# State Budgets in the Trump Era

## How President Donald Trump's and House Republicans' Federal Reform Plans Could Affect State Budgets

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The election of Donald Trump as president and Republican majorities in both houses of Congress have Washington primed for major legislative reforms. But it's important to keep in mind that what the new government in the nation's capital does will reverberate in all 50 statehouses. Most state income tax systems are linked to the federal government's rules and definitions, so Washington's changes affect state tax revenues. In addition, federal funds provide nearly one-third of revenue for total state expenditures, so federal spending reforms affect states' abilities to provide services and can undermine the social safety net.

State budgets, still recovering from the Great Recession and grappling with long-term trends that create problems on both sides of the ledger, are already precarious. At the start of 2017, over half the states face budget deficits because of weaker-than-expected revenues and increases in program demand. Thus, while dealing with their own fiscal questions, states must simultaneously be aware that major federal changes on the docket could upend their budget equations. Depending on how these legislative changes are crafted and implemented, they could also make planning for the next recession more difficult. Specifically, turning some spending programs into block grants based on current levels of spending could exacerbate the cyclicality of state budgets, leaving states more responsible for increased enrollment demand when their economies face a downturn. However, although many of these federal changes may negatively affect state budgets, some could increase state revenues or provide flexibility in making spending decisions. Knowing changes are coming, but having uncertainty as to the extent of these changes, is clearly making it more difficult for governors in their own budget-setting process.

Indeed, as California Governor Jerry Brown wrote in the introduction to this year's budget (Brown 2017, 10):

> The incoming presidential administration and leaders in Congress have suggested major changes to Medicaid, trade and immigration policy, and the federal tax structure. Many of the proposed changes could have serious and detrimental effects on the state's economy and budget. At this point, it is not clear what those changes will be or when they will take effect.

This brief gives an overview of the current state of state budgets and how possible federal reforms may affect the following fiscal issues:

- individual income tax
- corporate income tax
- Medicaid, Affordable Care Act (ACA), and health care
- Temporary Assistance for Needy Families (TANF) and Supplemental Nutritional Assistance Program (SNAP)
- infrastructure
- elementary and secondary education

Most of these changes could hand states more control over programs but also demand more fiscal responsibility, forcing states to address big questions about how much they want to tax and spend in the future.

When examining possible federal reforms, this brief relies mostly on the Trump campaign's policy proposals[1] and the set of reports released by Speaker Paul Ryan, called "A Better Way,"[2] in the run-up to the 2016 election. We attempt only to analyze how these changes could affect state budgets and do not comment on any other merits or faults of such federal proposals. We also do not cover all federal policy changes that could affect state budgets, but instead focus on those we are best equipped to analyze.

# The State of State Budgets in 2017

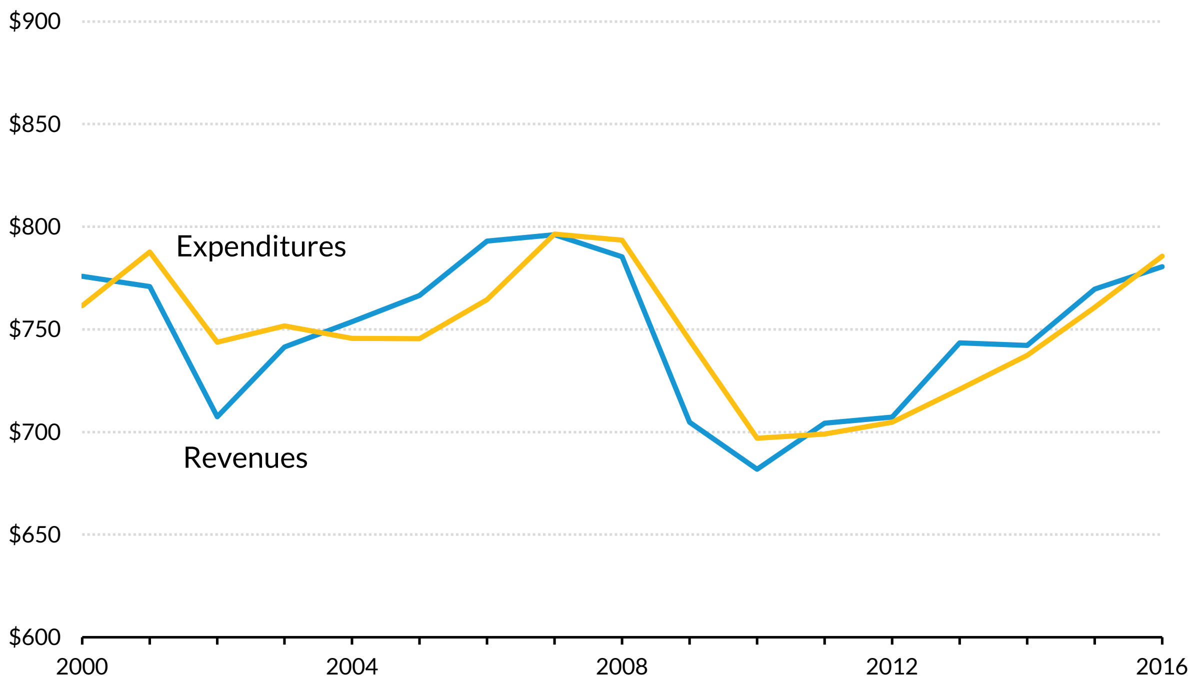
As a new administration and Congress take the reins of the federal government, their state government counterparts are facing a growing fiscal gap between revenues and expenditures. Changes in the market place (e.g., online sales, service economy) have eroded sales tax revenue, and inflation continues to eat away at many excise taxes that are based on volume rather than price. Income tax cuts are increasingly politically popular (Gale, Krupkin, and Rueben 2016). Meanwhile, the cost of government programs, particularly health care (Government Accountability Office 2016), steadily increase. An aging population puts pressure on both sides of the ledger: lowering some tax revenue sources while pushing up the need for spending on services, especially health care. In short, current state revenue tools are increasingly not meeting expenditure needs (Gordon, Auxier, and Iselin 2016), and absent mitigating actions this mismatch is likely to increase. The Government Accountability Office estimates state and local governments would need to reduce current expenditures 3.3 percent annually to close fiscal gaps (Government Accountability Office 2016). There are fiscal pressures in all 50 states (Francis and Sammartino 2015).

A National Association of State Budget Officers (NASBO) survey reported revenue was less than budgeted in 25 states last year, the most since the Great Recession (NASBO 2016a). According to a MultiState Associates study, 31 states enter 2017 with deficits.[3] The NASBO (2016a) report also noted that despite aggregate state general fund spending increases for six consecutive years, real levels of total spending are still below spending levels found before the Great Recession (figure 1).

FIGURE 1

**Total Real State General Revenues and Expenditures, 2000–2016**

*$2016 billions*




**Sources:** National Association of State Budget Officers, Fall Surveys 1999-2016; US Bureau of Economic AnalysisTable 3.10.4. Price Indexes for Government Consumption Expenditures and General Government Gross Output (State and Local Price Index).
**Note:** Fiscal year inflation rates determined through quarterly averages.

After adjusting for inflation, 32 states spent less in fiscal year 2016 than at their prerecession peak in fiscal year 2008 (NASBO 2016a). Furthermore, 11 states made across-the-board spending cuts, and 26 made targeted cuts to manage their budgets last year.

State general fund revenue grew only 1.8 percent in fiscal year 2016. Enacted 2017 budgets had projected 3.6 percent more general fund revenue than the year before, but 24 states already report actual collections are not meeting these estimates—the highest number since 2010 (NASBO 2016a). This slow revenue growth is troubling[4] considering the relative health of the national economy. Looming federal changes are making forecasting more difficult: for example, many taxpayers may be postponing realization of capital gains in expectation of expected federal tax reform, including lower rates on earnings from capital. (Lowering the federal tax rate would eventually lead to more realizations and thus more revenue in states that tax capital gains, but estimating the timing in these revenues is problematic.)

Many state legislatures are already grappling with big deficits in 2017—partly because of earlier budgetary decisions. Although some states are dealing with difficult economic conditions, most notably states that rely on natural resource extraction, many others face low revenues because of tax cuts and other policy decisions. At the start of the year, Connecticut and Oregon faced budget deficits of more than $1 billion each.[5] Alaska's, Nebraska's, and Oklahoma's deficits are each approaching $1 billion.[6] Louisiana, Pennsylvania, New York, and Wisconsin all face budget gaps greater than $600 million.[7] West Virginia is $400 million in the red.[8] These and many other states face legislative trade-offs to balance their books this year that are made more uncertain by looming federal changes.

# How Will Federal Tax Changes Affect States Budgets?

Both President Trump and House Republicans proposed ambitious tax plans in 2016.[9] Although the plans diverge in several important ways, the tax reform packages proposed by both Trump (Nunns, Burman, Rohaly, and Rosenberg 2016) and House Republicans (Nunns, Burman, Rohaly, Rosenberg, and Page 2016) are estimated to cost a significant amount of federal revenue. The Tax Policy Center estimates the Trump plan would cost $6.2 trillion over the first decade and the House GOP plan would cost $3.1 trillion. Although incoming members of the Trump administration and congressional Republicans have discussed using unspecified base-broadening measures to pass revenue-neutral reform, none of the independent estimates of the two plans have found this to be the case. If a revenue-losing tax plan is passed, it could lead to higher deficits and increases in the debt level. Alternatively, the president and Congress could choose to offset some losses with lower spending levels. Such cuts would directly affect state budgets. These potential changes add even more uncertainty to the effects of federal actions.

## Individual Income Tax

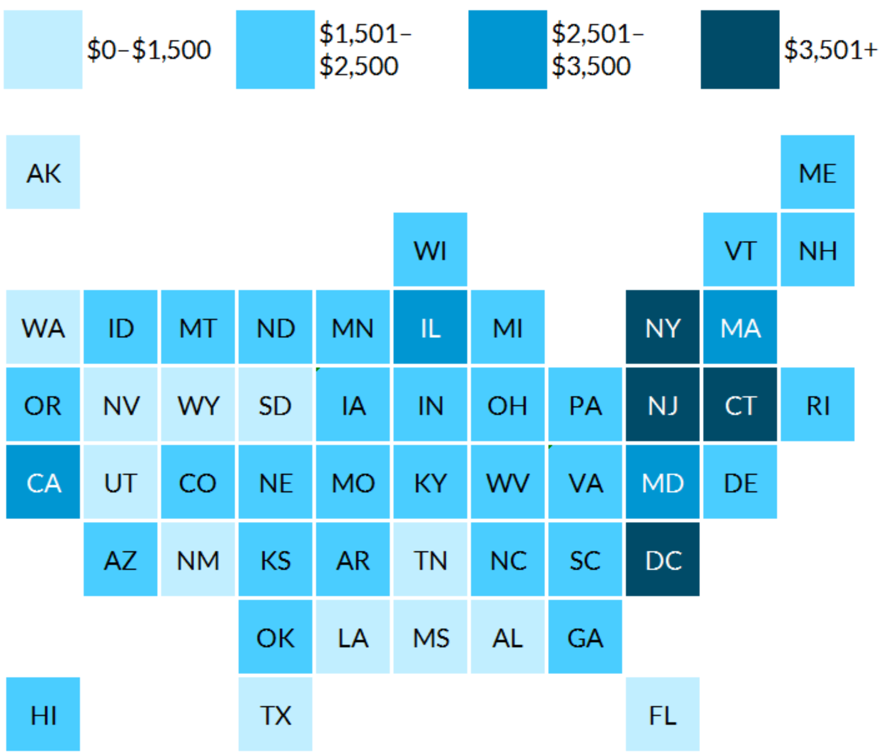
- Ending the state and local tax (SALT) deduction could push states to cut taxes and lose revenue.
- Federal base broadening could increase state tax revenue.
- Uncertainty from capital gains tax changes could affect timing of state revenues.
- Congress could decide to offset revenue losses from tax changes with cuts in federal discretionary spending and intergovernmental transfers.

For states, possible reform or elimination of the SALT deduction could affect support for their own tax systems. The Trump plan caps the total amount of itemized deductions that could be claimed at $100,000 for single filers and $200,000 for joint filers while expanding the size of the standard deduction. The Tax Policy Center estimates this higher standard deduction would reduce the number of filers who itemize from 45 million to 18 million in 2017, meaning fewer filers would take advantage of the SALT deduction (Nunns, Burman, Rohaly, and Rosenberg 2016). The House GOP plan would completely eliminate the SALT deduction.

Eliminating or curtailing the SALT deduction could cost states tax revenue because the SALT deduction acts as an indirect federal subsidy to state and local governments (Sammartino and Rueben 2016). Essentially, if state residents can deduct state taxes on their federal returns, state tax rates can be higher with the federal government offsetting some of the increase in residents' state tax burden. Overall, eliminating the SALT deduction would increase taxes on 24 percent of taxpayers, but the percentage would be far higher in some states (Sammartino and Rueben 2016), such as Connecticut and Maryland, which have higher percentages of high-income residents and higher state personal income tax rates (figure 2).

FIGURE 2

**Average Federal Tax Increase after Repealing SALT Deduction, 2016**




**Source:** Urban-Brookings Tax Policy Center Microsimulation Model (version 0515-1).
**Note**: Average increase only among tax units with an increase. Baseline uses current law; estimates use current federal tax rates. See Sammartino and Rueben (2016) for more details.

Faced with the possibility of a higher marginal tax burden of state and local taxes on residents, some states could respond with tax rate cuts or with changes in the composition of revenue sources. In theory, because the SALT deduction only lowers the burden for taxpayers who itemize, and those itemizers tend to be high earners,[10] the deduction incentivizes a more progressive state income tax. Thus, ending the SALT deduction could push states away from progressive tax structures. However, only a few studies found an effect on total state revenue and expenditures (Sammartino and Rueben 2016), and given that accompanying rate cuts would lower federal tax burdens, average tax burdens may alternatively leave room for increasing state taxes.

Recent federal tax changes might foreshadow limited state action in response to this reform. The Tax Reform Act of 1986 eliminated the deduction for general sales taxes and lowered the benefit of the SALT deduction for state income taxes because it lowered federal tax rates. Research found that reducing the income tax benefit had more consequence than eliminating the deduction for sales taxes. Thus, the 1986 reform actually increased the incentive for states to use sales taxes (even without the deduction) rather than state income taxes. After 2004, when taxpayers were again allowed to either deduct state sales tax or income tax, the Tax Policy Center did not find states changing their tax structures to rely more heavily on either tax (Sammartino and Rueben 2016). Finally, the American Taxpayer Relief Act of 2012 raised federal income tax rates on the highest income brackets, which made itemized deductions more valuable and thus subsidized state income tax rate hikes. However, many states did just the opposite and cut income tax rates following the federal change (Sammartino and Francis 2016).

Beyond the SALT deduction, the Ryan plan would eliminate all itemized deductions other than those for mortgage interest and charity. Because most states piggyback off the federal tax code, these federal base-broadening reforms could broaden state tax bases and potentially increase revenue (if states don't change their own tax rates). The Trump plan's cap could have a similar effect. In the aftermath of the 1986 tax reform, it was estimated that base broadening increased state income tax revenue 20 percent or more in 19 states (Ladd 1993).

The Trump and the House GOP plans would also change the taxation of capital gains. Trump's plan eliminates the 3.8 percent surtax on net investment income (a part of repealing ACA taxes), which would lower the rate on long-term capital gains to 20 percent. A lower tax rate could lead to more realizations (and thus revenue), but generally changing the federal tax rate would not have a big effect on state budgets. However, the House GOP proposal is far more substantial for states. It would replace the special tax rates on capital gains and dividends with a 50 percent exclusion or deduction for capital gains, dividends, and interest income (the federal government currently taxes interest income at the same rates as normal income).[11] Because this proposal would affect the tax base, and many states use the federal base as a starting point, this change could lead to a reduction in state taxable income. For example, Maryland, like many states, starts with federal adjusted gross income and adds and subtracts from it to arrive at its state adjusted gross income. With no change to the state tax law, Maryland taxpayers would be using the reduced federal capital gains, dividends, and interest income amount for their state income tax base.

Although states can respond to federal changes by decoupling, one consequence of capital gains taxes is out of their control: the timing of capital gains realizations. Given expectations of a reduced federal rate, taxpayers might delay realizations. This delay would not negatively affect the net income (assuming there are not phased-in state changes), but it would affect the timing by shifting gains and losses from one year to another. Similar state revenue volatility and uncertainty occurred in 2013 and 2014 following federal tax changes in 2012 (Francis 2015).

Finally, to the extent that the marginal tax rates on capital are lowered, the implicit subsidy to state and local municipal debt would also fall. Currently, most state and local borrowing is exempt from federal income tax,[12] which allows state and local governments to borrow more cheaply than other debt issuers, such as corporations, for a given level of risk and length of maturity. However, as marginal tax rates on other debt fall, the value of this exemption falls. Assuming there is one market for borrowing, the lowering of this subsidy would translate into state and local governments facing higher borrowing costs.

**Looming budget questions: Do states cut taxes to prevent increasing state tax burdens on some residents? Do states respond to changes to the federal tax base?**

## Corporate Income Tax

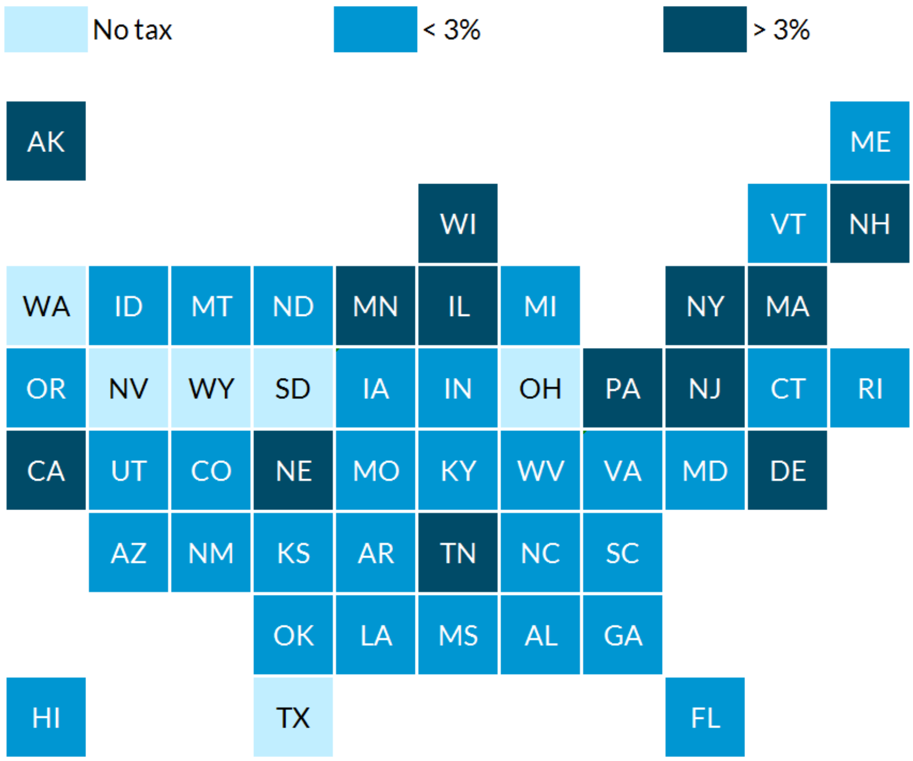
- Changes to the calculation of taxable income could lead states to decouple from federal rules to avoid revenue losses.
- Federal base broadening could increase state tax revenue in the long run.
- Major federal reforms could lead states to switch to gross receipts taxes.

Reforming the federal corporate income tax could prove disruptive for states because most states use federal definitions of income to calculate state corporate income, making it much easier to administer a state corporate tax. The House GOP plan would allow corporations and pass-through businesses to immediately deduct all investments, rather than depreciate these costs over time, and interest would no longer be deductible. These changes would transform the corporate income tax into a cash-flow tax, treating business income as it would under a consumption tax. The plan also would exclude receipts from exports, but it would disallow a deduction for imports. These changes will likely lower revenues in the short run, but in the long run they will likely increase the corporate tax base and thus increase revenue in states that do not decouple (assuming states don't lower tax rates).

Currently, 44 states levy a corporate income tax, and Texas and Ohio have a gross receipts tax. Nevada, South Dakota, Washington, and Wyoming have no corporate income tax or gross receipts tax. Nationally, the state corporate income tax represents only 3 percent of state general funds, but a handful of states are more reliant on the tax (figure 3). For example, Illinois' corporate tax raised 6 percent, and New Hampshire's business profits tax raised 9 percent.[13]

FIGURE 3

**State Corporate Income Tax Revenue as a Percentage of General Revenue**




**Source:** Census of Governments, 2014 Annual Survey of State Government Finances.

How states would react to a reform like the one proposed in the GOP plan is unclear. When the federal government allowed "bonus depreciation" in the early 2000s, 31 states decoupled from the new rule to prevent revenue losses (McNichol and Johnson 2005). States could continue to piggyback off the federal definitions and effectively change their corporate income tax into a cash-flow tax. However, if they wanted to retain current rules, including disallowing deductions of business expenses, they could require businesses to modify reported returns. Such a requirement would create more work for businesses, especially those that operate across multiple states. Some states may decide it would be easier to replace their current tax with a gross receipts tax, such as Ohio's commercial activity tax[14] or Texas's franchise (or margin) tax.[15] Alternatively, if the federal changes broaden the corporate tax base, they could potentially increase state corporate tax revenues.

The Trump tax plan also proposes giving corporations the option of choosing expensing or interest deduction, but it does not provide details on how the election would be implemented.

**Looming budget questions: Do states accept federal changes or decide to decouple and reinstate restrictions? Are federal reforms an opportunity to completely restructure state corporate tax systems?**

# How Will Federal Expenditure Changes Affect State Budgets?

Both President Trump and House Republicans proposed specific changes to several federal spending programs during the 2016 campaign.[16] Additionally, if federal tax changes result in revenue losses, the president and congressional leaders could decide to cut federal spending. Furthermore, they would also need to decide how new programs will fit under existing spending limits passed under sequestration. Current discussions include providing more block grants to states. If these changes are implemented, states will find that many of these approaches could exacerbate the cyclicality of the budget challenges they face with federal support not rising as much (or perhaps at all) in bad times or falling when the economy improves.

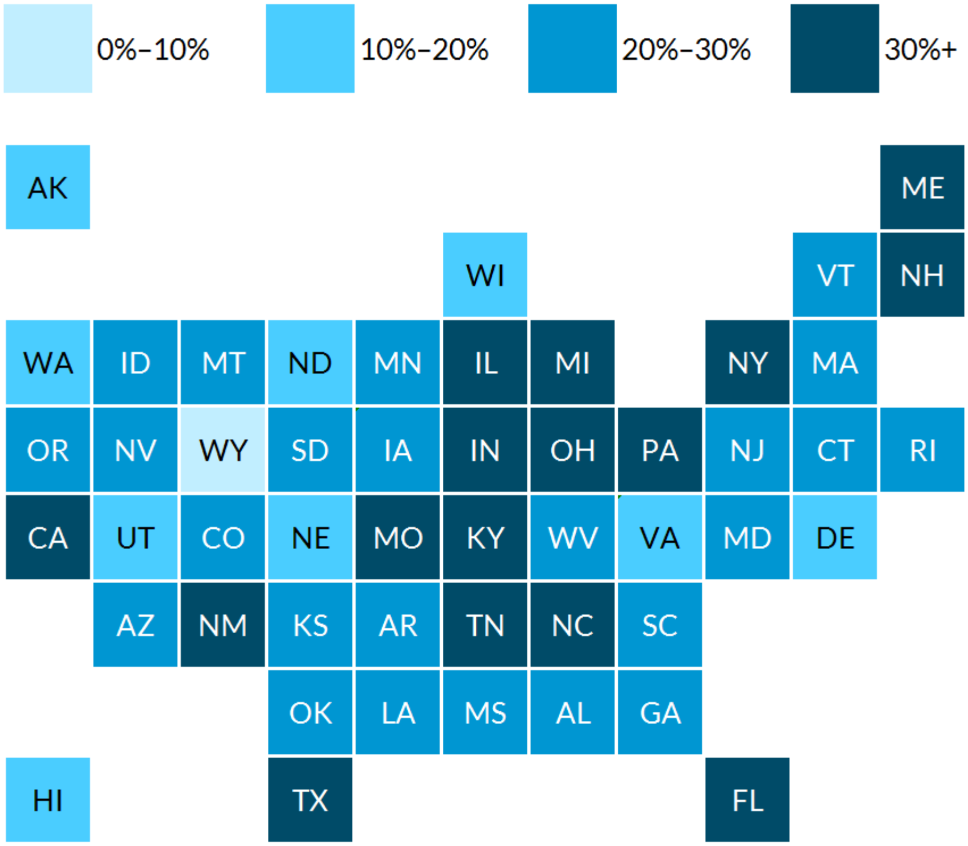
## Medicaid, the Affordable Care Act, and Health Care

- Repealing the ACA, specifically the Medicaid expansion, could lower required state Medicaid spending but also increase the number of uninsured, which in turn could create new fiscal problems or require states to find new revenue to maintain current enrollment levels.
- Other Medicaid reforms, such as block grants and per capita caps, could add to state spending costs if states want to maintain current levels of coverage and benefits.
- Raising the Medicare age would also put more pressure on state health care spending by potentially raising both the cost of Medicaid and costs of health insurance provided by state and local governments for retired public-sector workers.

In fiscal year 2016, states spent $558 billion on Medicaid, or 29 percent of total state expenditures including federal funds (NASBO 2016b), the largest component of state spending. Individually, state Medicaid spending ranged from 8 percent of total expenditures in Wyoming to 38 percent in Ohio (figure 4). The ACA expanded the eligible Medicaid population to all adults with incomes up to at least 138 percent of the federal poverty level, but a subsequent Supreme Court ruling made this expansion optional. As of October 2016, 31 states had adopted the Medicaid expansion.[17] Nonexpansion states have comparatively restrictive programs (e.g., adults without children are not eligible in all such states except Wisconsin; Brooks et al. 2017). Although Medicaid is administered by the states, the federal government provided 61 percent of overall Medicaid funding in 2016. The federal government funded 100 percent of Medicaid expansion costs from 2014 to 2016 and 97 percent in 2017; their contribution will gradually phase down to 90 percent in 2020 and then remain at that level.

FIGURE 4

**Medicaid Expenditures as a Percentage of Total Expenditures, Fiscal Year 2016**




**Source:** NASBO 2016b.
**Note**: States that did not accept the Medicaid expansion: AL, FL, GA, ID, KS, ME, MO, MS, NC, NE, OK, SC, SD, TN, TX, UT, VA, WI, WY.

Both the Trump and the House Republican plan for health care call for the complete repeal of the ACA, including the Medicaid expansion, with some discussion but little detail about what the replacement plan would entail.[18] The Urban Institute estimates that repealing the expansion would lower state spending on Medicaid and the Children's Health Insurance Program (which is provided through Medicaid) by $76 billion between 2019 and 2028. However, repealing the ACA—ending both the Medicaid expansion and the marketplace with subsidies—would take health insurance away from 30 million people, with nearly 13 million specifically losing Medicaid or Children's Health Insurance Program coverage (Blumberg, Buettgens, and Holahan 2016). The Congressional Budget Office (2017) recently reached a similar conclusion. It estimated that repealing these portions of the ACA (as was done in the Restoring American's Healthcare Freedom Reconciliation Act of 2015) would increase the uninsured population by 32 million by 2026, after the Medicaid expansion and subsidies are repealed. These newly uninsured individuals would seek an estimated $1.1 trillion in uncompensated care over the same period, a large portion of which would end up being the responsibility of state governments (Buettgens, Blumberg, and Holahan 2017).

Beyond repealing the ACA's Medicaid expansion, both the Trump and House GOP plans call for additional Medicaid reforms. Currently, states must enroll certain groups (e.g., qualified pregnant women and children) to receive federal funds, but otherwise they can choose how much coverage they provide to their residents.[19] The federal government then funds a share of each state's Medicaid expenditures based on a matching rate, which varies based on the state's per capita income (Kaiser Family Foundation 2012). Under the House plan, federal spending on Medicaid would be capped, and states could choose to receive their funds as a block grant (a base year of funding) or on a per capita allotment (using a formula that includes factors considering the number of aged, blind, and disabled individuals; children; and adults in the state). The Trump plan only discusses block grants. Given changing demographics, the relative health of the economy, federal budget constraints, and medical costs growing faster than inflation, it is likely that block grants or a per capita system will likely lead to lower growth in the Medicaid funding formula than under current rules. This slower growth would mean states could have even more control over who they choose to cover and what services are included but less money for that coverage.

An Urban Institute and Kaiser Family Foundation analysis (Holahan et al. 2012) of a previous House GOP plan for block grants estimated the caps would reduce federal Medicaid transfers to states by more than $800 billion, or 22 percent, over 10 years. The report also estimated states would need to increase Medicaid spending between 46 and 77 percent (depending on efficiency gains) if they wanted to avoid enrollment reductions (this estimate was made with a pre-Medicaid expansion baseline).

A Congressional Budget Office (2012a) analysis of the same House GOP plan concluded it could provide states more flexibility and thus improve efficiency. However, even accounting for those possible gains, the analysis concluded that "the magnitude of the reduction in spending relative to such spending in the other scenarios means that states would need to increase their spending on these programs, make considerable cutbacks in them, or both" (Congressional Budget Office 2012a, 9).

Notably, such Medicaid reforms would also have disparate effects (Holahan and Buettgens 2016). The Urban Institute found they would hurt low-income states more than high-income states. Typically, public block grant and per capita proposals establish a funding baseline based on current federal expenditure levels (however, this does not have to be the case, and the final legislative details are important). High-income states like New York that spend more on Medicaid would get more federal dollars per capita than most low-income states like Mississippi that spend less. This distribution of funds tends to be the case even though the current Medicaid matching formula is inversely related to income: New York's spending match is 50 percent (the low) and Mississippi's is 75 percent (the high). Low-income states would have to spend more to reach previous levels of enrollment. The Urban Institute and Kaiser Family Foundation study (Holahan et al. 2012) estimated New York would have to increase its current spending 66 percent and Mississippi would have to increase its spending 131 percent if each state wanted to maintain its pre-ACA enrollment levels after federal changes.

The House GOP plan would also tie the Medicare eligibility age to the Social Security eligibility age, increasing it from age 65 to age 66 or 67 (depending on year of birth). The Trump health care plan does not mention Medicare changes. Increasing the eligibility age would make Americans currently receiving both Medicaid and Medicare more dependent on the former and thus increase the burden on state governments. A recent Urban Institute report (Waidmann and Lawton 2015) estimated raising the Medicare age to 67 would increase federal Medicaid spending $766 million annually, with states contributing an additional $369 million. This estimate did not account for repealing the ACA and the Medicaid expansion, but it did note that nonexpansion states faced lower increases. The budget effects of raising the Medicare age would depend on how generous state Medicaid programs are after ACA repeal.

Raising the Medicare age would also increase the amount of money state and local governments spend on the health care expenses of retired state and local public-sector workers. Health care costs are the largest fraction of other postemployment benefits, which are the costs of retiree benefits excluding pension payments. These other postemployment benefit liabilities are already estimated to be about $862 billion (Munnell, Aubry, and Crawford 2016). Health care plans for retirees are typically written as secondary coverage to Medicare. Thus, increasing the Medicare eligibility age would also likely increase state and local governments' direct health care costs for these retired public-sector workers.

**Looming budget question: Following federal reforms, do states increase health care spending to maintain services or deal with the ramifications of more uninsured (or underinsured) residents?**

## TANF and SNAP

- Public welfare programs could see large cuts.

The TANF block grant is $16.5 billion each year (Falk 2016). States administer TANF—including setting eligibility standards—and must spend some of their own funds on TANF programs to receive federal funds (Cohen et al. 2016). Roughly a quarter of total federal and state funds are spent on monthly cash aid payments (Schott, Pavetti, and Floyd 2015). States also use TANF funds on a variety of other programs, such as expanding the state earned-income tax credit, child care programs, work training, and economic development projects.

The federal government completely funds SNAP, which is administered by states. The states and federal government only split administrative costs. President Barack Obama's fiscal year 2016 budget provided over $70 billion for the program.[20]

The House GOP plan released in June 2016 mentions strengthening both SNAP's and TANF's work requirements and consolidating federal welfare programs that overlap.[21] A related "Frequently Asked Questions" document states the plan will not increase or decrease spending and that no one will lose benefits.[22] However, the House Budget Committee budget released in March 2016 converts SNAP into a block grant and cuts the program by more than $150 billion, or 20 percent, over 10 years (House Budget Committee 2016; Rosenbaum and Keith-Jennings 2016). There are also unspecified spending cuts in the March budget (Kogan and Shapiro 2016), which means TANF could also see less funding.

None of Trump's proposals mentioned SNAP or TANF, but his economy page lamented the number of Americans on food stamps.[23]

**Looming budget questions: Do states increase spending on public welfare programs or allow services to expire if the federal government reduces spending? If states do not increase their spending, does that add more demand and pressure to other low-income state programs?**

## Infrastructure

- Trump's plan promises financing for projects but not direct funding for states.

Trump's infrastructure plan, as detailed by Ross and Navarro (2016), calls for $1 trillion of new infrastructure spending. However, the plan would not send $1 trillion from the federal government directly to state and local governments. Instead, the federal government would provide tax credits to private investors to spur more public-private partnerships, an arrangement in which a private company assists the government in managing the design and construction of, operating, or financing a project (Kile 2014).

Public-private partnerships offer many potential benefits, including faster access to capital when states and localities are up against statutory or constitutional limits on their ability to issue debt (Kile 2014). There is also suggestive evidence that these projects are completed sooner and at lower taxpayer cost (Congressional Budget Office 2012b).

However, many details of the Trump plan remain unclear. For example, it is not totally clear how projects would be selected. Any project would require permitting approval from the relevant authorities, but it is unclear if there needs to be a state or local public partner on the project. In addition, investors will require a rate of return, and projects offering a revenue stream to compensate for contributing equity and bearing risk may not be the infrastructure projects that yield the greatest social benefit. For example, toll roads have a reliable revenue stream, but it might be harder to fund infrastructure projects this way for projects with a large public good component, such as wastewater projects.[24]

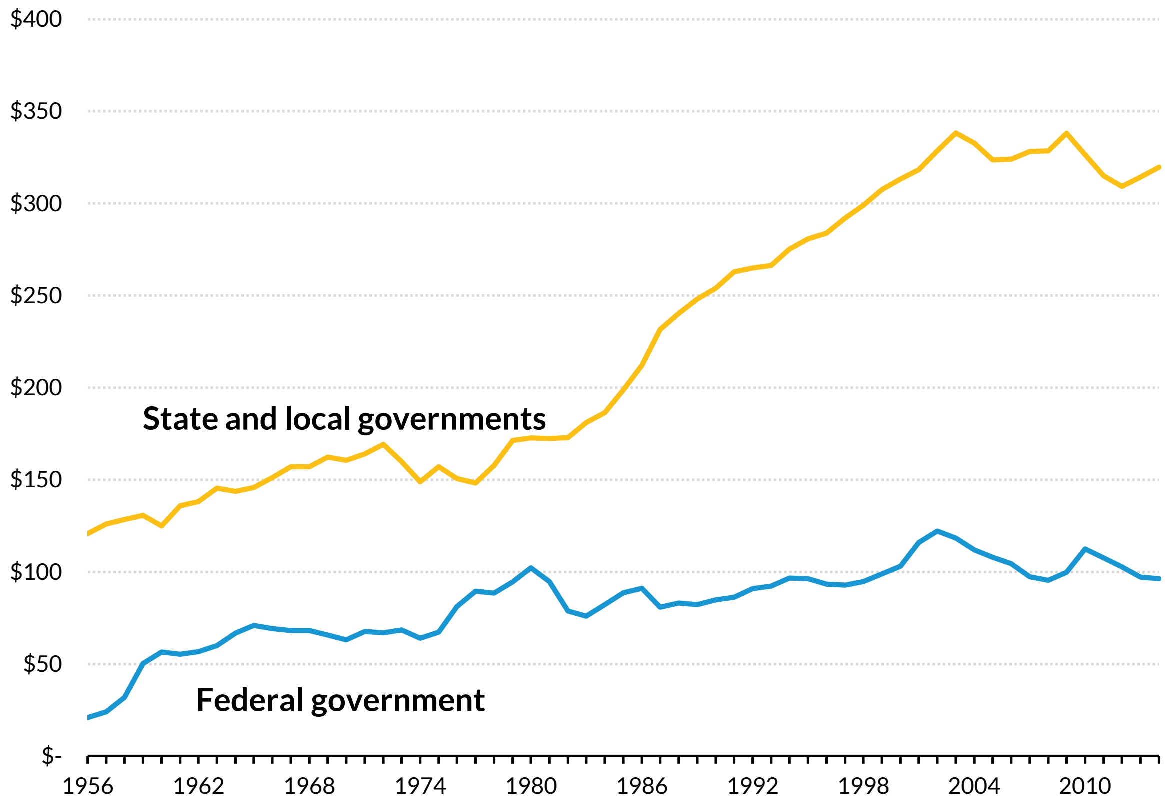
Alternatively, if the Trump administration were to revive a program like Build America Bonds, states (and local governments) could still be responsible for the necessary borrowing, albeit at lower costs because of the tax credits. The credits would then then be repaid through state user fees (e.g., tolls) or state tax revenue.

According to the Congressional Budget Office (2015), total public spending on infrastructure (highways, mass transit, water, and so forth) was $416 billion in 2014, with state and local governments providing the majority of funds ($320 billion). Roughly two-thirds of the total went toward transportation, and the other third was for water and wastewater systems. Since the 1980s, real federal spending has remained stagnant, meaning states and localities have spent more of their own funds on infrastructure (figure 5). From 2003 to 2014, however, federal, state, and local spending declined in real dollars. Going forward, the Budget Control Act of 2011 established 10-year caps on federal discretionary nondefense spending that would put downward pressure on federal infrastructure spending.

FIGURE 5

**Public Spending on Infrastructure, 1956–2014**

**$2014 billions**




**Source**: Congressional Budget Office (2015) based on data from the Office of Management and Budget, Census Bureau, and Bureau of Economic Analyisis.

Stagnant federal grants and a desire for more infrastructure projects is putting pressure on state budgets, forcing states to choose between infrastructure improvements and tax hikes (or other spending reductions). Since 2013, 17 states have raised taxes on motor fuel to support transportation spending (American Road & Transportation Builders Association 2016).

Beyond the limited types of programs that might be attractive for private investment as recounted above, such a federal subsidy program could focus on new projects at the expense of maintenance and upkeep. Private investment and building new projects will likely exacerbate the current underinvestment in maintenance for existing infrastructure. Indeed, current match rates and political considerations may already encourage underinvestment in upkeep, leading to the development of costly problems (Pagano 2012).

The House GOP plans did not include anything on infrastructure spending.

**Looming budget questions: Will states continue to increase gas taxes or raise other revenue (or cut other services) to fund desired infrastructure projects if the federal government does not increase funding? If investment is done directly by private companies, who decides which projects should be selected?**

## Elementary and Secondary Education

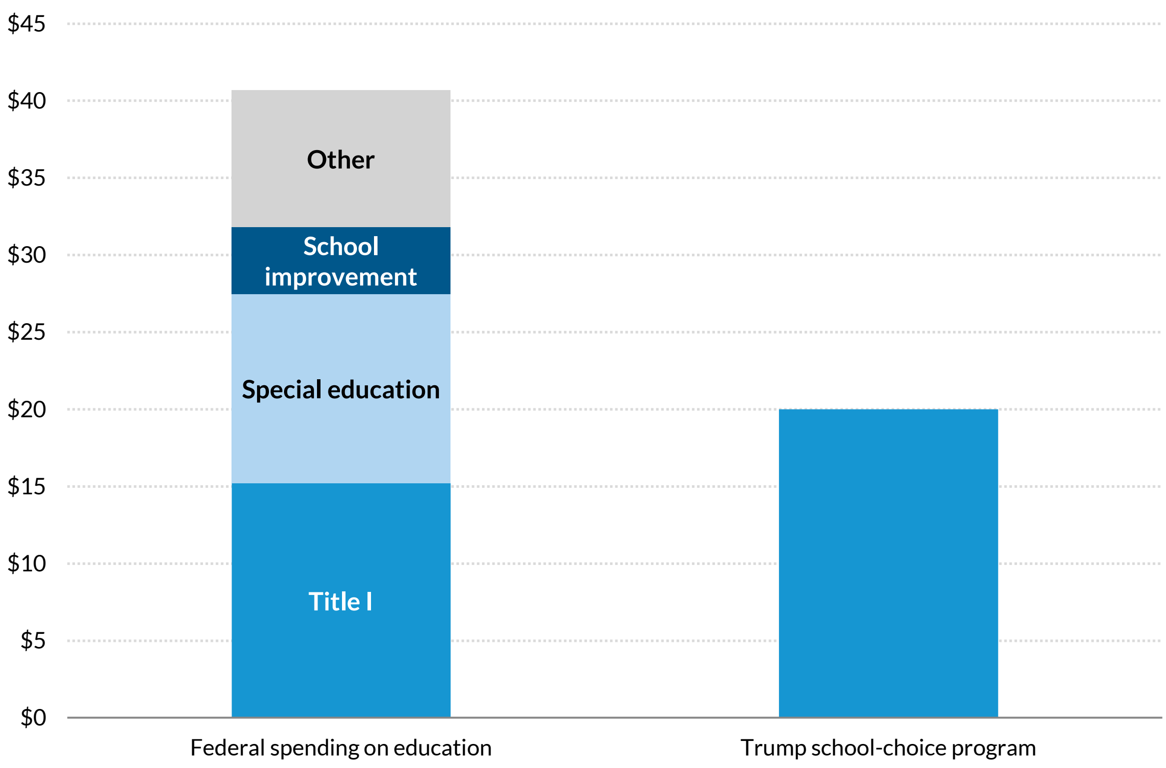
- Trump's plan would shift federal funds to school-choice programs

The Trump education plan calls for a $20 billion federal investment in school choice programs.[25] Trump's spending request is roughly half of what the federal government spent on kindergarten through grade 12 education in 2015, $41 billion (Edelstein et al. 2016), and it is more than the federal government currently spends on Title I funds earmarked for disadvantaged students (figure 6).

FIGURE 6

**Current Federal Education Spending (Fiscal Year 2015) versus Trump Proposal**

*$ billions*




**Sources**: Urban Institute calculations based on *Budget of US Goverment Fiscal Year 2017*; "Education," Donald Trump 2016 campaign website, accessed January 25, 2017, https://www.donaldjtrump.com/policies/education/.

Trump's plan also asks states to contribute another $110 billion of their own funds (to reach its goal of $12,000 in school choice funds for every student living in poverty). That sum is more than a third of what states spent from their own funds on elementary and secondary education in 2016 ($317 billion). The federal government can deficit finance this enormous expansion, but states will have to raise taxes or reduce other spending to meet this goal. The House GOP plans did not include anything on changing education spending.

Federal funds for elementary and secondary education spending have declined since the Great Recession.[26] After a brief increase with the American Recovery and Reinvention Act, federal spending was reduced after congressional nondefense discretionary cuts in 2011 and 2013. Meanwhile, the economic downturn and resulting state budget problems have prevented real (or inflation-adjusted) state and local spending from reaching prerecession levels. Many states have continued to cut education spending during the recovery.

**Looming budget questions: How will states respond if Title I funding is cut and/or if there are pressures to move state funding to school-choice programs? Who will define these programs, and what will these transfers mean for existing public schools?**

## Other Issues: Trade, Immigration, and More

In addition to these major fiscal issues, President Trump and House Republicans are discussing changing numerous other federal policies that, if turned into law, would affect the economies and budgets of states.

For example, President Trump spent much of the campaign deriding America's trade policy.[27] He pledged to renegotiate the North American Free Trade Agreement, take a tougher approach with China, and either use tariffs against specific companies that move jobs out of the United States or implement a simpler across-the-board tariff on all imports.[28] All these actions would have wide but unpredictable repercussions: they could keep companies (and jobs) in states or stifle economic activity across the country (or in specific regions). President Trump also seems to want to negotiate individual deals with specific companies. This unprecedented action began during his transition, most notably with Carrier. Although the specifics of the deal are still debated,[29] the federal government doing business with individual corporations gives all companies an incentive to demand concessions[30] from both the federal government and their state government—with pressure directly from the president—before any business decision.

Trump was also hostile toward immigration.[31] He promised to "build a wall" on the Mexican border, order a mass-scale deportation of criminal undocumented immigrants, suspend immigration from terror-prone regions where vetting cannot safely occur, rescind the Deferred Action for Childhood Arrivals, and deny federal funds to cities that protect undocumented residents from being deported.[32] Any or all of these actions could upend the economies and budgets of states with large immigrant populations.[33] More than 40 million people in the United States were born in other countries, and roughly 11 million are undocumented immigrants (Passell and Cohn 2016). Most undocumented immigrants live in six states (California, Florida, Illinois, New Jersey, New York, and Texas), but many other states in the South and West have relatively large undocumented populations (Passel and Cohn 2016). Immigrants (both documented and undocumented) currently help counterbalance an aging native workforce[34] and account for many high-skilled laborers (e.g., in fields such as science, technology, and math). Indeed, a recent National Academies of Sciences, Engineering, and Medicine report on immigration[35] found immigrants added to national economic growth. In the short term, on average immigrants cost state and local governments more than they provide in taxes (mostly because of the cost of educating their children);[36] however, over the long term their positive contributions are key to both the nation's and states' economic and fiscal futures.

Many other federal issues—from affordable housing[37] to criminal justice reform—will affect all 50 state budgets, and other issues (such as a federal hiring freeze[38] or rolling back environmental regulations[39]) would have a big effect on certain states. In short, states need to pay attention to nearly every major reform debated and passed in Washington because it will affect their budgets either directly or indirectly through repercussions on their economies.

# Conclusion

Nearly a decade removed from the Great Recession, states are still struggling to make their budget math work. Most states entered 2017 with a deficit, and nearly two-thirds of states spend less on services today in real dollars than they did before the recession. Given these challenges, states will spend the next few months debating tough fiscal trade-offs.

As states work through their budgets they must keep an eye on Washington, because federal policy changes could force even tougher decisions. President Trump and the House Republicans bring ambitious agendas to Washington that would hand states greater control of programs but likely more responsibility as well. If federal reforms detailed in this brief are passed, many states that have spent the past few years avoiding tough decisions and balancing their budgets with one-off policies will face unavoidable questions about how much they want to tax residents and what level of services they want to provide.

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