvency measures the state's cash position relative to its current or short-term liabilities. Budget solvency assesses whether the states' revenues match their expenses while long-run solvency compares net assets, or those that are left over after the government has paid its debts, to total assets. Service-level solvency measures how much "fiscal slack" states have to raise taxes or increase spending, according to the authors. Trust fund solvency assesses the state's risk-adjusted pension obligations, other post-employment benefits, and total debt outstanding relative to the state personal income.

The two researchers said they included information from Puerto Rico "to provide a benchmark for poor fiscal performance." Puerto Rico, which has roughly $70 billion in debt and more than $40 billion in unfunded pension liabilities, ranked far below the other states in each of the study's major areas of comparison.

Connecticut was the lowest ranked state, followed by Massachusetts, New Jersey, Illinois, and Kentucky. They were at the bottom for their lack of cash on hand and large debt obligations, Norcross and Gonzalez said in the report.

"Each of the bottom five states exhibits serious signs of fiscal distress, making these states' debt levels look more like Puerto Rico's," the two women wrote. Additionally, they said each state "holds tens, if not hundreds, of billions of dollars in unfunded liabilities — constituting a significant risk to taxpayers in both the short and long term."

Kentucky, which ranks 46th on the list, has a long-term deficit per capita of $3,933. Its total debt is $8.23 billion and it has $82.68 billion in unfunded pension liabilities.

Illinois, which ranks one place below Kentucky, has a higher long-term deficit per capita of $6,067 and total debt of $35.55 billion. In addition, its unfunded pension liabilities are the highest by far of any of the bottom five states at $332.54 billion, according to the report. The unfunded pension liabilities are equal to 61% of total state personal income, according to the study.

New Jersey has similarly high unfunded pension liabilities at $255.2 billion or 58% of total state personal income. The 48th-ranked state has total debt of $41.84 billion and liabilities that are 2.1 times the size of total assets, resulting in a long-term liability per capita of $9,285, according to the report.

The states ranked as the lowest, Massachusetts at 49 and Connecticut at 50, have relatively average long-term liabilities, total debt, and pension obligations, but have less of an ability to cover short-term liabilities and a heavy reliance on debt financing, something the report weighed heavily in its rankings.

Massachusetts only has between 0.39 and 1.12 times the cash needed to cover short-term liabilities while Connecticut has between 0.46 and 1.19 times the cash it needs to cover those liabilities.

The study authors found through the metrics that many states' rankings and outlooks stayed relatively stable from a similar study done last year.

Alaska, Nebraska, Wyoming, North Dakota, and South Dakota made up the top five healthiest states fiscally, but even though they were considered healthy compared to the other 45, the authors said there are still concerns because the states face "substantial long-term challenges related to [their] pension and healthcare benefits systems." Some states also have a problem with unpredictable revenue sources.

For example, since fiscal year 2014, where the report data ends, states like Alaska and North Dakota that rely heavily on oil production for revenue have been hit hard by falling prices in that industry. Norcross and Gonzalez said those states' struggles "highlight the danger of expanding revenue based on volatile revenue sources."

"Even states that appear to be fiscally robust—perhaps owing to large amounts of cash on hand or revenue streams from natural resources—must take stock of their long-term fiscal health before making future public policy decisions," the two wrote.
