



## U.S. States Count Cash While Hoping Congress Reaches Debt Deal

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by William Selway*

July 27 (Bloomberg) -- Arizona is prepared to draw on its \$1 billion in cash to cope with a possible federal government shutdown. South Carolina has plans to idle all but its most essential employees. Michigan may have to cut aid to the poor.

With Washington in a political deadlock that may stop the federal government from borrowing money as soon as next week, states are preparing for the fallout should the Treasury Department run out of cash. Used to the brinkmanship in their own legislatures, state officials say they expect Congress to reach a deal to head off a shutdown, or that any disruption would last only a few days.

"They're banking on compromise," said Michael Bird, who follows federal affairs for the National Conference of State Legislatures in Washington. He said states typically have enough cash to cover a few weeks of lost federal funding. "It gets worrisome after you get past that."

States are intertwined with Washington, which provided \$564 billion, or 35 percent, of the \$1.62 trillion they spent in the 2010 budget year, according to the National Association of State Budget Officers. The shutdown could affect programs such as unemployment insurance; Medicaid, which provides health care for the poor; and transportation projects.

"There's a lot of uncertainty," said Scott Pattison, the director of the budget officers' group in Washington. "The federal government isn't going to say until it actually occurs what funding streams it's going to impact and what they're going to fund."

### **Bearing the Burden**

Without the ability to borrow, the federal government would have to cut about \$134 billion of outlays in August, about 44 percent of what it's slated to spend, according to a report by the Washington-based Bipartisan Policy Center, which advocates politically balanced policy making. The cuts may force states to bear the burden of federal programs or shut them down, the legislatures group advised members this month.

New Jersey Governor Chris Christie, a Republican, said no one has any clear idea of how grave the fallout would be. He said it would be "irresponsible" of congressional leaders from both parties and President Barack Obama to not meet the deadline or allow a downgrade of the U.S.'s AAA credit rating.

"They're engaged in a bunch of brinkmanship right now, and we're getting pretty close to the brink," Christie told reporters today in Newark. "I don't want to speculate about what will happen because we're all just guessing. I don't want to add to the hysteria."

### **'Short-Lived'**

The prospect of U.S. default hasn't set off panic in statehouses or on Wall Street this week as an agreement eluded President Barack Obama and congressional leaders. Top-rated 10-year municipal debt yielded about 2.69 percent, little changed from the end of last week, according to a BVAL index. In April, a standoff over the federal budget was averted less than an hour before agencies were set to close.

"Most people believe that any shutdown will be very short-lived, so I don't think it would have a big impact on state government cash flows," said Peter Hayes, a managing director with Blackrock Inc., which owns \$98.2 billion in municipal bonds.

States are benefitting from a recovery in tax receipts. In Massachusetts, Treasurer Steven Grossman said the state has \$2.2 billion in cash at its disposal. Even if it didn't get the \$850 million it expects from the federal government in August, it would still be able to pay those bills and have almost \$1.1 billion at the beginning of September.

## **September Is Critical**

"When you get into the month of September, all states will be in a highly challenged position, and as you get further into the month of September obviously it becomes very difficult for us as well as for all states," Grossman said.

The broader spending cuts that may emerge from a deal to cut the federal budget could have a broader impact on programs like Medicaid, the largest single expense for states.

"A deficit-reduction package may be more meaningful in how it affects state governments," said Hayes, the Blackrock investor. "You really have to wait and see."

The effects of the debt-ceiling standoff may also push up borrowing costs for state and local governments should the federal government lose its AAA rating. Moody's Investors Service said July 19 that five top-rated states -- Maryland, South Carolina, New Mexico, Tennessee and Virginia -- may be downgraded because their dependence on federal revenue makes them vulnerable to a U.S. credit cut.

## **California Loan**

The impasse may also threaten a recovery in tax collections if it slows the economic recovery. California this week took out a \$5.4 billion loan in case it were unable to access investors -- or forced to pay higher rates -- in the bond market in the wake of a U.S. default.

California Governor Jerry Brown, a Democrat, told reporters he expects Congress to reach a deal to avert a default. Florida Governor Rick Scott, a Republican, also views a default as unlikely and views the impact as "relatively minimal," said Lane Wright, his spokesman.

New York is expecting \$7 billion of federal payments in August and September for hundreds of programs, said Mark Johnson, a spokesman for Comptroller Thomas DiNapoli. Without that money, the state would have to either drain its cash on hand -- expected to be \$6.5 billion by the end of September -- or delay payments.

The comptroller's office has been working with state agencies to look for outstanding claims for federal programs so New York can be reimbursed before Aug. 2, when the Treasury forecasts it will hit the debt limit.

## **Contingency Plans**

In South Carolina, Comptroller General Richard Eckstrom said today the state has contingency plans to reduce spending if federal funds are withheld, including furloughing all but the most essential workers.

In Arizona, Treasurer Doug Ducey said the state has enough cash on hand to fund its operations for six weeks and that he anticipates that the debt-limit will be raised soon enough to prevent the state from running into financial difficulty. He said he anticipates that the state could also access a \$1 billion credit line if necessary.

"We are confident they will agree on a solution," he said. "We have enough cash on hand to navigate through that."

Michigan Budget Director John Nixon said agencies that administer federal cash flow for Medicaid, food stamps and other programs have been alerted to possible effects should negotiators fail to agree by the deadline.

"Hopefully, they're big enough to realize that more than politics, we've got a real solution on our hands and it needs to be thought through the best way possible," he said. "I personally think they'll get it done. We'll have to kick into high gear and start scaling back if they don't."

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