46

states and the District of Columbia had a balanced budget requirement in 2015.

Balanced Budget Requirements

How States Limit Deficit Spending

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Balanced budget requirements (BBRs) prohibit states from spending more than they collect in revenue. They vary in stringency and design, and stricter antideficit provisions produce "tighter" state fiscal outcomes, such as reduced spending and smaller deficits.[1]

Characteristics of BBRs

BBRs vary by state. Some states have lenient BBRs that only require governors to propose a balanced budget; stricter BBRs require that the enacted budget be balanced. BBRs typically only apply to states' operating budgets. Capital and pension funds are usually exempt from BBR limitations. Researchers often use a classification system from 1987 that ranks BBRs by their stringency. In that system, strong antideficit rules

- are constitutional, because constitutional provisions are more difficult to override than statutory provisions;
- contain limited or no deficit carryover provisions; and
- require the legislature to pass and the governor to sign, rather than merely propose, a balanced budget.

In 44 states and the District of Columbia (DC), the governor must propose a balanced budget to the legislature; in 41 states and DC, the legislature must pass a balanced budget; and in 40 states, the governor must ultimately sign a balanced budget. States combine rules differently. For example, although Texas and West Virginia require the legislature to pass and the governor to sign a balanced budget, they do not require the governor's initial proposal to be balanced. Hawaii, meanwhile, requires the governor to propose and eventually sign a balanced budget, but the state does not require the legislature to pass a balanced budget as an intermediary step.

Eight states with BBRs also have permission to carry over deficits, allowing them to plug unexpected budget gaps with reserve funds or to address them in the following fiscal year rather than enacting midyear spending cuts or tax hikes. Five of these states budget annually, and three of them budget biennially.

How Do BBRs Affect Spending and Deficits?

Research has found that strong antideficit provisions such as those in BBRS are associated with

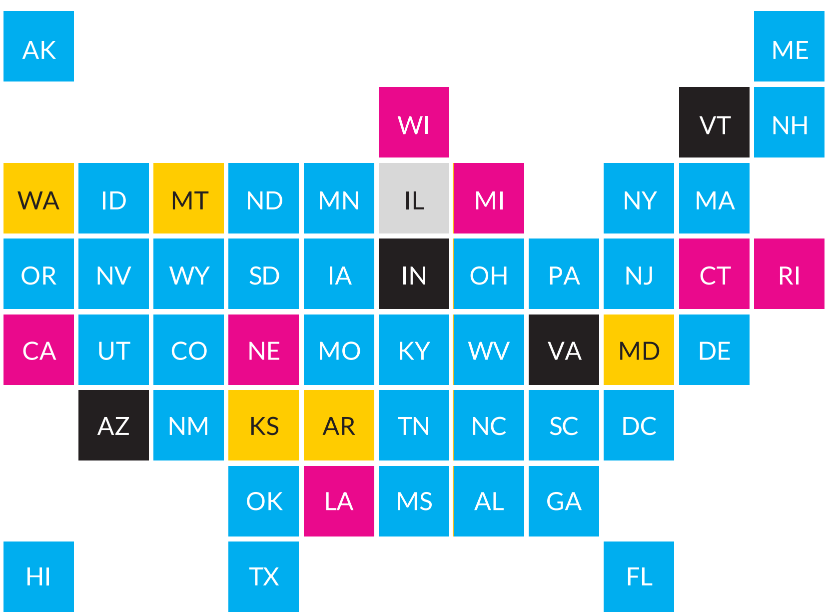
- reduced spending;
- smaller deficits;
- more rapid spending adjustments during recessions;
- less debt;
- lower borrowing costs; and
- higher surpluses, which states can then deposit into a budget stabilization fund to smooth over gaps in spending at later dates.

For example, a 1994 study examining deficits in 45 states between 1988 and 1992 found that states with strong antideficit provisions reduce spending by $44 for every $100 deficit overrun compared with a $17 reduction among states with weak antideficit provisions.

But are BBRs always beneficial? Some research suggests that strict BBRs increase fiscal and economic volatility because they can force spending cuts or revenue increases when a state's economy is already hurting. And research has shown that states are more prone to cut services rather than raise taxes to meet BBR requirements, meaning that strict BBRs can lead policymakers to slash school aid, restrict eligibility for optional Medicaid programs, or enact other cuts.

Balanced Budget Requirements in the States by Stringency, 2015

- Governor must ultimately sign, no deficit carryover permitted
- Governor must ultimately sign, deficit carryover permitted
- Governor must propose or legislature pass, no deficit carryover permitted
- Governor must propose or legislature pass, deficit carryover permitted
- None



WHICH STATES HAVE BBRS?

In 1977, only 33 states and DC had a requirement to balance revenues with expenditures. In 2015, 46 states and DC had some type of BBR in place. Thirty-seven of them and DC's were constitutional.

Even in the four states lacking formal BBRs, debt restrictions and similar provisions effectively restrict their ability to run a deficit.

For example, Arizona doesn't have any statutory or constitutional prohibition on running a deficit. However, the state restricts borrowing and requires a positive cash flow to maintain operations.

Scholars have recommended that states use budget stabilization funds to offset the pressure states experience to cut spending during recessions (when revenues fall) or to mitigate the effects of rising revenue volatility.

[1] For more information, see Megan Randall and Kim Rueben, *Sustainable Budgeting in the States: Evidence on State Budget Institutions and Practices* (Washington, DC: Urban Institute, 2017).

Source: National Association of State Budget Officers, *Budget Processes in the States* (Washington, DC: National Association of State Budget Officers, 2015).

Note: States have adopted numerous combinations of the above BBR requirements. In this figure, states that require the governor to ultimately sign a balanced budget may also require the governor to propose or legislature pass a balanced budget (or all the above) earlier in the budget process. In Virginia, the governor or legislature are not required to propose or sign a balanced budget, but the state does prohibit a deficit carryover. The governor must execute a balanced budget.

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