First Trust

Monday Morning OUTLOOK

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Positive Policies to Cut the Debt Burden

When government forces businesses to close (even if it is for a pandemic), it's a "taking" in the legal sense. And we can think about \$3 trillion in extra federal spending as "just compensation" to businesses and workers for that taking. Basically, we decided to borrow from future generations in an attempt to stop a virus and save the economy.

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. And it appears some of that borrowing is to bailout states for problems that already existed. For example, in Illinois, unfunded pension obligations were roughly \$200 billion before COVID hit. Illinois politicians are not letting a crisis go to waste and want to get bailout money now.

Those who worry about federal spending and the "moral hazard" of rewarding bad financial behavior by states look at a bailout as a huge mistake. The question is: Could there be anything positive that comes from this? What policies could the US put in place to limit the damage to future generations from all this borrowing? If we are asking our children and grandchildren to pay for this, are there things we can do that boost growth and limit the odds of more bailouts ahead?

We think there are.

First, the Treasury should issue 50- and 100-year Treasury bonds to finance Coronavirus debt. While the virus will pass, the economic costs will not and should be financed over a long period of time.

One of the reasons this has not happened already is that, in the normal budget process, issuing longer-term debt at higher interest rates than short-term borrowing rates increases debt costs and therefore total government spending. This takes away shortterm budget dollars that politicians hope to spend on other things, so they don't like it. But these days, nobody in Washington, D.C. seems to care about adding to spending. So, lock-in the financing costs for decades to come. After all, that's realistically how long it will take to pay it back.

Second, if US taxpayers are going to bail out states, we should force states to change policies so bailouts are less likely in the future. This means the President and Congress should ask

for three changes in the way state and local governments manage their affairs.

Taxpayers should demand that states immediately shift to defined contribution pension plans (like 401-K's) from defined benefit plans. The private sector has already done this; states should too. It limits the liabilities of state and local governments and pushes government workers to think more about their own retirement rather than putting the burden on taxpayers. If taxpayers are going to bailout Illinois for running up \$200 billion of unfunded pension debt, they deserve to know it won't happen again.

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. The incentives are all wrong and vouchers will adjust those incentives.

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, with no gimmicks about when a worker has to give notice to stop paying dues. Unions support more pay and bigger pensions for government workers with campaign donations to government officials. This helped create the budget problems that state and local government currently have today and government workers have not been hit as hard by shutdowns as private sector workers.

If taxpayers need to spend \$1 trillion to bail out state and local government for decisions made prior to (and during) COVID, and these states are unwilling to open up their economies today, these states should be willing to make changes that will limit the chances of similar problems recurring in the future.

And if Washington, D.C. made these changes a requirement 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, why shouldn't states be required to do the same?

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
9-8 / 2:00 pm	Consumer Credit–Jul	\$12.9 Bil	\$12.0 Bil		\$8.9 Bil
9-10 / 7:30 am	Initial Claims – Sep 7	830K	830K		881K
7:30 am	PPI – Aug	+0.2%	+0.2%		+0.6%
7:30 am	"Core" PPI – Aug	+0.2%	+0.2%		+0.5%
9-11 / 7:30 am	CPI – Aug	+0.3%	+0.3%		+0.6%
7:30 am	"Core" CPI – Aug	+0.2%	+0.2%		+0.6%

Consensus forecasts come from Bloomberg. This report was prepared by First Trust Advisors L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.