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Budget Battles Drag On in Two Northeast States.

Connecticut and Pennsylvania have seen ratings downgrades and state aid cuts amid stalemates

Connecticut and Pennsylvania lawmakers are still struggling to reach agreements to cover multibillion-dollar budget gaps, and the consequences from the stalemates are adding up.

Nearly three months into their new fiscal calendars, they are the last two states without finalized budget plans. The delay has cost Pennsylvania a ratings downgrade and temporarily stalled payments to Medicaid providers and school districts, while Connecticut cities are facing major cuts in state aid.

“Now the squeeze is happening,” said John Hicks, executive director at the National Association of State Budget Officers.

If Connecticut can’t pass a solution by Sunday, a wave of nearly $1 billion in reductions to municipalities will move forward under the terms of an executive order signed by Gov. Dannel Malloy, a Democrat, to keep state operations running. That could prove damaging for Hartford, the state capital, which had its credit rating downgraded this week. City officials have warned Hartford could file for bankruptcy by early November without more state assistance.

Connecticut and Pennsylvania are required by state laws to pass balanced budgets. Their stalemates follow a bruising year for budget fights around the U.S. Negotiations came down to the wire in many states this summer—the fiscal year starts July 1 almost everywhere—and New Jersey and Maine partially shut down their governments when lawmakers couldn’t reach accords in time.

Fiscal challenges differ from state to state, although persistently weak revenue has been a broad challenge in recent years. Pennsylvania faces near-term funding challenges because lawmakers passed a spending plan before shoring up how to pay for it. Lawmakers are now fighting over how to plug the gap.

Connecticut, meanwhile, faces stark longer-term fiscal challenges, according to Moody’s Investors Service . Income-tax hikes in the state in 2011 and 2015 haven’t stabilized its finances. The state is burdened with a heavy debt load, hefty unfunded pension liabilities and a shrinking population. These factors have contributed to a $3.5 billion projected deficit in its two-year budget.

With funding for infrastructure, schools and public safety all at stake, towns around the state are worried, said Elizabeth Gara, executive director of the Connecticut Council of Small Towns.

Schools in Groton, Conn., a community on the Thames River, could lose funding for roughly a quarter of the school budget, according to Keith Hedrick, the city’s mayor.

S&P Global Ratings placed nine Connecticut municipalities on negative credit watch Thursday, including New Haven, Bridgeport and New London. The rating agency cited the state’s budget impasse and the possibility of big cuts to municipal aid beginning Sunday.

“I worry about the impact to residents,” Mr. Hedrick said. “Depending on the size of the cut, we are going to have cut education or raise taxes or both.”

A spokesman for Mr. Malloy said the executive order can only provide money for cities and towns based on the state’s current revenue projections.

“The solution is to pass a balanced budget as soon as possible,” he said.

To plug the hole, Mr. Malloy has called for shifting some teacher pension payments to cities and towns, which has been opposed by municipalities across the state. Labor unions have pushed for higher taxes on corporations.

Republican legislators won a surprising victory in early September when they netted enough Democratic votes to pass a GOP budget. That plan includes higher retirement contributions from teachers and steep cuts to the University of Connecticut, the state’s higher education flagship.

Mr. Malloy vetoed the plan Thursday, saying the GOP budget was unbalanced and unsustainable.

“I remain committed to engaging in honest dialogue with legislative leaders to reach an agreement,” Mr. Malloy said.

Democratic and Republican lawmakers said Thursday that a budget deal before Oct. 1 was unlikely and now aimed to reach an agreement by mid-October. Absent an agreement, Republicans said they would seek to override the governor’s veto on Oct. 10.

Meantime, lawmakers in Pennsylvania managed to pass a $32 billion spending plan on June 30, but not a revenue plan that will fill a $2.2 billion gap, much of which was caused by weak revenue in the last fiscal year. This caused “a virtually immediate liquidity shortfall that the state is already scrambling to cover,” according to Moody’s.

Gov. Tom Wolf, a Democrat, instructed the state treasury earlier this month to delay about $1.7 billion in payments pegged mostly for Medicaid providers and school districts.

The state soon caught up and made the payments, but weak liquidity and the chance for more delays contributed to an S&P downgrade last week.

“The downgrade largely reflects the commonwealth’s chronic structural imbalance dating back nearly a decade, a history of late budget adoption, and our opinion that this pattern could continue,” S&P analyst Carol Spain said.

The state treasurer and auditor general, also Democrats, warned lawmakers in a recent letter that they were “disinclined” to support more lending to a general fund if the state can’t balance revenues and costs.

Pennsylvania’s current budget fight hasn’t yet trickled down in a way that affects average citizens, said Dan Seymour, a Moody’s analyst. This differs from a nine-month impasse, following the end of a fiscal year in mid-2015, which hurt state funding to social-service agencies that help seniors and students.

Gov. Wolf supported a plan in the GOP-controlled state Senate that would raise taxes by roughly $550 million to $600 million, but the GOP-controlled House has turned that plan down. A spokesman for the governor said he continues to work with lawmakers to resolve the stalemate.

The Senate, meantime, has spurned a state House plan that would rely more on money shifted from other state funds. “We do not believe that taxes should be the first option, it should be the last option,” a spokesman for the House GOP said.

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