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# Think Your State Is Fiscally Sound? Think Again


It's that time of the year again when we find out how deep in the red our country is thanks to the 2018 edition of the Mercatus Center State Fiscal Rankings. The study authors, Eileen Norcross and Olivia Gonzalez, find that when you rank states by their fiscal health, you can identify the best and worst state. But the scariest finding is that no state is really fiscally healthy.

Norcross and Gonzalez are very transparent about each decision behind the study methodology. They use states' own audited financial data to create five different indices (cash solvency, budget solvency, long-term solvency, service-level solvency and trust-fund solvency) to analyze and create the overall ranking. The final product is the result of many factors and deliberative choices.

Based on the most recent government data available for all states, this year, the top five most fiscally solvent states, from one to five, are Nebraska, South Dakota, Tennessee, Florida and Oklahoma. One thing these states have in common is that they have some cash on hand and relatively low short-term obligations. That makes them relatively healthier than others.

The bottom five states in terms of fiscal solvency, from 46 to 50, are Kentucky, Massachusetts, New Jersey, Connecticut and Illinois. These states face large debt obligations and have too little cash on hand to pay short-term bills. It doesn't take a professional accountant to understand that those bad fiscal habits could spell disaster for states during a recession or emergency.

Again, the study's most important finding is that being at the top makes you healthier than others by comparison but not necessarily healthy overall. In fact, the authors show that every single state would be in trouble if another financial crisis were to happen.

For instance, the data show that long-term liabilities have increased over time on average, with a pretty big jump since 2015. This is partly due to a recent transparency requirement by the Governmental Accounting Standards Board that makes states report unfunded pension obligations on their balance sheets. Under the older standards, states didn't have to report the true size of their pension liabilities. To understand the impact of this change, consider the following: From 2006 to 2014, long-term liabilities per capita grew by about 4 percent annually, on average. Between fiscal year 2015 and fiscal year 2016, that average ballooned by a sobering 54 percent.

The older standards were obviously inadequate to expose the true size of the pension liabilities faced by most states. The new standards, however, aren't perfect either. For instance, until next year when a new requirement will come into effect, states haven't had to report their health care liabilities, which allowed them to appear more fiscally fit than they truly were and are.

Look at Nebraska, the state in first place overall. Upon closer inspection, the state ranks 37th in budget solvency, which means that it spent more money than it made in tax revenue in 2016. Nebraska's pensions show that it's in a worse position than advertised. The state reports unfunded pension liabilities of $1.17 billion. Yet when valued on a true market basis, it's actually underfunded by $20.9 billion. Nebraska does better than most states on underfunding pensions, but it has room to improve. Its weakening budget position and growing unfunded pension obligations place more pressure on fiscal health than its top rank lets on.

Just because your state is ranked higher doesn't mean you're ready for a downturn.

Alaska is another interesting case study. The state was on the top of the ranking for several years in a row, due to its oil revenue. However, in previous reports, Norcross and Gonzalez warned that an overreliance on oil and the restrictions put on the use of oil revenue could be problematic in an age of decreasing oil prices. Sure enough, a drop in oil prices confirmed their fears. Alaska's fiscal ranking slid from first to 11th in just two years.

For this reason, I'd caution the healthier ranked states to temper their excitement. That top ranking is a little like a kid bragging about getting the best grade in math when it's a C+ and the class average is closer to an F.

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