# [Fitch: State Ballot Initiatives May Affect Budgets Over Time]

Fitch Ratings-New York-16 November 2022: Recently passed state ballot initiatives and political leadership changes following the mid-term elections may lead to budget decisions or shifts in fiscal direction that could have credit implications in the medium- to long-term, Fitch Ratings says.

While the power balance in most states remains the same, there were four states, Maryland, Massachusetts, Michigan, and Minnesota, where the Democrats gained control of the executive and legislative branches and may now appear to have a mandate to enact party priorities. Single party control can also lead to more predictable and orderly fiscal decision-making as evidenced in states such as Illinois. Fitch anticipates states will generally maintain a focus on long-term structural balance, even as they implement new policy initiatives. Where policymakers fail to prioritize balance, new initiatives could add to credit pressures.

Most states have broad budgetary authority, which is a core credit strength. Some ballot initiatives that passed restrict states' fiscal powers by lowering taxes or limiting how funds may be spent. While these initiatives will not affect ratings in the near-term, greater limits on state governments' ability to respond to changing circumstances could negatively affect credit quality over time.

Prop 28 in California and Prop 123 in Colorado are examples of ballot initiatives that would put constraints on state spending decisions by directing a portion of existing revenue to specific purposes. California's Prop 28 allocates general fund money to arts and music education in public schools, while Colorado's Prop 123 commits 0.10% of existing income tax revenues to housing programs. Neither of these initiatives will materially shift Fitch's assessment of these states' fiscal flexibility, but are indicative of the broader trend toward the use of the voter initiative process to restrict states' budget powers.

Another example is Colorado's Prop 121, which reduces the state income tax to 4.4% from 4.5%. The state's legislative council staff expects the law to lead to a general fund decrease of $638 million in fiscal 2023 and $413 million in fiscal 2024.

Another successful and notable ballot initiative was Massachusetts' Question 1, which raises new revenue by levying a 4% surtax on incomes above $1 million with a constitutional amendment. The surtax does not have immediate credit implications, but could generate an estimated $1.2 billion, or approximately 2.4% of the current state budget according to the commonwealth's official voter guide. The amendment specifies that surtax revenues must be used for public education (K-12 and higher education) and transportation (roads, bridges and public transit). Fitch considers the new revenues will provide Massachusetts with additional fiscal flexibility, as these designated uses are typically amongst the largest components of the commonwealth's budget. The income limit for the commonwealth's new levy will adjust annually for inflation, unlike some 'millionaires' taxes' in other states. Taxes levied on high income earners tend to exhibit more revenue volatility.

South Carolina increased its General Reserve Fund to 7% from 5% and the Capital Reserve Fund to 3% from 2%, which will provide the state with greater cushion during a recession. Fitch views this as credit supportive.

Oregon voters passed Measure 111, which obligates the state to provide all residents with cost-effective, clinically appropriate and affordable health care. The measure is notable in its broadness and potential fiscal implications. Legislators referred the question to voters on a largely party-line basis with nearly all Democrats in favor and all Republicans against. Fitch considers the amendment somewhat akin to the requirements in many state constitutions (including Oregon’s) for public education. Importantly, the proposed amendment does not confer unlimited resources but requires that implementation of a right to healthcare “must be balanced against the public interest in funding public schools and other essential public services”.

Contacts:

Eric Kim
Senior Director, US Public Finance
Head of US State Ratings
+1 212 908-0241
Fitch Ratings, Inc.
Hearst Tower
300 W. 57th Street
New York, NY 10019

Sarah Repucci
Senior Director, Fitch Wire
Credit Policy – Research
+1 212 908-0726

Media Relations: Sandro Scenga, New York, Tel: +1 212 908 0278, Email: sandro.scenga@thefitchgroup.com

The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.