
Government Accountability Office Study on Long-Term Liabilities.

Sure, day-to-day finances are improving for state and local governments. But this week's Municipal Market Analytics outlook points out that a recent Government Accountability Office study on long-term liabilities bolsters the firm's view that Medicaid and retiree health care represent major challenges for state and local governments. MMA (which changed its name this year from Municipal Market Advisors), said in its write-up that investors should note the secondary treatment unsecured bondholders received in last year's bankruptcy cases in Stockton, Calif., and Detroit. In MMA's opinion, investors should "retreat from issuers with both a large retiree health care liability AND a material risk of being dragged into chapter 9 [bankruptcy]." (In related news, a Luxembourgian bondholder company sued bankrupt San Bernardino, Calif., this week for favoring pensioners over bondholders as the city navigates its bankruptcy.)

Despite recent strides in the economy, state and local government revenues are not keeping pace with expenditure growth and the GAO expects the gap to widen without major policy changes. As a percentage of GDP, MMA notes, revenues are not expected to reach 2007 levels until 2058. Meanwhile, health care costs are expected to nearly double, to 7.4 percent of GDP by 2060. According to the GAO, state and local governments will need to reduce expenses or increase revenues by 18 percent for the next half-century to close the fiscal gap. "We think the fiscal challenges will reasonably constrain infrastructure spending by these governments — and therefore, municipal debt issuance," MMA said, adding that the greatest pressure would trickle down to the local level.

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