Fiscal Affairs Forum: Planning for Uncertainty Fiscal Federalism

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Government Finance Research Center

- Established in 2018, the only public university-based research center in Illinois dedicated exclusively to advancing excellence in fiscal policy and public financial management
- Through applied research, technical assistance, professional education, and collaboration with government leaders, the GFRC helps state and local governments strengthen fiscal performance across the Chicago region, Illinois, and the nation
- Our research clusters include:
  - Tax policy and administration
  - Fiscal Policy and financial condition
  - Debt and long-term obligations
  - Energy and water policy
- Delivers the <u>only</u> accredited Certified Public Manager® program in Illinois

Federal Flow of Funds to State & Local Governments

Federal Funds to State and Local Governments, 2024

Source: U.S. Census Bureau

Federal Funds to State and Local Governments, 2017-2024

Source: U.S. Census Bureau

Federal & State Funds to Local Governments, 2017-2024

Source: U.S. Census Bureau

Federal Grants to State and Local Governments by Function, 2025

Source: Office of Management and Budget (OMB)

Federal Grants to State and Local Governments by Function, 2020-2031 (est.)

Source: Office of Management and Budget (OMB)

Federal Health Grants to State and Local Governments, 2020-2031 (est.)

Source: Office of Management and Budget (OMB)

Federal Grants to State and Local Governments, 2020-2031 (est.)

Source: Office of Management and Budget (OMB)

Federal Grants to States for Medicaid, 2020-2027 (est.)

Grants are also payments for individuals

Source: Office of Management and Budget (OMB)

Federal Grants for Children's Health Insurance Fund, 2020-2027 (est.)

Grants are also payments for individuals

Source: Office of Management and Budget (OMB)

Federal Grants for SNAP, 2020-2027 (est.)

Grants are also payments for individuals

Source: Office of Management and Budget (OMB)

Federal Grants for Supplemental Feeding Programs (WIC & CSFP), 2020-2027 (est.)

Grants are also payments for individuals

Source: Office of Management and Budget (OMB)

Federal Grants for Child Nutrition Programs, 2020-2027 (est.)

Grants are also payments for individuals

Source: Office of Management and Budget (OMB)

Federal Grants for Temporary Assistance for Needy Families, 2020-2027 (est.)

Grants are also payments for individuals

Source: Office of Management and Budget (OMB)

One Big Beautiful Bill Act (OBBBA)
Public Law 119-21
Enacted July 4, 2025

Anticipated Impacts of OBBBA

- OBBBA does **not simply reduce federal aid to states and localities!**
- OBBBA changes the federal-state fiscal relationship through:
  - Medicaid and SNAP cost shifts
  - Changes to federal tax policy that affect state revenues
  - Reductions and changes in energy incentives
  - Larger federal deficit that could affect future federal grants and borrowing costs
- Implications for state and local governments characterized as:
  - Fiscally disruptive
  - Uneven across jurisdictions
  - Increasingly visible over the next 3-5 years
- Largest impacts expected for jurisdictions with high reliance on federal programs, limited revenue flexibility, high poverty, high Medicaid enrollment, and limited fiscal reserves

Greater Pressure on State & Local Budgets

- CBO estimates federal deficit to increase by ~$3.4 trillion over FY2025–FY2034, plus $718 billion additional debt-service costs
- Added pressure in future federal budgets could:
  - Constrain discretionary spending
  - Reduce grants to state and local governments
  - Increase interest rates and borrowing costs
- State and local governments should plan for more uncertain federal funding environment

Biggest Issue for States: Medicaid

- Largest source of federal funding for state governments
  - Provides health coverage to roughly 1 in 5 Americans
- CBO estimates reduced federal Medicaid spending by ~$989.7 billion over FY2025–FY2034
  - Pew: Medicaid enrollment & health-care costs already putting pressure on state budgets
  - Could increase the number of uninsured people by ~10 million by FY2034
- OBBBA increases administrative costs by requiring states to develop eligibility-verification, reporting, data-sharing, and compliance systems
- Coverage costs previously flowing through Medicaid could shift down to local levels

SNAP Cost-Shift

- CRS estimates reduced federal SNAP spending by ~$187 billion over FY2025–FY2034
  - Previously: federal government paid full cost of SNAP benefits, while states shared administrative costs
  - OBBBA: requires states to assume a portion of SNAP benefit costs, and increases state share of administrative costs
    - Amount states pay for benefits depends on SNAP payment-error rates
- Changes could have strong multiplier effect for local governments if fewer households receive SNAP or if benefits decline
  - Secondary effects on local sales, employment, tax revenues from reduced economic activity

State Tax Revenues

- Changes to federal taxable income can automatically change state tax revenues for states conforming closely to the Internal Revenue Code
  - Tax Foundation identified 26 states with rolling corporate conformity
- Policy Choice for States:
  - Conform to federal tax changes and potentially reduce state revenues, or decouple from them and create a more complicated state tax system
- Example: Tax Foundation estimated potential 2026 revenue loss from expensing provisions at ~$1.57 billion for Illinois

Summary of Anticipated Impacts

Area	Anticipated State Impact	Anticipated Local Impact
Medicaid	High fiscal and administrative pressure	Higher demand for uncompensated health, behavioral-health and social services
SNAP	Direct assumption of additional costs	Increased demand for food, emergency and social services
State Taxation	Revenue losses or conformity decisions	Indirect effects through state aid and local economic activity
SALT	Changes tax-policy incentives	Particularly important in high-tax jurisdictions
Energy	Changes to state energy strategies and incentives	Reduced incentives for EVs, charging and public energy projects
Infrastructure	Greater competition for federal resources	Greater reliance on local revenues, fees, bonds and partnerships
Federal Grants	Greater uncertainty about future federal support	Potential reductions in state pass-through funding
Administration	Higher compliance and implementation costs	Greater coordination and service-delivery burdens
Economic Growth	Potential increase in investment and employment	Potentially higher tax base and economic activity
Federal Debt	Greater long-term federal fiscal pressure	Potentially higher borrowing costs and less predictable federal aid

Fiscal Disparities Among States

- States with:
  - large rainy-day funds
  - diversified economies
  - strong tax bases
  - relatively low Medicaid costs
  - substantial budget reserves

will likely have more flexibility to absorb the changes

- States with:
  - high Medicaid enrollment
  - high poverty
  - limited revenue capacity
  - weak reserves
  - significant dependence on federal transfers

may have fewer options

How States Can Respond

Looking Forward

- State and local governments can place greater emphasis on:
  - Long-term fiscal forecasting
  - Medicaid and SNAP contingency planning
  - Building and preserving rainy-day reserves
  - Evaluating state conformity with federal tax changes
  - Diversifying state and local revenue sources
  - Prioritizing federally supported infrastructure projects carefully
  - Improving administrative capacity and data systems
  - Monitoring state-to-local fiscal transfers
  - Stress-testing budgets against reductions in federal aid
  - Developing multi-year strategies for health, human services, energy and infrastructure

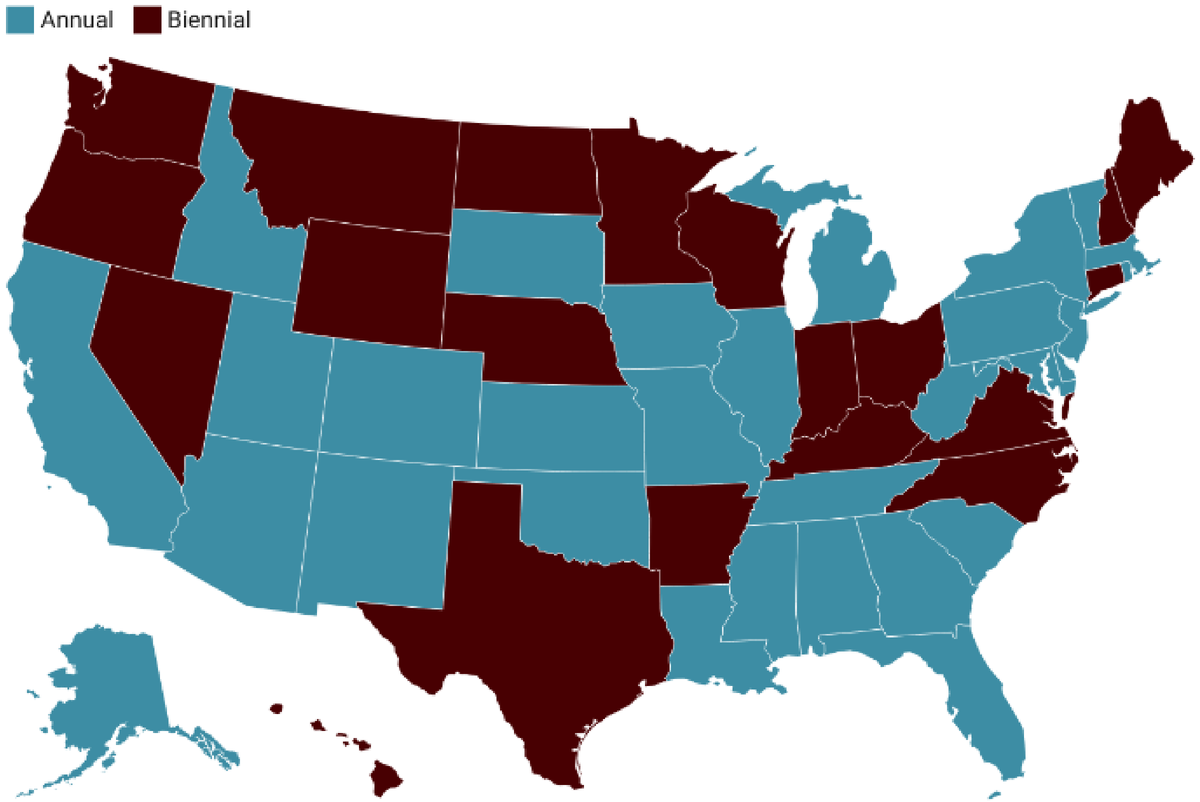
Why Expenditure Forecasts Matter

- States make long-term spending commitments before costs are realized
- Forecast errors can trigger budget gaps, reserve drawdowns, or service reductions
- We provide one of the first systematic reviews of state expenditure forecasting institutions
    - Williams (1998) focused on Medicaid forecasts only

> **Indiana Medicaid program is $1 billion more expensive after forecasting error**
>
> By Brandon Smith
> Published December 19, 2023 at 12:00 AM EST

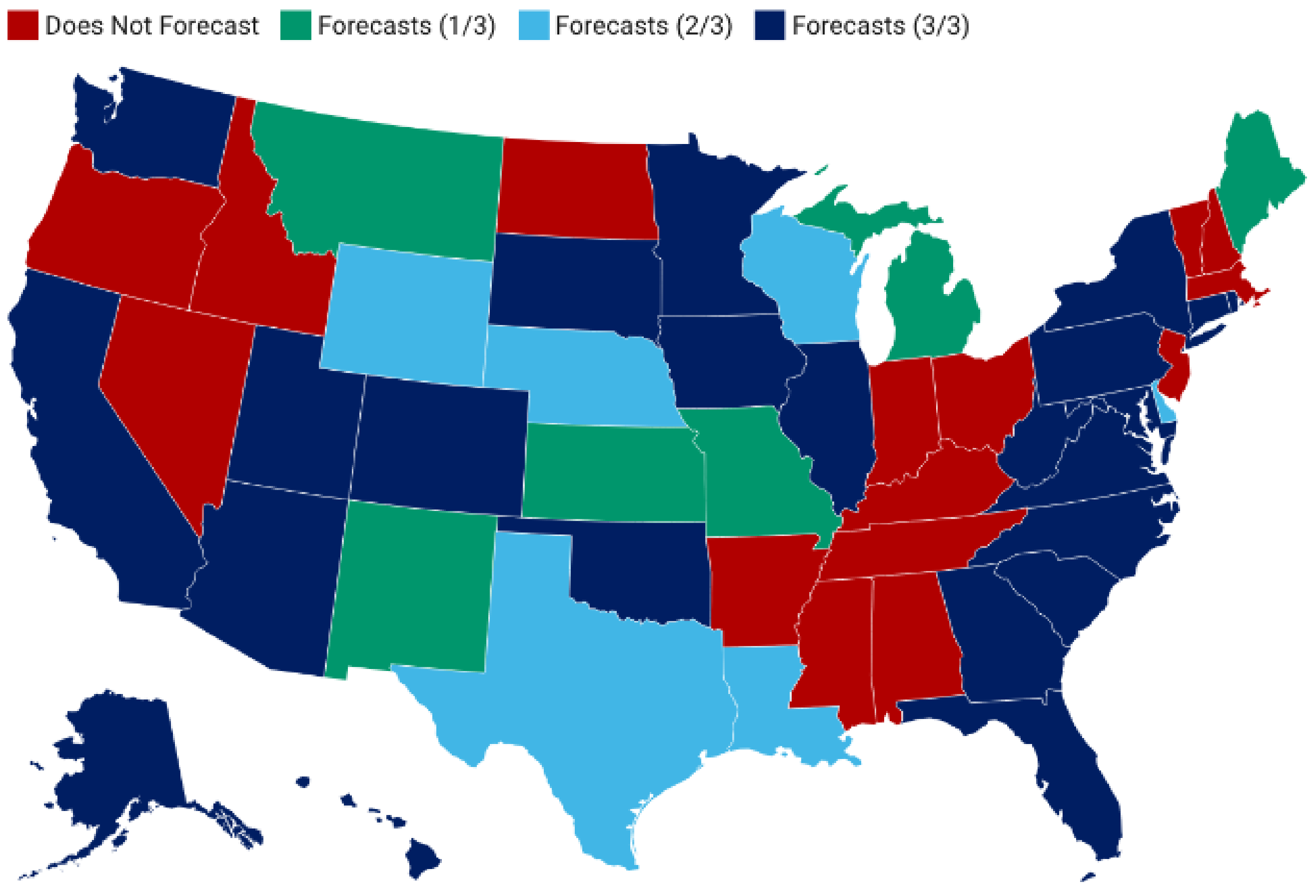
Budget Cycles Shape Forecasting Needs

- Annual budgeting dominates among states that produce multi-year expenditure forecasts
- Biennial states face different forecasting and planning challenges



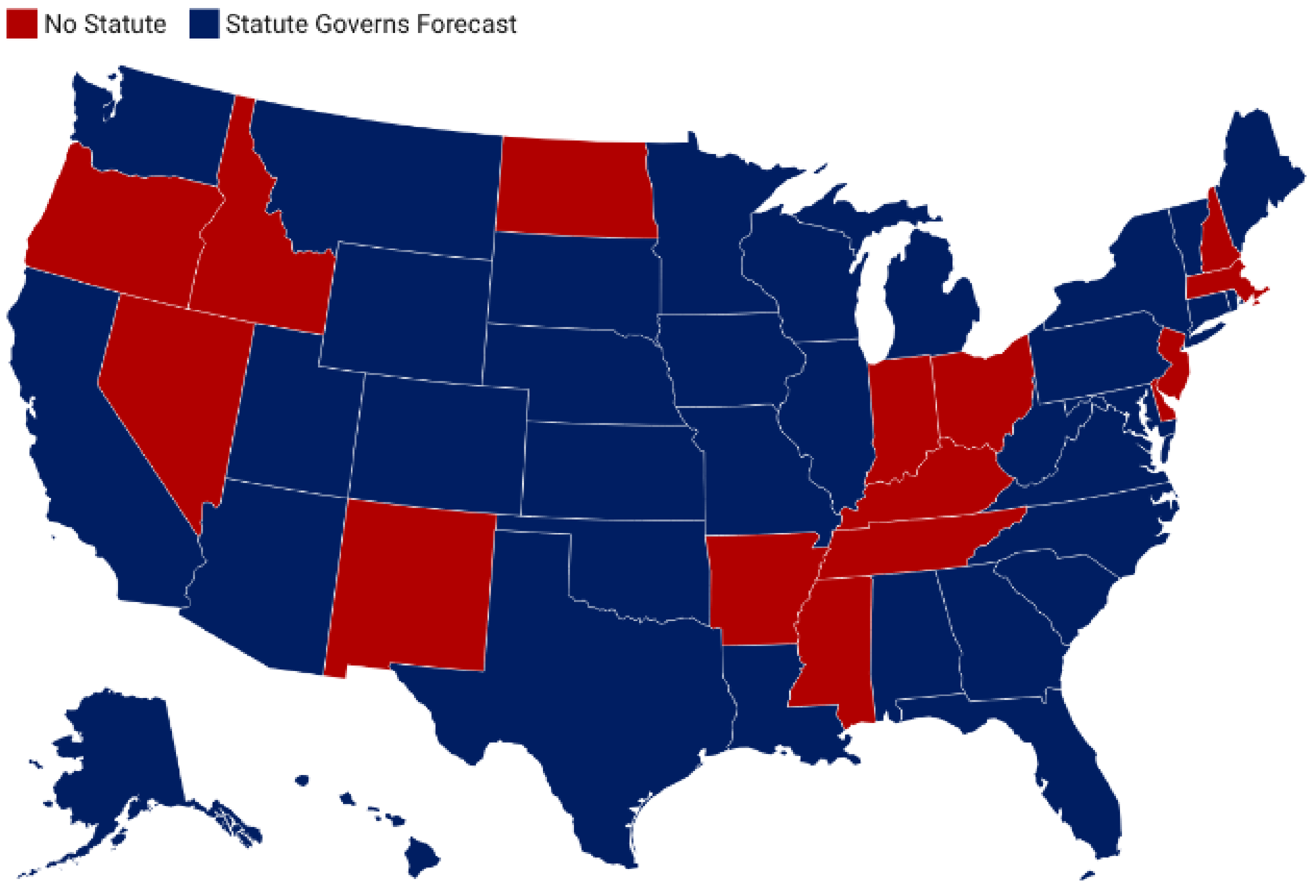
States Differ in Forecast Determination

- Nearly half of states do not publish multi-year expenditure forecasts or only do so under broader definitions
- Classification based on definitions used by NASBO, Pew, and the Volcker Alliance



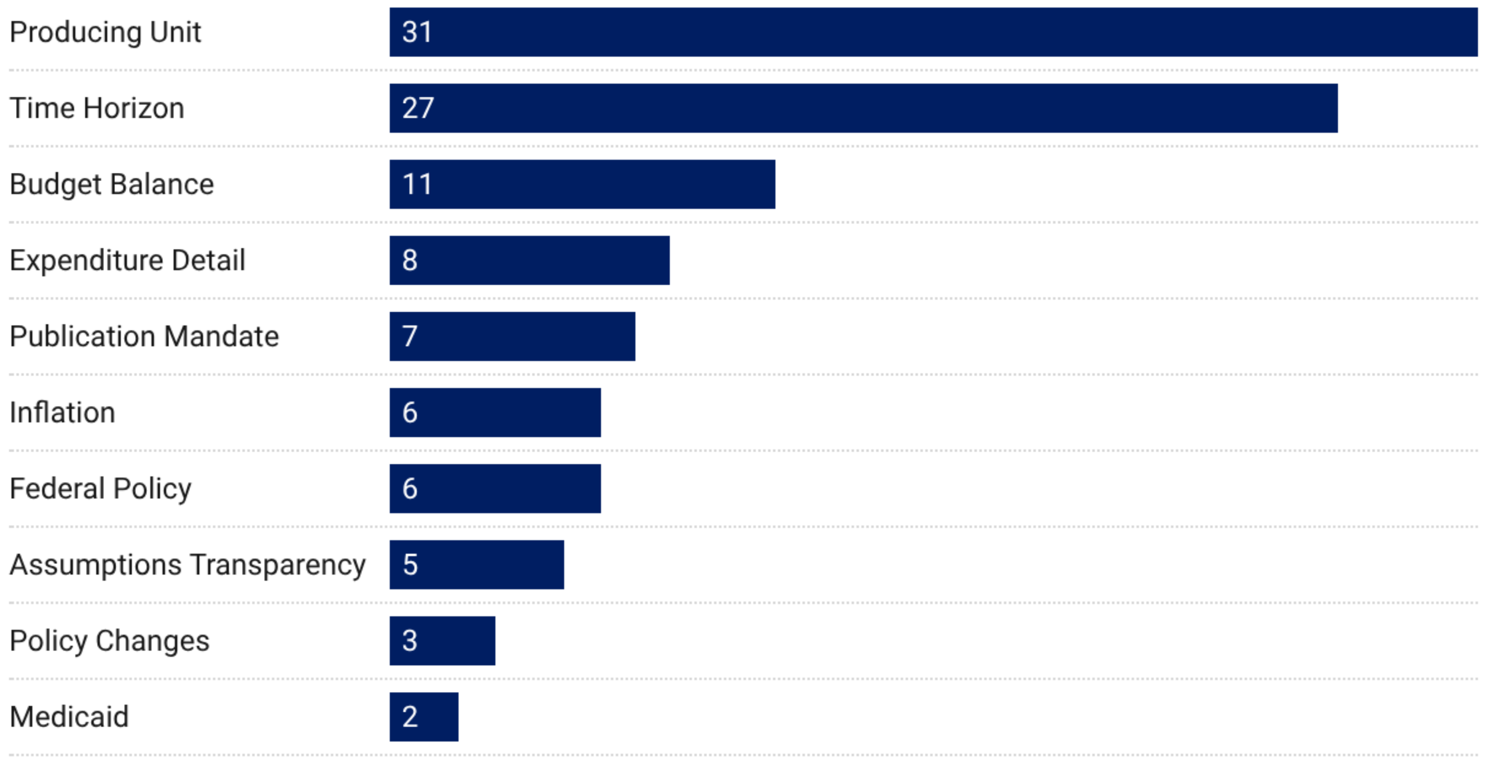
Multi-Year Forecasting Embedded in State Law

- Forecast publication and statutory authority are strongly associated, but statutes alone do not guarantee forecasting



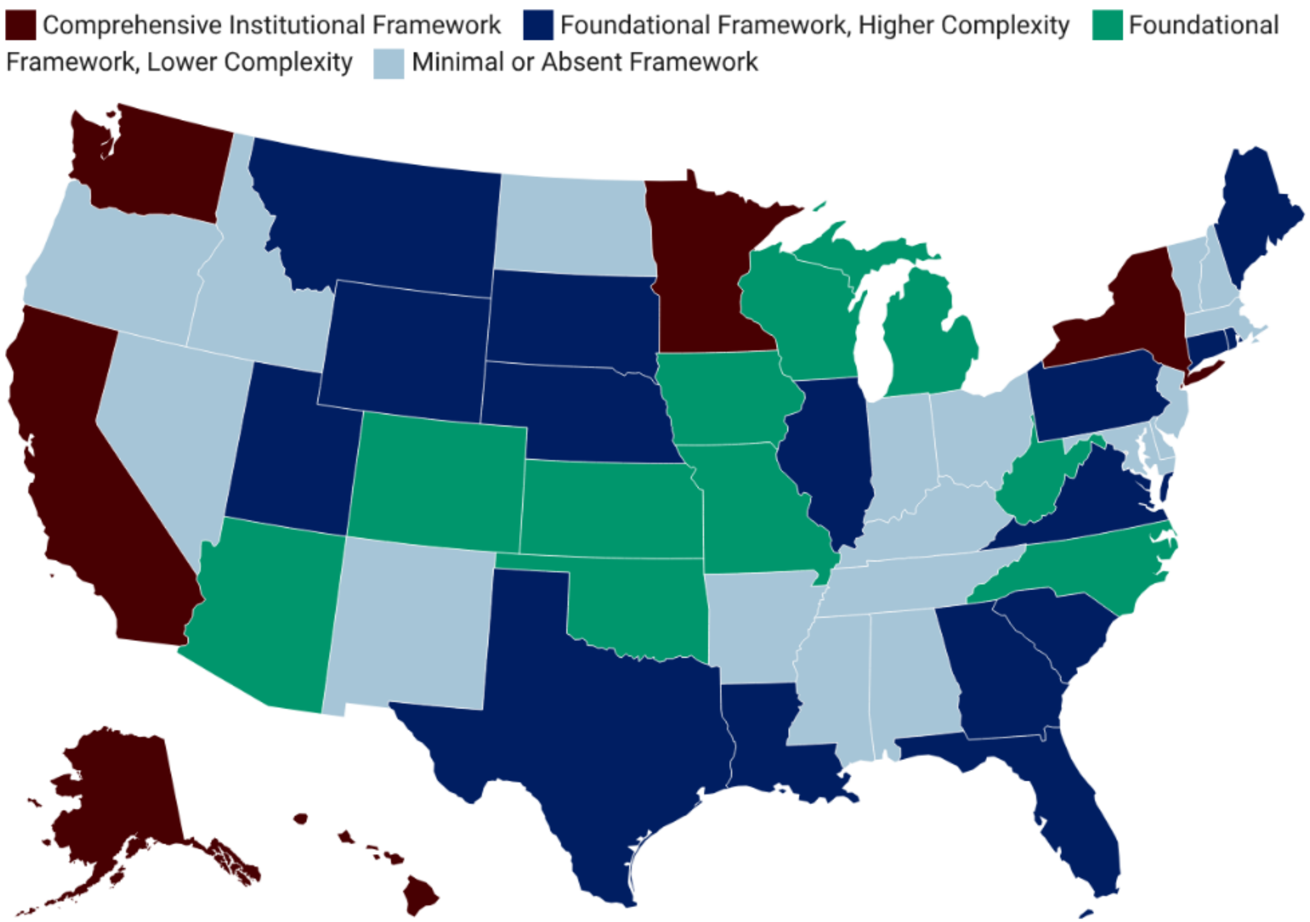
Operationalizing Forecasting Best Practices

- Drawing on prior Pew guidance and public budgeting scholarship, we identify 11 statutory parameters associated with effective multi-year expenditure forecasting



Four Models of State Expenditure Forecasting

- States differ not only in whether they forecast, but in how forecasting is institutionalized and implemented



Want to Learn More?

- Forecasts and relevant statutes by state can be found here:

- Forecasting guidebook coming soon!

Thank You!

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