# OVERVIEW AND ANALYSIS
# OF THE
# STATE OF HAWAII'S FINANCIAL CONDITION

A Report to the Legislature of the State of Hawaii

Submitted by the
Legislative Auditor of the State of Hawaii

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# FOREWORD

The Legislative Appropriations Act of 1981 authorized the Office of the Legislative Auditor to initiate a pilot program of budget review and analysis to assist the Legislature. This is the first of several reports which we intend to submit under that pilot program.

This initial report is an overview and analysis of the State's financial condition from the perspective of January 1982. Its purpose is to identify those factors affecting the State's financial condition and to determine whether there are any alternatives by which the State can strengthen or safeguard its condition.

The principal problem identified in our overview and analysis is the changing and volatile municipal bond market, a condition external to the State but having far reaching effects on the State's capital improvements program as well as the condition of the State's general fund.

While alternatives to deal with a problem of external origins are limited, there are some, and we identify and discuss them in this report.

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## INTRODUCTION

From the perspective of January 1982, the State of Hawaii's financial condition is seemingly strong. This is reflected by the financial indicators derived from data reported by the State administration, which include the following:

- A general fund balance of some $231.7 million at the close of fiscal year 1980–81.
- A projected general fund balance of some $175.7 million at the close of fiscal year 1981–82, even when some $90 million in income tax credits are taken into account.
- A projected general fund balance of some $87.8 million at the close of fiscal year 1982–83, even when some $21.5 million in additional general fund appropriations requested by the administration and some $61.5 million in downward tax adjustments proposed by the administration are factored into the general fund financial plan through the close of the current fiscal biennium.

However, there are other factors which do not show up on any financial balance sheet which portend difficulty for the State and which could adversely affect the State's financial condition, even over the short term of the current biennium. The most important, volatile, and potentially damaging of these factors is the condition of the municipal bond market, upon which the State is dependent as virtually its sole source to finance the capital improvements program and without which extreme pressures would be exerted against the general fund. A disrupted bond market, added to such factors as the Legislature being constitutionally required to provide for special tax credits or tax refunds in the 1982 legislative session and the virtual certainty that it must do so again in the 1983 session, the full effects of federal funding cutbacks when these become known, and the tentativeness of revenue estimates under not the best and most stable of economic conditions–all these factors suggest that the State's seemingly favorable financial condition should be viewed with a good deal of caution.

The purpose of this overview and analysis is to identify the major factors affecting state finances and to suggest alternatives if they have the potential of safeguarding or strengthening the State's financial condition during an immediate short-term period of considerable uncertainty.

## SUMMARY OF FINDINGS

Generally, our analysis points to the following:

1. Interest rate trends in the municipal bond market have cut off the State from access to long term borrowing over the immediate, short term, and access to the market can be regained only if the Legislature lifts or removes the interest rate ceiling on general obligation borrowing.

2. Financial commitments for capital improvements have been partially met through a heavy infusion of temporary loans from the general fund, and the condition of the general fund would be jeopardized if bond resources are not available to reimburse the general fund.

3. Against the contingency that the long term interest rates of the municipal bond market will remain at relatively high levels, other financing alternatives for capital improvements should be considered, including general obligation bond anticipation notes and shortening the period of the State's option to call or redeem bonds prior to their maturities. The State may also have to consider tailoring its bond offerings to meet changing investor preferences in the bond market.

4. While the State's financial condition is still relatively good, a prudent course would be to set aside and reserve some resources from the general fund to meet the eventuality of needs and emergencies, the full dimensions of which are not known at the present time.

We expand on the foregoing findings in the remainder of this overview and analysis.

## THE CHANGING MUNICIPAL BOND MARKET

For decades, the municipal bond market was a safe haven for certain types of investors: mainly commercial banks and casualty insurance companies purchasing state and local government securities as part of their investment portfolios and individual investors in high tax brackets sheltering their interest income from federal taxation and, in most cases, state taxation. The most distinguishing characteristic of municipal bonds–i.e., state and local government securities–is their tax-exempt status. The most distinguishing characteristic of *general obligation bonds,* the strongest category of municipal bonds, is that the issuing jurisdictions pledge their full faith and credit, supported by their entire taxing powers, to pay the principal and interest on the bonds that are issued. As a form of investment, general obligation bonds have had the appeal of both tax-exempt income and virtually ironclad safety.

**Interest rate trends.** The State of Hawaii has relied on the issuance of general obligation bonds to finance a major portion of its capital improvements program. The level of CIP implementation is predicated on the State being able to issue $150 million in general obligation debt annually, and until recently, it has been able to do so, and at relatively cheap rates. In the 1960s and in the early 1970s, interest rates of four or five percent were commonly obtained by the State on its general obligation issues, and even in the second half of the 1970s, when tax-exempt interest rates began to trend somewhat higher, the State was still able to issue its bonds at average interest rates below six percent. The stability of the interest rates the State was paying paralleled the stability of bond yields in the municipal bond market generally, as reflected in Table 1, which shows the average annual yields of the *Bond Buyer's Index* of 20 municipal bonds from 1968 to 1980.

Beginning in the first quarter of calendar year 1980, bond yields began to take an ominous turn from the standpoint of state and local government issuers. The year opened just as the previous year ended with yields hovering around 7.30 percent in January 1980, but then moving dramatically to over 9 percent in March and April. While yields declined in May and June, it again moved upward during the rest of 1980, hitting a high of 10.56 percent in the middle of December and closing the final week of 1980 at 9.76 percent. This type of movement was unprecedented in the municipal bond market and reflected the dramatic increase in interest rates in virtually every other financial market. The most basic explanation is that supply exceeded demand and investor confidence in long term investments was being undermined by inflation and a faltering economy.

As can be seen from Table 2, which shows monthly bond yield averages from January 1981 to the first two weeks of January 1982, the upward trend of 1980 has accelerated rather than declined, with yields moving from 9.66 percent to 13.40 percent in little over a year. By the fall of 1981, commercial banks and casualty insurance companies, which had been over the years two of the biggest investors in municipal bonds, had virtually pulled out of the market in investing in new long-term issues.

Other factors further weakened a disrupted and saturated market. Among the federal income tax changes made by the Congress in 1981 was the reduction of the top tax rate on investment income from 70 percent to 50 percent, and this has had the effect of shrinking the market for tax-exempt investments as a form of tax shelter. The All Savers certificates which became available on October 1, 1981, with its provision for tax-exempt interest, also operated

Table 1

Bond Yields (20—Bond Index)
Annual Average
1968—1980

| *Year* | *Percent* |
|---|---|
| 1968 | 4.44 |
| 1969 | 5.70 |
| 1970 | 6.35 |
| 1971 | 5.48 |
| 1972 | 5.26 |
| 1973 | 5.20 |
| 1974 | 6.17 |
| 1975 | 7.06 |
| 1976 | 6.62 |
| 1977 | 5.68 |
| 1978 | 6.03 |
| 1979 | 6.52 |
| 1980 | 8.57 |

Source: Derived from *Bond Buyer's Index of 20 Municipal Bonds*, January 1968 to December 1980.

Table 2

Bond Yields (20—Bond Index)
Monthly Average
January 1981—January 1982

| *Year/Month* | *Percent* |
|---|---|
| *1981* | |
| January | 9.66 |
| February | 10.10 |
| March | 10.16 |
| April | 10.62 |
| May | 10.78 |
| June | 10.67 |
| July | 11.14 |
| August | 12.26 |
| September | 12.92 |
| October | 12.83 |
| November | 11.89 |
| December | 12.92 |
| *1982* | |
| January | 13.40 |

Source: Derived from *Bond Buyer's Index of 20 Municipal Bonds*, January 8, 1981 to January 14, 1982; January 1982 yield based on January 7 and January 14 weekly compilations.

adversely against the municipal bond market, the effect being to lure smaller investors out of the market into attractive one-year investments. The expansion of independent retirement accounts (IRAs), with its provisions for reducing taxable income and deferring interest income, was still another blow at the tax-exempt market.

**The immediate outlook.** With bond yields and interest rates continuing to advance higher, the immediate outlook for a stabilized or more normal municipal bond market is not at all promising. Moreover, there are signs that long-term borrowing conditions in the tax-exempt market might become even more difficult.

Because many state and local government issuers were crowded out of the market in 1981, either as a result of statutory interest rate ceilings, the unwillingness to pay the soaring interest costs the market was demanding, or the inability to attract bids or negotiate sales on their offerings, there is a pent-up need for funds and a backlog of bond issues in the borrowing market. Competition for available tax-exempt investment funds in the national market is likely to be intense, one estimate being that some $47 billion in new bond issues will hit the market this year, 12.5 percent more than in 1981.[1]

The early 1982 bond survey reports of Moody's, the major national bond rating service, indicate that for long-term municipal bonds, the upward interest rate spiral is continuing and that by the middle of January, Moody's own composite municipal bond yield average had registered an all-time high of 13.25 percent. This rate had forced Louisiana and Dallas County, Texas to postpone a total of $167 million in bond sales. Still, Moody's financing calendar showed that as of January 18, a total of 161 municipal bond issues were due to be marketed in the ensuing six weeks in the aggregate amount of $2.6 billion, an indication that many jurisdictions are willing to—or are being compelled to—enter the market, even with interest rates at record highs.[2]

In the meanwhile, commercial banks and casualty insurance companies are still shying away from the market, leaving individual investors and tax-exempt mutual funds as the only major potential absorbers of new issues. Some state and local government agencies are beginning to shorten the maturities of their new issues in the expectation that the long-term market will continue to be weak. Among municipal bond analysts willing to guess about a volatile market, the more prevailing opinion appears to be that bond yields will remain high—good for investors but bad news for state and local governments.

## THE STATE'S PROBLEM DEFINED

In this section, we analyze how the condition of the municipal bond market and other factors affect the State's financial condition.

**A disrupted borrowing plan.** For the past several years and for several years into the future, the state administration's normal borrowing plan was to issue $150 million in general obligation bonds each year, usually in two issues of $75 million each. The $150 million in new

1. *Business Week,* January 25, 1982, p. 95.

2. *Moody's Bond Survey,* January 18, 1982.

general obligation issues each year is an amount which state finance officials have understood the municipal bond market could absorb without adversely affecting the State's credit rating.[3] However, the normal borrowing plan was interrupted in fiscal year 1980–81 when no general obligation bonds were issued during the entire year.

The State's last issue prior to fiscal year 1980–81 was a $75 million issue in June 1980. Normally, the underwriters expect a reasonable period of time to elapse for the purpose of market protection of the new issue, enabling inventories to be cleared without being impaired by a subsequent issue. The State could possibly have gone to market with another issue in the fall of 1980, but by then, interest rates had begun to swing dramatically upward. In January 1981, bond yields had already exceeded the State's statutory interest rate ceiling of 9.5 percent, and the State was to be effectively locked out of the municipal bond market for the rest of the year.

In the Special Session of 1981, the Legislature did lift the interest rate ceiling to 12 percent, on a temporary basis until March 31, 1982. Consequently, the State was able to market a $75 million issue in August (Series AR, August 1, 1981) at interest rates of 11.50, 11.60, 11.70, 11.80 and 12.00 percent against the various maturities. It was also able to market another $75 million issue later in the year (Series AS, November 1, 1981) but this time at exactly 12 percent for all maturities. State finance officials had hoped to be able to partially catch up with its disrupted 1980–81 borrowing plan by marketing another $75 million issue in February 1982. However, with bond market interest rates where they are in relationship to the State's interest rate ceiling, the State cannot now enter the market, and it is doubtful that it will be able to do so over the short term unless the statutory ceiling is increased or removed. If no action is taken, the temporary ceiling of 12 percent, which bond market trends indicate has already been exceeded, will expire on March 31, 1982, and the statutory ceiling of 9.5 percent will be the governing ceiling.

Therefore, it is evident that one of the more urgent legislative decisions that needs to be made is whether the temporary ceiling should be extended and raised to some higher level or whether the statutory ceiling itself should be lifted or removed. How that decision turns would greatly affect not only the implementation of the capital improvements program but also, as we review in the ensuing section, the condition of the general fund.

3. Minutes of the Committee on Taxation and Finance, 1978 Constitutional Convention, July 14, 1978, p. 23.

**Pressures on the general fund.** Whenever the State markets a new issue of general obligation bonds—e.g., $75 million as has been the normal amount of an issue in recent years—this does not necessarily mean that the State has an additional $75 million in resources to pay for a new round of capital improvement projects. More often, the proceeds from the new issue are used to reimburse the general fund for temporary loans the general fund has made to meet capital investment expenditures. Seldom has the State been able to synchronize its bond issues, in either amounts or frequencies, so as to enable bond proceeds to pay for capital investment expenditures directly. Therefore, it has long been the practice of the State to advance temporary loans from the general fund to pay for capital expenditures and then to reimburse the general fund at some later time from the proceeds of bond issues.

Whatever the wisdom of this practice,[4] it is possible to engage in this practice only if two conditions exist: *first,* there needs to be a sufficient amount of idle cash—i.e., cash which is in excess of immediate operating needs—in the general fund to enable temporary loans to be made; and *second,* the proceeds from the bond issue will be available for timely reimbursement to the general fund so that general fund obligations can be met without impairing the condition of the general fund. In those years when the State has realized surpluses in the general fund and when a stable bond market has enabled the State to market its issues pretty much in accordance with its borrowing plan, the foregoing conditions were met, and the result has been that the financial condition of the State has not been impaired, from the standpoint that the practice has not prevented the State from meeting its general fund obligations.

However, with the disruption of the State's borrowing plan—no bonds having been sold in fiscal year 1980–81 and the unlikely prospect of bonds being sold over the immediate, short term—the practice of making temporary loans from the general fund for the interim financing of capital improvements could place the general fund in difficulty.

During fiscal year 1980–81, when no general obligation bonds were issued, the capital improvements program was able to continue and capital expenditure commitments were able to be met only through large loans from the general fund. Some $124 million was borrowed in fiscal year 1980–81 from the general fund to keep the capital improvements program going, and that entire amount was still outstanding as an amount to be repaid to the general fund at the close of the fiscal year.

4. This practice of borrowing from the general fund to meet capital expenditures is examined in a forthcoming report of selected aspects of the general obligation bond fund.

In the first half of the current fiscal year, the State has been able to acquire $150 million in new general obligation resources. In the meanwhile, however, since the beginning of the current fiscal year, the State has incurred additional capital improvement obligations and made additional capital expenditure payments. Thus, while $148.5 million has since been repaid to the general fund from the two $75 million issues marketed since the first of the fiscal year, an additional $53.5 million still had to be borrowed from the general fund through December 31, 1981, and on that date, $29 million was still owed to the general fund.

The present situation, then, is that with capital investment expenditures continuing to be made and additional obligations continuing to be incurred and with no prospects of replenishment of funds over the near term through bond resources, there will be increased pressures on the general fund to meet CIP financial commitments.

If the situation continues for a brief period, the general fund's condition is such that it can probably withstand the pressures of having to make additional temporary loans. However, if the situation continues for any substantial length of time, there is the danger that the general fund could be in difficulty if not in jeopardy.

Thus, if no bond resources are acquired during the second half of the current fiscal year and if the capital expenditures required from current encumbrances and additional commitments take their normal course, possibly another $75 million in temporary loans might be required from the general fund before the end of the fiscal year. Added to the $29 million already owed at December 31, 1981, there could be a general fund squeeze of over $100 million by June 30, 1982. Given the uncertainties of cash flows, that would be an ominous condition.

**Revenues and expenditures.** The latest estimates of general fund tax revenues, which were submitted by the Council of Revenues on January 11, 1982, indicate that general fund tax revenues for the current fiscal year will be 2.9 percent less than what they were in fiscal year 1980–81.[5] The primary reason for the decline is the decrease in income tax revenues in the current fiscal year as a result of the Legislature having provided for special tax credits in meeting the constitutional requirement for disposition of excess revenues. These tax credits have been estimated to amount to $90 million,[6] which will be credited or paid

5. Letter, Wesley H. Hillendahl, Chairman Council of Revenues to Governor George R. Ariyoshi, January 11, 1982, Figure 1a.

6. Official Statement, State of Hawaii, *General Obligation Bonds of 1981, Series AS,* November 1, 1981, p. 14.

in connection with the filing of State individual income tax returns for calendar year 1981. Other decreases are the result of 1981 legislation affecting the excise tax, including the shift from the general fund to the highway fund of some $17.3 million in excise tax collections from highway fuel sales.

While the estimates of the Council on Revenues indicate that general fund tax revenues will increase by 17.9 percent in fiscal year 1982–83 over the current, extraordinarily low year, the estimates are likely to be affected once again by the constitutional requirement to provide for special tax refunds or tax credits. Article VII, Section 6, of the State Constitution states:

> "Whenever the state general balance at the close of each of two successive fiscal years exceeds five percent of general fund revenues for each of the two fiscal years, the legislature in the next regular session shall provide for a tax refund or tax credit to the taxpayers of the State, as provided by law."

The state general fund balance exceeded five percent of general fund revenues at the close of fiscal year 1979–80 and again at the close of fiscal year 1980–81. Against this condition, a literal reading of the constitutional provision governing disposition of excess revenues would appear to indicate that in the 1982 Regular Session, the Legislature will be required to provide for tax refunds or tax credits to taxpayers. Moreover, the general fund balance at the close of fiscal year 1981–82, projected by the administration to be $175.7 million, would also exceed five percent of general fund revenues.[7] Thus, the Legislature may again be faced with the consitutional requirement for tax refunds or tax credits in the 1983 Regular Session. The consequence of implementing the constitutional requirement is that there may be substantially less general fund revenues than are currently projected through the close of the current fiscal biennium and into fiscal year 1983–84.

On the expenditure side, debt service costs are almost certain to be driven up, if the State chooses to regain access to the bond market and borrows in the amounts that it has borrowed in recent years. When debt service was estimated for the current biennium, the administration had assumed that interest rates on its borrowings during the biennium would be at 7.50 percent and 8.00 percent.[8] While these interest rate assumptions may have been reasonable at the time they were made, they have since fallen by the wayside.

7. State of Hawaii, *The Executive Budget Supplemental* (Budget Period: 1981–83), Volume I, December 1981, p. 79.

8. State of Hawaii, *The Multi-Year Program and Financial Plan and Executive Budget for the Period 1981–87, Budget Period: 1981–83,* Volume I, December 1980, p. 83.

Future interest costs loom large. On a $75 million issue, a 1 percent increase in the interest rate means an increase of $8.6 million in interest payment over the life of the bonds under current maturity structures. Illustrated in another way, the State's total interest payment requirements on its $75 million issue of June 1, 1980, the last issue sold in a more or less normal market with interest coupons ranging from 6.30 percent to 7.10 percent, amounted to some $57 million. This amount is to be compared with the $103.5 million in interest payments which the State will be required to make on the same amount of bonds over the same life of the bonds on its latest issue when the interest rate was 12 percent. Thus, from one issue to another identical issue, interest rate changes alone have increased State interest payment requirements by a staggering $46.5 million.

Finally, also on the expenditure side, an ominous but uncertain factor at the present time is the sharpness of federal cutbacks and their effects on levels of state expenditures. Until the President presents and the Congress acts on the 1983 budget and final action is taken on the 1982 budget, the full effects of cutbacks will not be known, making it all the more difficult for the Legislature to devise a strategy to deal with the problem within the context of the State's financial condition.

**Summary of the problem.** From the foregoing, the overall financial problem faced by the State can be summarized as one of the State facing potential difficulty as a result of: unfavorable bond market conditions disrupting the State's borrowing market and cutting off the State's access to the market over the immediate, near term; temporary loans to continue the capital improvements program having the effect of putting pressures on the general fund, pressures which pose real dangers if the situation persists over a substantial period of time; and the possibility that the State will be faced with the exacerbating effects of lower revenues and higher expenditures.

## ALTERNATIVES

The origins of the problem affecting the State's financial condition being external and outside of State control, the alternatives to deal with the problem are limited. Still, there are some that should be considered, and in this section, we review those alternatives.

**Options in a high interest rate market.** The two basic conventional ways of dealing with high interest rates in a long-term borrowing market are to: (1) issue "callable" bonds, i.e., bonds which can be redeemed prior to their maturity at the option of the issuer; and (2) issue short-term notes and refund the notes with long-term bonds when interest rates are more favorable. There is statutory authority for both approaches.

As to the first approach, the State has, in fact, been issuing "callable" bonds for some time. The basic purpose of having a "call" feature is to provide a means whereby the State can, if market conditions improve, redeem the bonds which might have been issued at high interest rates and replace them with bonds at lower interest rates. It is generally understood that when bonds have a "call" or prior redemption option reserved to the issuer, interest rates are likely to be slightly higher than if the bonds were non-callable. In addition, a premium is usually paid by the issuer for the privilege of exercising the calling of outstanding bonds. Still, particularly in very high interest rate periods like the present, the conventional wisdom is to include the "call" feature.

Bonds which have been issued by the State, including its recent issues, cannot be called until after ten years. Commonly among other jurisdictions, on bonds previously issued, the "call" option cannot be exercised until after ten or fifteen years. More recently, some municipal bond issuers have begun to explore with the market the possibility of shortening the "call," i.e., enabling the "call" option to be exercised within a shorter period of time after issuance, e.g., five years. This would provide greater protection to the issuer against being saddled with high interest payments over a long period of time should interest rates take a downward turn in the next few years. The Senate Committee on Ways and Means of the Commonwealth of Massachusetts, which has studied this problem, recommends the issuance of future debt with a five-year "call" provision and believes that after initial objections from underwriters are overcome, such a practice "will only increase issuance costs by a handful of basis points."[9] Because of the potential advantage, it would be advisable for the State to explore with potential underwriters whether there would be market acceptance of State issues with a shorter call provision and to insert a shorter call in future issues if it is found feasible to do so.

As to the second option, that of issuing short-term notes, Section 39–2.1, HRS, authorizes the Director of Finance, with the approval of the Governor to issue general obligation bond anticipation notes for which bonds have been authorized by the Legislature. The bond anticipation notes can be for a period up to five years. The underlying assumption for the issuance of such notes is that interest rates will be more favorable sometime in the near horizon whereupon long-term refunding bonds would then be issued. While it is an option which the State might have to exercise if the long-term borrowing market continues to deteriorate, it is also an option with a substantial risk. If the underlying assumption turns

9. Senate Committee on Ways and Means, Massachusetts, Policy Report No. 1, *Debt Policy of the Commonwealth*, June 1981, p. 5–14. One basis point is 1/100 of one percent.

out to be incorrect and interest rates are higher when the notes are due, refunding would then be even more costly. Notwithstanding this risk, the State should consider this option if other approaches are not available or appear to be even more disadvantageous.

**Tailoring bonds to meet investor preferences.** In order to gain greater market acceptance for their securities, a number of jurisdictions are tailoring their offerings to meet investor preferences or to attract investors who would otherwise be disinterested. The greatest change has been the shift to issues with shorter maturities. The State's practice has been to issue bonds which are retired in substantially equal installments of principal beginning in the third year and annually thereafter up to the twentieth year. The most immediate effect of shorter maturities would be an increase in annual debt service charges. Other jurisdictions are going to market with a "put" option, i.e., providing the investor with the option to "put" or sell the bond back to the issuer prior to maturity at a specified price.

These new kinds of offerings, designed to lure investors, are weighted in favor of investors. But the lengths to which new issuers are willing to go in order to attract investors tell a lot about competition in the bond market. Despite the disadvantages of such features as bonds with shorter maturities or the "put" option, the State, even as it strives to offer bonds which are to its best advantage, might well have to consider tailoring its bonds and incorporating features to attract investors.

**Funds to meet contingencies.** While the State's financial condition is still relatively good from the standpoint of a projected fund balance at the close of fiscal year 1982–83, the Legislature may wish to set aside a portion of the unappropriated general fund balance at the close of each year to meet contingencies or emergencies not now foreseen or fully revealed. The common parlance for setting aside such revenues is a "rainy day" fund.

The State of Michigan established a Budget and Economic Stabilization Fund in 1977 for the purpose of reducing the severity of peaks and valleys in state revenues and to provide the capability for the state to take countercyclical action during periods of high unemployment. While the economic problems of Michigan, with massive unemployment in the auto industry, are probably too severe for any particular state fund to resolve, the concept of setting aside funds to meet emergencies or for the purpose of budget stabilization has attracted some attention.[10]

10. The Council of State Governments, *Innovations,* Michigan's Budget and Economic Stabilization Fund, 1979.

If the State cannot have access to the long-term borrowing market, the funding of the most urgent and critical CIP projects might be one purpose for which an emergency or budget stabilization fund could be used. If such a fund is established, its applications could be specified by law, along with its prohibitions.

## CONCLUDING COMMENT

In our overview and analysis of the State's financial condition, we have focused on a disrupted municipal bond market and its far reaching effects on both the State's capital improvements program and the condition of the general fund. We believe that the State administration is currently doing the best that it can under very difficult circumstances, but it cannot for long continue on the present course of borrowing heavily from the general fund to pay for capital expenditures. What is now needed is an early legislative policy decision as to whether the State should attempt to re-enter the bond market, even at a time when interest rates are at record highs. What is also now needed is contingency planning to meet the changing conditions and requirements of the borrowing market and to safeguard state revenues so that the State has the capability to respond to the bad times which may be ahead.