Why Can’t Some States Balance Their Budgets?

With the recovery slowly taking hold, now is a natural time for state and local governments to begin getting serious about shoring up their battered finances. The 50 states face varying degrees of fiscal difficulty. A few of them managed to come through the Great Recession without incurring budget shortfalls, but many have piled up more debt on budgets that were already groaning under the weight of chronically underfunded pensions.

What accounts for these differences among states, and why will some have a harder time getting their affairs in order than others? In many, limited budget tools hamper lawmakers. In others, the reasons have been institutionalized into their constitutions and policies. In some states, a polarized political climate bedevils budget reforms. In various combinations, these forces may hamstring policymakers who could otherwise respond quickly and efficiently. At the same time, some states seem to keep their finances in balance smoothly and consistently.

Against that backdrop, we present a primer on how these different forces may combine to affect policymakers’ ability to respond to a fiscal crisis — and why some states may weather fiscal storms better than others.

**Force no. 1: Budget tools**

Many states keep rainy day funds to offset unexpected budget deficits. These funds vary in size, but most states set aside about 5 percent of annual expenditures, an amount that is often insufficient to address a serious crisis. Several states have adopted restrictions to prevent frivolous spending, such as requiring a supermajority vote (more than 50 percent) to release funds; limiting the amounts that can be disbursed at one time; or imposing unrealistic requirements for replenishing the fund. A rainy day fund may sound like a good idea, but the restrictions just mentioned can delay or even prevent tapping the fund when it is most needed. The lesson here is that states must strike a balance between restrictions that preserve the funds during surplus years and those that limit their use during deficit years.
On this front in particular, independent fiscal agencies — nonpartisan, publicly funded organizations like the California Legislative Analyst’s Office or New York’s Legislative Finance Committee — can give state officials objective fiscal and policy analysis and guidance. This increases the likelihood that officials will recognize problems early enough to seek an effective solution, preferably before they must tap rainy day funds. Fiscal agencies are most effective when they are appropriately funded and truly independent and enjoy a solid reputation with the media and the general public. In times of crisis, they can be a state government’s best friend.

Force no. 2: Institutional requirements
Most states have constitutional requirements for balanced budgets, but how a balanced budget is defined and how well requirements are enforced can vary greatly. Some states are barred from carrying deficits into the following fiscal year or issuing debt to finance a deficit. Others require only that shortfalls in their operating budget are corrected, but allow deficits to pile up in other parts of their budgets, like pension funding. In fact, the pension problem is a prime reason why some states are in their current budget predicaments, while others have closed budget gaps more effectively.

Balancing a budget in times of economic strain would be hard enough in itself. But several states must also clear the hurdle of a supermajority voting requirement for legislation on taxes and appropriations. While intended to safeguard against abuse by one party, this requirement can also result in deals in which earmarks are promised to gain additional votes that ultimately increase the budget burden. Supermajorities in practice have proven less than optimal for many states.

Another institutional force is at work in states where budget-related legislation must be approved by the public. Of course, gaining voters’ approval for budget-related legislation requires a significant investment in time and resources to inform the public and put the issue on the ballot. Even then, the risk that voters will not approve new taxes remains, reducing a state’s flexibility in responding to fiscal stress. Likewise, in states with tax and expenditure limits, state officials have less flexibility in responding to changing public needs or complying with expenditures imposed by federal mandate.

Old policy hands would be especially useful at times like these, but their numbers have been depleted by term limits, another institutional effort to reduce the influence of special interests. What’s sacrificed here is experience, which deepens elected officials’ knowledge of complex legislative processes such as budget development. First-time legislators, however, often rely on the advice of career administrators or even special interest groups that may not share the views of the legislator or the voters who elected her.

Finally, some states have institutionalized the use of voter referendums, which empower citizens to enact legislation through statewide ballot initiatives. Although special interests could potentially drive the process, these referendums can be an effective channel for voter-enacted changes. Often, referendums are a means of imposing requirements, like those we have cited, on the state. Still, it’s important to recognize the possibility that voter referendums could limit a state’s flexibility in responding to a fiscal crisis. Almost half of the states have a voter referendum process, but they vary widely in the frequency with which they use it.
Force no. 3: Political environment
Ah, politics — a necessary but often cumbersome part of our democratic process. The balance of power between political parties can strongly influence the effectiveness of state government. The notion that a balance of political power between factions inevitably leads to legislative gridlock is often false. Split legislatures can make effective decisions based on robust political debate and a comprehensive representation of the electorate. On the other hand, crises often call for rapid responses, and having one political party in control can increase the likelihood of decisive action. Under the pressure of a fiscal threat, this can be preferable to letting two equally powerful parties duke it out.

While fringe organizations are part of the democratic process, they can reduce bipartisanship and make it more difficult for states to reach compromise on fiscal issues. These organizations’ potential influence on subsets of the voting public could encourage legislative gridlock. They cannot be ignored, and they can really get in the way.

The solution? You. Ultimately, it’s up to voters to tell their representatives what they want. High levels of voter participation that encourage elected officials’ accountability can either offset or contribute to gridlock, depending on which segments of the voting population are most engaged (e.g., if only senior citizens show up at the polling place, then only their views will be reflected).

A path forward
In a fiscal crisis, state officials must always make difficult and unpopular policy choices. For some states, the choices are especially hard. The budget tools available, the underlying institutional infrastructure, and the current political environment all weigh on policymakers.

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But these obstacles are by no means insurmountable. History suggests that policymakers, especially those backed by an informed electorate, can successfully navigate their states’ political infrastructure and use the tools available to bring their finances in balance. The first step is to proactively consider how different factors might interact in the midst of a financial emergency. In fact, it might make sense to remedy some of them now so that we needn’t do so when the next crisis arrives.

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