
Fed Should Buy Muni Bonds to Fight the Next Recession.

There's a strong case for letting the U.S. central bank help states weather an economic downturn.

Almost 10 years after the Great Recession ended, the growing threat of a new economic slowdown raises a troubling question: When the next recession strikes, what can the world's central banks do? With interest rates low and their balance sheets still loaded with assets bought to fight the 2008 crisis, do they have the tools to respond? This column is one of five looking at that question.

U.S. state governments suffered major damage from the last recession 10 years ago. During the second quarter of 2009, the final months of the downturn, personal income taxes tumbled 27 percent from a year earlier. At the same time, expenses grew as enrollment for Medicaid and state unemployment insurance soared, while crumbling asset prices suddenly left public pension systems with massive shortfalls relative to their liabilities. In statehouses across the country, money was tight, to say the least. California went so far as to issue IOUs.

Over the past decade, the slow-but-steady economic expansion has covered up these issues, but hasn't erased them. State government employment remains below its pre-financial crisis peak. Public pension plans are still largely in a sea of red ink, with an overall shortfall of $1.4 trillion at the state level, and even those with an acceptable level of assets are just one bear market away from the brink. And it's no secret that the U.S. has fallen terribly behind in funding its roads, bridges, airports and public transit systems. The American Society of Civil Engineers estimates the money needed to get infrastructure into an overall "state of good repair" will fall short by $2 trillion over the next several years.

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