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State Balanced-Budget and Debt Rules

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The recent debate over increasing the federal debt limit included the following argument, summarized earlier by U.S. Senator John Cornyn: "[S]tates already have some form of a balanced budget amendment in their state constitutions, and we can draw from the experience of the states in drafting an amendment appropriate for the federal government."[1] The implicit assumption in this argument is that state balanced-budget requirements yield sound fiscal health. Such requirements, however, do not necessarily translate into balanced budgets or provide for the long-term fiscal health of state governments.[2]

Balanced-budget rules alone are not sufficient to ensure states' long-term fiscal health.

State balanced-budget requirements (either constitutional or statutory) in general apply only to operating budgets, which include government employee salaries, aid to local governments, and health and welfare benefits.[3] The operating budget represents roughly 50 to 60 percent of total state spending; the remaining spending is allocated to capital budgets (e.g., for highway and building construction). In 2008, 44 states required their governor to submit a balanced budget to their state legislature; 41 states required their state legislature to pass a balanced budget; and 37 states required their governor to sign a balanced budget. In 2008, only two states did not have at least one of these requirements: Indiana and Vermont. The noted requirements, however, apply to the *passage* of state operating budgets only; they do not ensure that states have a balanced operating budget at the end of the fiscal year. In 2008, only seven states were legally allowed to carry a deficit into the next fiscal year. The 43 states that did not allow such a carryover will not necessarily avoid fiscal problems, however. While these states can adjust their revenues and expenditures before the end of the fiscal year, they can also issue bonds and use the revenue from this sale of debt to fund the shortfall.[4]

State policies that limit the issuance of government debt to cover operating-budget shortfalls and finance capital projects—and not balanced-budget requirements—are more important for ensuring states' long-term fiscal health. Some states do limit the amount of issuable debt. For example, Kentucky has a $500,000 statutory limit for general obligation bonds (not tied to a particular revenue source); New Hampshire's statutory limit is 10 percent of its general fund revenue. Many states, however, either have no statutory limit or can issue an unlimited amount of debt with legislative approval. Such states can increase deficit spending and debt issuance for capital projects year after year. In the end, these states will likely face budget crises similar to those in California and Illinois today: They will become unable to pay their bond obligations, exhaust their revenue sources (some of which pay bond obligations), and either have to make drastic and politically unpopular cuts in expenditures or increase taxes.

Although useful, balanced-budget rules alone are not sufficient to ensure states' long-term fiscal health. State governments must also limit borrowing used to alleviate operating-budget deficits and finance capital projects. States with no statutory debt limit, or with a limit easily surpassed by legislative action, have less of an incentive to halt deficit spending and debt issuance. This is true at the national level as well. ■

[1] See Cornyn, John. "Wisdom of a Balanced Budget Amendment." *Dallas Morning News*, December 1, 2010; www.dallasnews.com/opinion/latest-columns/20101201-john-cornyn-wisdom-of-a-balanced-budget-amendment.ece. This article incorrectly notes that all states have a constitutional provision for a balanced budget; in some states, the provision is statutory and not constitutional.

[2] Here "fiscal health" simply refers to the lack of budget crises or generally balanced budgets year after year.

[3] All data are from *2008 Budget Processes in the States*, National Association of State Budget Officers, Tables 11 and 12; http://nasbo.org/Publications/BudgetProcessintheStates/BudgetProcessesintheStatesArchives/tabid/108/Default.aspx.

[4] Other options states could use to eliminate operating-budget deficits include tapping rainy day funds, selling state assets, delaying payments to vendors, and reducing pension fund payments.

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