

Bond Case Briefs

Municipal Finance Law Since 1971

Fitch: Federal Questions Linger for State and Local Governments Following President Trump's Speech.

Fitch Ratings-New York-01 March 2017: In the president's speech to Congress last night and in details of a budget plan disclosed on Monday, the administration proposed and affirmed broad policy goals that could significantly affect state and local governments, but essential details remain unknown. The future of the Affordable Care Act, Medicaid financing, an infrastructure plan, and even federal education funding were all topics in the speech or budget proposal – but state and local governments remain without clear guidance on how possible changes will affect them.

On the Affordable Care Act (ACA) and Medicaid, President Trump's speech listed five principles to guide legislative deliberations. These principles were broad in scope, but generally consistent with the recently released House Republican Obamacare Repeal and Replace Plan from House Speaker Paul Ryan. Other than an explicit statement supporting the use of tax credits, the president's speech added no new clarity on the administration's view for the role of the federal government in healthcare.

The federal Department of Health and Human Services (HHS) estimated that in federal fiscal year 2015, 9.1 million people received insurance coverage under state Medicaid expansions authorized under the ACA. With the ACA's enhanced matching rate (100% in 2015 and phasing down to 90% by 2020), HHS estimates the states received \$58.1 billion in federal funding to provide that coverage in 2015. The Ryan plan phases down that ACA funding significantly over an unspecified transition period. The president's speech was not clear on the administration's view of that decrease.

Medicaid represents approximately one-third of state budgets so changes to the program, such as ending the open-ended federal commitment, could have material effects on state fiscal conditions. The president's healthcare principles included a statement to provide governors "the resources and flexibility they need with Medicaid to make sure no one is left out." Regarding the ACA Medicaid expansion, the speech hinted at some support for continued federal funding for the newly eligible. But the reference to flexibility implies support for a block grant or per capita cap program as envisioned under the Ryan plan, to trade limits on federal spending for unspecified new flexibility for states on implementation. Fitch anticipates states would likely respond with health care spending cuts, cuts to other programs such as education, and revenue measures.

In his speech, President Trump reiterated his support for legislation to support new infrastructure investment of up to \$1 trillion. The president's statement on infrastructure did not include a specific commitment of federal direct funding and instead referenced creating a legislative structure to support a mix of public and private investment. This aligns with President Trump's campaign proposal (co-authored by the incoming Secretary of Commerce and head of the White House's new National Trade Council) to use tax credits, rather than direct federal funding, to encourage private investment. More clarity is still needed on how non-revenue-generating projects will be financed as the opportunities for investment in user-fee-supported infrastructure will be only a limited subset of the overall need.

The president's speech also included an educational legislative priority that could affect state and local governments, urging congress to enact legislation that provides federal funding to support school choice, including for charter and private schools. Fitch notes that expansion of charter schools has generally been neutral to negative for competing public school districts' fiscal conditions. Any proposals to provide new federal aid to charter schools, or redirect existing traditional public school aid, could exacerbate challenges for school districts, such as Philadelphia and Los Angeles Unified, already struggling to adjust to ongoing enrollment shifts. School districts would need to address any reduced federal aid through spending cuts or additional revenue sources. As the current situation in Chicago demonstrates, urban school districts can be challenged to find additional room for cuts and have limited independent revenue raising capacity in many states.

Monday's disclosure of details on the president's upcoming budget proposal also leaves open questions for state and local government. The proposal reportedly includes an additional \$54 billion in defense spending, offset with a commensurate reduction in federal discretionary funding. For state and local governments, 70% (approximately \$400 to \$500 billion) of federal aid comes for mandatory programs (primarily Medicaid), which are reportedly not subject to cuts in this proposal. The largest single discretionary program potentially subject to the \$54 billion reduction is federal highway aid (\$40 billion). Given the president's repeated statements on infrastructure investment, Fitch views cuts in federal highway aid as unlikely. Absent highway aid cuts, it remains unclear how the president's budget plan would affect state and local governments. The administration has indicated changes to mandatory programs (which include Medicaid) will follow after the administration formally releases the budget plan in mid-March.

Contact:

Eric Kim
Director
+1-212-908-0241
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Laura Porter
Managing Director
+1-212-908-0575

Amy Laskey
Managing Director
+1-212-908-0568

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available on www.fitchratings.com