Federal Reserve May Have To Rescue Strapped States

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Senator Mitch McConnell, the majority leader, shot down the possibility of additional federal aid for state governments, suggesting that they should instead be allowed to declare bankruptcy. His comments could leave the Federal Reserve at the center of helping strapped state and local leaders.

"This whole business of additional assistance for state and local governments needs to be thoroughly evaluated," Mr. McConnell, a Republican from Kentucky, said in an interview with a conservative radio host on Wednesday. "There's not going to be any desire on the Republican side to bail out state pensions by borrowing money from future generations."

States cannot declare bankruptcy to restructure their debt, though local governments sometimes do. That means that when cash shortages crop up — like now, as coronavirus quarantines delay income tax filings and tank other sources of income, like casino revenue, just as costs skyrocket — they must tax more, slash spending or issue more debt.

If the federal government is not willing to come through with the cash that states need to cover expenses, they will probably turn to the third option, which is where the Fed will come in. The central bank announced this month that it would begin buying short-term debt from states and some large cities and counties.

States are already laying plans to tap the program, and lawmakers from both parties have called on the Fed to make it broader and more inclusive of smaller local governments, something officials have signaled that they are working to do. The Fed has yet to give a start date for the program.

The CARES Act did provide some funding to the state and local governments in the form of a $150 billion relief fund. That was insufficient to plug the hole coronavirus has shot through budgets, though, and government could again be forced to lay off teachers and other public workers. A similar scenario played out in the wake of the 2008 financial crisis, hampering the economic recovery.