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Fitch: Governance, Fiscal Autonomy Insulate U.S. States & Locals from Sovereign Rating

Fitch Ratings-New York-08 December 2021: U.S. state and local governments possess significant autonomy in the U.S. framework, which, according to Fitch Ratings in a new report, limits the federal government's power to affect state and local operations. As a result, most U.S. Public Finance ratings, including all state and local governments, are not explicitly tied to or capped by the U.S. sovereign rating.

"U.S. States are autonomous within the U.S. federal system, and retain the power to make laws covering all matters not pre-empted by the U.S. Constitution, federal statute, or ratified treaties," said Senior Director Karen Krop. "The federal/state relationship stands out from many other sovereign/sub-sovereign relationships globally."

Local governments also have significant, albeit less, autonomy within the U.S. government framework. Elsewhere, most revenue-supported municipal sectors have limited exposure to federal government spending, though not-for-profit healthcare is a notable exception.

The federal government is the largest single payor of healthcare services in the U.S. through Medicare and Medicaid. "With such a large share of providers' revenue streams derived from the government, policy and budgetary considerations can strongly affect revenue and profitability, utilization patterns and employer-based healthcare insurance coverage and financing mechanisms," said Krop.

Nonetheless, Fitch believes that operating within the U.S. economy and legal system is a significant positive rating factor. While not linked or capped at the U.S. rating, public finance ratings are subject to the same macro and structural factors that affect the sovereign rating. Federal policy actions have ramifications for the operating environment of states, local governments, and revenue-supported entities, which over time could influence the risk profile of the sector.

"U.S. Public Finance Ratings and their Relationship to the U.S. Sovereign Rating" is available at www.fitchratings.com.

Contact:

Karen Krop
Senior Director
+1-212-908-0661
Fitch Ratings, Inc.
300 West 57th Street
New York, NY 10019

Media Relations: Sandro Scenga, New York, Tel: +1 212 908 0278, Email: sandro.scenga@thefitchgroup.com

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