

# **Bond Case Briefs**

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## **Late State Budgets: Summer Cliffhangers No One Wants to See.**

The arrival of June means that 46 states are now in their final month of fiscal 2015. Although a majority of them still have not finalized their budgets for fiscal 2016, Standard & Poor's Ratings Services expects that most will do so before month-end. A handful of states, however, continue to grapple with large projected budget gaps or still have major policy issues to resolve. This doesn't necessarily mean these states won't have budgets in hand by the start of the new fiscal year. But the significance of what remains unresolved does raise the specter that in at least a few of them, budget adoption could be late.

When states have difficulty reaching agreement on final budgets, it's usually because they face large projected budget deficits and lawmakers are stymied over how to close them. Negotiations are especially prone to go into stalemate in states with divided government, where opposing political parties control different legislative houses or branches of government. The lead-up to fiscal 2016 is no exception, although in our view, the projected shortfalls this time are rooted in public policy differences more than economic weakness. Divergent preferences among lawmakers on major public policy matters, such as whether to expand Medicaid or how to revamp their state's tax structure, have resulted in protracted negotiations in some legislatures. Given the importance of these issues, the stakes are high, which in our view sometimes warrants allowing the discussion to play out. And as long as debt payments are not impaired in the process, states are not always worse off for the wait.

Most of the time, however, the failure of a state to enact its budget prior to the start of the fiscal year amounts to a breaking down of the fiscal policymaking process. And while an extended legislative session can sometimes result in substantive policy reforms being undertaken, it also can be a time when states resort to the use of budgetary gimmicks. The latter usually undermine, not support, a state's structural fiscal alignment. In the extreme, late budgets or a heavy reliance on budgetary gimmicks represent a legislature's abdication of one of its most basic functions. Few activities are as fundamental to governance as that of enacting the annual (or biannual) plan for allocating a state's financial resources to its various needs. And yet, while late budget enactment is rarely a good sign, it's not necessarily an immediate threat to credit quality either.

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