Executive Office for Administration and Finance

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Impacts of the Cellucci/ Swift Debt Reduction and Contingency Reserve Plan

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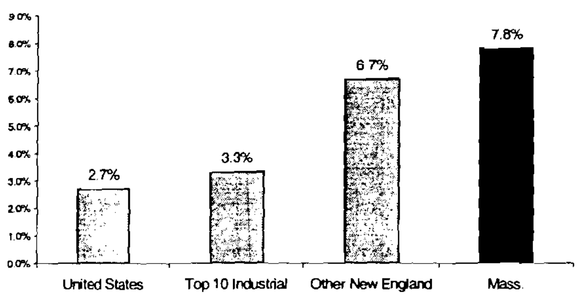
Current Outstanding Debt

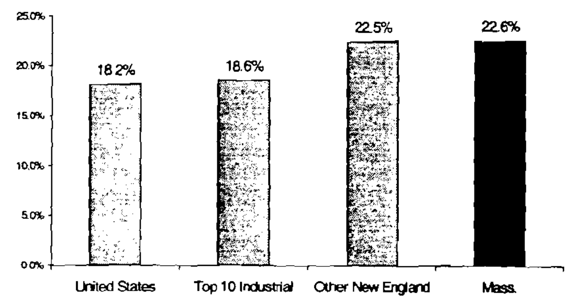
The Commonwealth currently has the third highest state debt per capita and the third highest debt burden as a percent of personal income in the United States. The Commonwealth's relative debt burden is smaller when all local debt and the debt of revenue authorities like the Massachusetts Port Authority are considered, ranking 5th nationally on a per capita basis and 11th in terms of total state and local debt burden as a percent of personal income.

Net State Tax-Supported Debt as a % of Personal Income
1997



Source: Moody's Investor Service

Total State and Local Debt as a Percent of Personal Income
1996



Source: US Census Bureau

The Commonwealth's debt has financed a massive reconstruction of the state's aging infrastructure, but Massachusetts' high debt burden has several adverse impacts. First and foremost, it negatively affects the state's credit rating. All three ratings agencies that regularly review the Commonwealth's credit have noted the Commonwealth's high debt burden as a hindrance to future upgrades. Wrote Moody's Investors Service in upgrading the Commonwealth's debt from Aa3 to Aa2 this January: "The Commonwealth's credit strengths are tempered somewhat by a heavy debt load."[1] To the extent we can demonstrate a commitment to reducing the Commonwealth's debt burden, we will go far in addressing these concerns.

The Commonwealth's high debt level increases the Commonwealth's borrowing costs independent of the effect it has on our credit rating. The large amount of Commonwealth debt outstanding means every new issue of debt must compete with supply bondholders already have in their portfolios. States that issue much less debt like New Hampshire and Maine actually save up to six basis points more than the Commonwealth on their debt service costs even though they have comparable credit ratings.

High debt also limits the Commonwealth's fiscal flexibility. The Commonwealth must pay debt service before any other expenses. If it does not, a court can order the Commonwealth to do so. This means that in adverse economic times, the Commonwealth has limited ability to reduce the fourth largest line item in the budget.

[1] Moody's Investors Service, Press Release, January 13, 2000

Year	Principal Savings	Interest Savings	Total Debt Service Savings	Contingency Reserve Interest Earnings	Contingency Reserve Fund Balance
2001	$175,625,000	$22,914,613	$198,539,613		$198,539,613
2002	$167,870,000	$14,584,351	$182,454,351	$9,926,981	$390,920,945
2003	$114,520,000	$9,541,093	$124,061,093	$19,546,047	$534,528,085
2004	$142,135,000	$7,128,251	$149,263,251	$26,726,404	$710,517,740
2005	$33,850,000	$4,774,466	$38,624,466	$35,525,887	$784,668,093
2006 and Beyond	$53,075,000	$7,805,111	$60,880,111	NA	NA
Total	**$687,075,000**	**$66,747,885**	**$753,822,885**	**$91,725,319**	**$784,668,093**

Reducing the debt will have the immediate impact of lowering debt service costs into the future, by almost as much as $200 million in some years. This means state government will cost less on a day-to-day basis. By depositing the first five years of savings into a contingency reserve, the Commonwealth will create capacity in future years to address its infrastructure needs or any other future uncertainties without the need for additional borrowing. This means any additional funding needs for the Central Artery will not impact the Commonwealth's credit rating or its capital commitments. In essence, using surplus funds to reduce debt provides the same security to the Commonwealth as the stabilization fund and our other reserves, but has the added benefit of lowering the costs of operating state government and positively impacting our credit ratings.

This is important because we are approaching the limit of the amount of money we can continue to put into our operating reserves like the Stabilization fund. Currently we have $1.4 billion in our stabilization fund relative to a statutory Fiscal year 2000 cap of $1.5 billion. A study by the *Center on Budget and Policy Priorities* indicates we have among the highest reserves and are among only eight states that can weather a recession as severe as the 1990-1991 downturn without cutting spending or raising taxes.[2] Further contributions to the Stabilization Fund will have a limited benefit. Some credit rating agencies have even noted that increasing our operating reserves to a greater extent has the negative effect of inviting unwise programmatic spending from this large pool of untapped cash, thereby building up our budget base. By putting this year's surplus into debt reduction, we will ensure the money is targeted to a worthwhile purpose. If the savings are not needed for infrastructure or other non-recurring items, they can further reduce our debt burden.

Conclusion

The Commonwealth continues to enjoy the fruits of its prosperity, with surpluses currently projected to be up to $500 million for this fiscal year. Managing these surpluses effectively is essential to maintaining fiscal discipline and preserving our hard-won credit status. Paying down debt with these funds will provide an immediate benefit to the operating budget without increasing base spending and still give the Commonwealth borrowing capacity to address future contingencies.

[2] "When it Rains, It Pours: A Look at the Adequacy of State Rainy Day Funds and Budget Reserves", Iris J. Lav and Alan Berube, Center on Budget and Policy Priorities, March 1999