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How will the Federal Reserve's new loan program for states affect Massachusetts?

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On April 9th, the Federal Reserve (Fed) announced it was taking the unprecedented step of creating a "Municipal Liquidity Facility" (MLF). The MLF is essentially a short-term loan program for states and for more populous cities and counties. (After hearing concerns raised about population its initial thresholds, the Fed announced on April 27th that it would reduce the MLF's city and county population eligibility requirements in order to allow cities with populations above 250,000 and counties with populations above 500,000 to participate directly in the program.)

Through the MLF, the Fed has pledged to buy up to $500 billion in short-term bonds and various tax anticipation notes issued by eligible entities (states and larger cities and counties). Under the MLF, the Fed can purchase bonds of eligible entities up to an amount equal to 20 percent of an entity's own-source 2017 general revenue. Maturity dates on these bonds and notes cannot exceed 36 months from issuance (an increase from the 24-month maturity period originally announced on April 9th). The Fed will cease purchasing bonds through the MLF on December 30, 2020 unless conditions warrant an extension of the facility. For cities and counties that do not have direct access to the MLF, the MLF rules allow states to use their MLF dollars to purchase short-term debt from "political subdivisions of the relevant state," thus extending the benefits of the program to some smaller towns, cities and counties.

The MLF is a timely and important form of support. These bond and note purchases will provide states and other eligible entities with greater fiscal capacity to maintain their programs and services in the near-term, as they grapple with immediate cash flow and other revenue shortfall challenges. Nevertheless, the program has significant design flaws. State constitutional prohibitions on debt may prevent some states from accessing these dollars altogether. Other states — including Massachusetts — may have constitutional problems in carrying the resulting debt from one fiscal year to the next, thus limiting the value of the program even for relatively short-term fiscal relief. (Recent media reports indicate that the Massachusetts House of Representatives hopes to vote soon on measures that would allow debt to be carried beyond a single fiscal year.)

Additionally, because states will continue to face large tax shortfalls in the coming few years, federal support that requires repayment in three years will only slow the future recovery and prevent states from replenishing their own reserves ahead of the next recession. As MassBudget analysis has shown, in each of the previous two recessions, it took six years from the onset of recession for state tax collections to return to their inflation-adjusted, pre-recession levels.

Recognizing the likely depth and length of the revenue challenges ahead, far more useful than short-term loans will be large grants to states from the federal government, without the expectation that these dollars need be repaid in the future. States, including our own, likewise will need to augment these federal dollars with additional, state-level revenue. The closure of costly, wasteful corporate tax breaks and tax loopholes should top this to-do list.

Rolled out with commendable haste – and usefully amended in response to concerns raised – the Federal Reserve's MLF program will provide important stop-gap funding to many states. The Commonwealth and the city of Boston very likely will be beneficiaries of the program. A short-term loan program, however, is no substitute for the more fundamental lifeline that states will need. In order to protect vulnerable communities during this crisis and lay the groundwork for a robust and just recovery down the road, states will need large, ongoing infusions of federal grant dollars, supplemented with new state tax revenue. These are the only real solutions to the core fiscal problem we face: a state tax system that does not deliver sufficient revenue even in good times, and which now is in a COVID-induced free-fall.