PERSPECTIVE

Judge Economic Policies By State's Credit Ratings

JAMES CARTER AND CHRISTINE HARBIN

The Tenth Amendment and America's federalist structure give the states the right to be "laboratories of democracy" — each with the opportunity to implement unique public policies within the confines of their borders.

Writing for the dissent in an early 1932 Supreme Court case, Justice Louis Brandeis celebrated this right, declaring:

"It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."

In the nearly eight decades since Brandeis issued his opinion, divergent state-level economic policies have led some states to prosper while others have learned — sometimes painfully — that not all "experiments" succeed. Divergent policies bring divergent outcomes.

Imperfect as they are, state credit ratings speak volumes about the underlying quality of a state's economic policies.

But what are they saying?

What are highly rated states doing right?

What are the lowest rated states — California and Illinois, in particular — doing wrong?

● *States with strong credit ratings have a few key traits in common. For one, they tend to keep taxes low.*

The average top marginal personal income-tax rate for states boasting the S&P's AAA and AA+ credit ratings (the two highest ratings) is 5.1%. This figure rises to 6.3% for states in the middle-rated group (AA and AA-) and 7.7% in states in the lowest-rated group (A+ and A-).

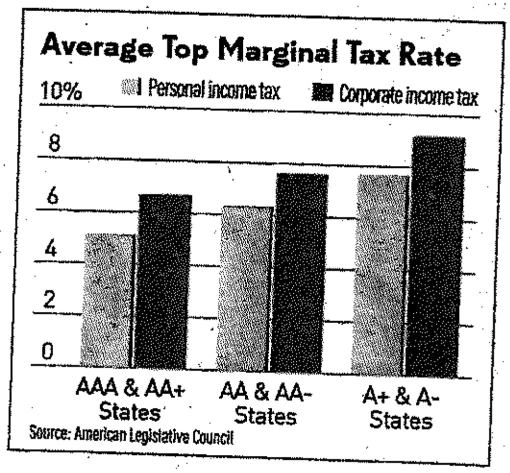
The average top marginal corporate income-tax rate for states boasting the S&P's AAA and AA+ credit ratings is 6.7%. This figure rises to 7.6% for states in the middle-rated group and 9.2% in states in the lowest-rated group.

The overall state and local tax burden is lowest in the highest-rated group and highest in the lowest-rated group.

● *State governments with strong credit ratings tend to carry less debt and spend less on debt service.* On average, the highest-rated states spend 7.8% of their annual tax revenue on debt service. States in the middle-rated group (AA and AA-) spend 8.4% while those in the lowest-rated group (A+ and A-) spend 9.2%.

● *State governments with strong credit ratings are far more likely to be a "right-to-work" state.* Roughly half of the states with AAA and AA+ credit ratings give employees the right to decide whether to join or financially support a union.

Fewer than one in three states in the middle-rated group, and none of the states in the lowest-rated group, give employees that right.



● *States with strong credit ratings maintain quality legal systems that are conducive to economic growth.* As a group, states with the highest credit ratings score the highest in the U.S. Chamber of Commerce's "State Liability Systems Ranking Study." States with the lowest credit ratings tend to fare among the worst in the study.

● *States with strong credit ratings tend to maintain those ratings for extended periods of time.* That is, credit ratings may rise and fall for most states, but the highest-rated states tend to maintain consistently high credit ratings.

For example, Missouri, North Carolina, Virginia and Utah have each held AAA credit ratings for at least 45 years while Maryland has held that distinction for 50 years.

None of this should come as a surprise. States that keep taxes and spending in check have a greater untapped capacity to meet their debt obligations and deal with budget problems as they arise.

States that maintain policies conducive to economic growth are less likely to encounter debt and budget crises and, over time, benefit from a healthier tax base.

Justice Brandeis believed in the usefulness of having states "try novel social and economic experiments."

But with decades of divergent policies and divergent outcomes behind us, the lesson going forward should be clear to anyone willing to listen.

■ **Carter** was a deputy assistant secretary of the U.S. Treasury under President George W. Bush and served on the staff of the Senate Budget Committee. **Harbin** is a research manager for the American Legislative Exchange Council, a nonpartisan group of state legislators.