
States Need Coronavirus Relief for Pensions and Health Care.

(Bloomberg Opinion) — States and localities have been leading the nation's response to the coronavirus — and unless Congress further intervenes, they're going to pay for it.

While the Senate's $2 trillion stimulus bill includes relief for individuals, families and businesses limping through the current slowdown, it's barely going to dent the impending budget increase for state and local governments. Medicaid and retiree pension costs — already the two most problematic spending areas for governments — will balloon as result of the Covid-19 crisis. Congress can help with both.

Start with Medicaid spending, which has rapidly grown over the past decade thanks to expansion and the rising cost of health care. It now accounts for 17% of state spending, up from 14% in 2008. In New York State, the epicenter of the coronavirus outbreak, Medicaid costs are already a whopping 28% of the budget.

Anticipating the skyrocketing costs to come, the nation's governors have asked Congress to temporarily increase federal matching funds by a minimum of 12 percentage points. The previous relief bill, the Families First Coronavirus Response Act signed last week, does allow for a temporary 6.2 percentage point increase in the regular federal matching rate for the emergency period. But it does not apply to qualified adults under the Affordable Care Act, even though it requires that states provide free coronavirus-related testing and treatment to all enrollees.

The current Senate bill includes $300 billion in combined aid for hospitals and state and local governments. But it's likely this will go to supplies and personnel, not mounting Medicaid bills. If Congress were serious about helping states, it would give governors the larger federal match they asked for. At a minimum, it would extend the current 6.2-point increase to cover ACA expansion adults.

Pensions are another matter. The stock market has lost about one-third of its value since mid-February and public pensions, which are heavily invested in stocks, are likely to have their worst year since the 2008 financial crisis. Pension assets still haven't recovered from those losses, and making up for these new losses over the next few years will be all but impossible.

Congress doesn't — and shouldn't — have control over state and local pensions. But it can offer a tool for public pensions to help with what Moody's Investors Service estimates will be a $1 trillion loss in investments. Pension obligation bonds, when governments issue debt and put the proceeds into pension systems, are generally frowned upon as a gamble by public finance experts. Such bonds are taxable, so governments pay a higher interest rate for them, and correctly timing investments made with the bond proceeds requires some luck. But this is a moment when they may be worth it.

Stocks are cheap now, and so are borrowing costs. The federal government can sweeten the deal even more by making these bonds tax-exempt for qualifying governments, which would lower borrowing costs even more. In fact, before the 1986 tax reform, these bonds were tax exempt.

Such a move might not be advisable for every pension plan; after all, pension bonds turn “soft” pension debt into hard bond debt with penalties for nonpayment. But for many, a boost in assets now would likely produce a welcome return on investment over the next few years and ultimately help stabilize government pension bills.

Unlike any economic crisis in the modern era, the driver of this slowdown isn’t a familiar industry like tech or finance. It’s a virus about which very little is known and which requires people staying away from one another. The usual government policy response — an economic stimulus to get people out and working again — isn’t a viable option. It’s a daunting prospect for local leaders.

And yet those leaders have been on the front lines of the Covid-19 crisis anyway, making difficult but necessary policy decisions that are blowing holes in their budgets. It took nearly a decade for most state and local governments to recover financially from the last economic crisis. Congress can and should do a lot more for them this time around.

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