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Determinants of state long-term debt: The political market framework

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ABSTRACT

Because it focuses on the moderating role of political institutions – which emphasize equilibrium policy outcomes under different institutional arrangements derived from the interaction of policy supply and demand – the political market framework provides useful insights for analyzing the determinants of state long-term debt. Thus, different types of state political institutions should affect the degree of long-term debt in terms of specific demands and supply. Despite the numerous studies that have either applied the political market approach to local governments in policy areas or have analyzed the determinants of long-term debt from only a financial management perspective, few studies have applied the political market framework to state governments. Thus, adopting a state financial management perspective and conducting a panel data analysis using state data from 1980 to 2014, this study identifies the reasons why state governments act on long-term obligations in terms of the political market framework. This study also aims to expand the application of the political market framework to state governments and to integrate determinants of state long-term indebtedness.

1. Introduction

The main purpose of this research is to identify factors that affect long-term debt management in state governments by applying a political market approach. Generally, the primary purpose of debt financing in state and local governments is to finance capital projects or public infrastructure, which are crucial to economic development (Fisher & Wassmer, 2014). That is, long-term debt is a primary policy tool for achieving economic growth. To promote economic growth, state governments must identify citizens' demands, which lead governments to provide infrastructure for economic development utilizing debt-financing strategies.

In this respect, the political market framework provides new and useful insights with which to analyze the determinants of state long-term debt. This framework's usefulness lies in its emphasis on the moderating role of political institutions, which emphasize equilibrium in policy outcomes under different institutional arrangements derived from the interaction of policy supply and demand (Feiock, Portney, Bae, & Berry, 2014). Different types of political institutions will favor different types of interests, which can enhance or reduce the ability of those interests to affect policy outcomes (Feiock, 2006; Feiock et al., 2014). Thus, it is expected that different types of state political institutions will affect the degree of long-term debt in terms of specific demands and supply.

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Most applications of the political market framework have been conducted at the local level to explain the various mechanisms of local policy in the areas of impact fees (Jeong & Feiock, 2006), policy instrument choices (Feiock, Tavares, & Lubell, 2008), climate protection and sustainability (Feiock, Kassekert, Berry, & Yi, 2009; Sharp, Daley, & Lynch, 2011), and regulation and land use (Lubell, Feiock, de la Cruz, & Ramirez, 2009; Lubell, Feiock, & Ramirez, 2005). A considerable number of studies have examined the determinants of long-term debt financing in both state and local governments (Bahl & Duncombe, 1993; Denison, Hackbart, & Moody, 2009; Hackbart & Leigland, 1990; Regens & Lauth, 1992). Previous studies have focused on public debt management, and several have focused specifically on public authorities and universities (Bunch, 1991; Moody, 2007; Trautman, 1995).

Despite the numerous studies that have either applied the political market approach to local governments in policy areas or analyzed the determinants of long-term debt from only a financial management perspective (such as by including institutional factors), few studies have applied the political market framework to state governments.

This leads us to ask: *What are the factors that affect long-term debt management in terms of the political market framework?*

Thus, this study identifies the reasons why state governments act on their long-term obligations from both the political market framework and state financial management perspectives. It also intends to expand the application of the political market framework to state governments and to integrate determinants of state long-term indebtedness.

This research explores this phenomenon through panel data analysis using state data from 1980 to 2014. The study is grounded in the political market framework and in previous literature on long-term debt obligations. We begin with an overview of determinants of state long-term debt according to the literature on the political market framework and long-term debt. We then present a discussion of the data and methods used. Finally, we present the findings and discuss both theoretical and practical implications.

2. Determinants of state long-term debt

According to the political market framework and previous studies, state debt per capita is a function of property rights, interest groups, and institutions (political and fiscal institutions), among other factors. In addition, political institutions interact with interest group factors, which can be stated as follows:

State Debt Per Capita = f (Property Rights, Interest Groups, Political Institutions, Fiscal Institutions, Political Institutions*Interest Group Factors, Other Factors)

2.1. Property rights and interest group factors

The political market framework incorporates property rights and interest group models to explain policy change (Feiock, 2006). Theories of property rights contend that institutions respond to both scarcity and changes in relative prices by utilizing dynamic contracting procedures (Alchian & Demsetz, 1972; Alston, Eggertsson, & North, 1996; Libecap, 1989; North, 1990). The political market framework conceptualizes institutional changes as the consequences of dynamic contracting processes between the suppliers and demanders of change in a society (Alston et al., 1996; Libecap, 1989; Lubell et al., 2005, 2009). The simplest form of a "political market" emphasizes the exchange between elected officials and constituents or interest groups (Feiock, 2006; Feiock et al., 2014). The political market framework emphasizes the equilibrium policy outcomes derived from the interaction of policy supply and demand under different institutional arrangements (Feiock et al., 2014).

Government officials supply specific policies to these groups in exchange for instrumental political resources, including political support from the beneficiaries of those policies (Feiock et al., 2014). Policy outcomes are determined by the relative political powers of demanders and the willingness of government authorities to supply favorable policies to diverse interests (Alston et al., 1996).

Political uncertainty (Clinger, Feiock, McCabe, & Park, 2008; Moe, 1990; Wood & Bohte, 2001) and the transaction costs of political exchange (Dixit, 1996; Horn, 1995) are crucial factors used to explain the establishment of governance structures in firms and bureaus. In the capital market, the political market yields transaction costs within long-term government bond markets and increases the risk within the capital market (Perry & Robertson, 1998); eventually, it limits the amount of long-term debt that public authorities can issue.

The property rights model provides relevant factors for analyzing state long-term debt. In the property rights model, population and population density (urbanization) represent the demands of local policies, while citizen preferences for public debt are related to several factors, including state wealth, population demographics and state-level ideology (Greer & Denison, 2016; Lubell et al., 2005, 2009). In the field of capital budgeting, competition for capital under the political economic system is highly associated with the way in which capital market investors evaluate the efficiency and effectiveness of property rights within democratic political markets (Inman, 1987; Robertson, 1998; Sobel, 1994, 1995). The political market involves citizens pursuing their preferences in the distribution public goods, and collective decisions made within political markets carry the weight of public authority (Buchanan, 1975; Gwartney & Wagner, 1988).

Population indicators have been used to identify demand for public services (Bahl & Duncombe, 1993). Generally, demand for public services is measured based on population density, which means having a higher number of people in relatively small areas (Bahl & Duncombe, 1993). In addition, the population growth rate over the past five years has been used to identify pressures on infrastructure systems (Bahl & Duncombe, 1993). Population density and population growth were revealed to have statistically significant positive relationships with the degree of long-term debt (Bahl & Duncombe, 1993). To capture differences in demand, Ellis and Schansberg (1999) studied the percentage of the population older than 65 and concluded that it was negatively related to the level of state long-term debt. In this study, the population aged between 18 and