TCM INSIGHTS

STATE BAILOUTS SHOULD BE CONDITIONAL

The Federal government has increased spending by $3 trillion in efforts to compensate businesses and workers for the government-mandated COVID-related shutdowns. This debt will eventually have to be repaid - most likely through higher taxes on future generations.

Federal borrowing is already more than 100% of GDP and politicians are debating how much more money to borrow as shutdowns drag on. Some of this potential borrowing, up to $1 trillion, is for direct state bailouts. However, it appears that some of that borrowing is earmarked to bail out states for problems which existed pre-COVID. For example, in Illinois, unfunded pension obligations were roughly $200 billion before COVID hit, but Illinois politicians are using the pandemic to justify receiving bailout funds.

Solutions

Economists have looked at this issue of 'moral hazard' - where bad financial management at the state level is 'rewarded' by Federal government bailouts - and have proposed several fixes to limit the burden on future generations and discourage future financial mismanagement.

The first proposal is for the Treasury to issue 50- and 100-year Treasury bonds to finance Coronavirus-related debt. With interest rates at historical lows, it would make sense to lock in low borrowing costs and spread the debt burden over multiple decades. Still, even though interest rates are at historic lows, in the normal government budgeting process, longer-term debt demands a higher rate than short-term borrowing, and this higher interest cost increases total government spending, removing short-term budget dollars to spend on other programs - something which politicians are hesitant to do. However, in the context of $3 trillion debt, the higher interest expense is negligible, so economists are urging politicians to play the long game.

Additionally, if US taxpayers are going to bail out states, those states should be forced to change policies to ensure bailouts are less likely in the future. Economists have proposed three changes that Congress should demand in terms of the way state and local governments manage their affairs.

Three Proposed Changes

First, taxpayers should demand that states immediately shift to defined contribution pension plans (like 401k's) from defined benefit plans. The private sector has already done this - states should too. Switching to defined contribution plans limits the liabilities of state and local governments

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and pushes government workers to think more about their own retirement rather than putting the burden on taxpayers.

Second, taxpayers should require any states getting a bailout to provide universal state-wide school-vouchers so that parents can choose where their kids go to school with the property taxes they already pay. Right now, private schools in many states are open for in-person education, while public schools are not. States are collecting taxes for services they are not fully providing.

Third, any state that gets a bailout should be forced to pass a Right-to-Work law and follow Wisconsin's example of making Union dues truly voluntary. Unions support more pay and bigger pensions for government workers with campaign donations to government officials. This has helped create the budget problems that state and local government currently have to deal with.

If the Federal government made these three changes a requirement for states to receive bailouts, it would help offset the financial burden that federal taxpayers are being asked to shoulder. Any bailouts should come with conditions.

Every bailout of banks in 2008/09 came with conditions, the recent bailout of the airline industry came with conditions, why shouldn't states be required to do the same?

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