
How to save the economy

by Brian Riedl | April 02, 2020 11:00 PM

The federal response to the COVID-19 pandemic has been historic in its magnitude, speed, and nearly unanimous congressional support. But it has also been misunderstood, and the differences between it and past federal crises, in terms of federal economic intervention, are instructive.

In just two weeks, Congress drafted and enacted one of the most expensive bills in American history, with a \$2 trillion price tag, that will affect every part of the economy. This speed reflects the rapid bipartisan consensus of economists and policy experts around a set of policies needed to prevent a short-term economic crisis from becoming a long-term depression.

It's also unique. Despite common comparisons, the 2020 federal response bears little relation to the 2009 stimulus legislation that was enacted near the end of the Great Recession. That purely [partisan](#), \$787 billion bill was based on the outdated Keynesian notion that public works projects (often pork) would increase consumption and demand, tap into a multiplier, and create a burst of economic growth. In reality, nearly all of the 2009 stimulus was [implemented after](#) the Great Recession had ended and coincided with an economic recovery that was even [slower](#) than the Obama White House's own projections of what would have happened without the administration's stimulus bill.

By contrast, the \$2 trillion Coronavirus Aid, Relief, and Economic Security, or CARES, Act is designed as social insurance, not stimulus. The goal is not to stimulate spending broadly across the economy (though that may result), but rather to provide a safety net for individuals who are no longer collecting a paycheck and businesses that have lost their customers due to the economic lockdown. It is meant to prevent businesses from disappearing, key industries such as restaurants, airlines, and hotels from collapsing, and families from losing their livelihoods. The standard of success is not to boost consumption, but simply to keep families and businesses afloat.

To analyze the economic effects of the lockdown, imagine that certain industries closed for a period in order to let their workers take an extended summer vacation. In theory, this should reduce output in the short run and draw down savings and business inventories. However, because the economic structure would not be permanently changed, the end of the "vacation" should revert this part of the economy back to its prerecession performance. Production and demand should roughly return to earlier levels, and the same number of workers would, all else staying constant, be needed in the same businesses and industries.

The obvious difference today is that workers and businesses have not budgeted for this extended, unpaid “vacation.” So the economic policy challenge is to make sure that the economy does not lose the businesses and workers who can revert the economy back to its pre-lockdown status. Thus, the federal response has consisted of five broad strategies: 1) address the public health crisis, 2) avoid business bankruptcies with loans to distressed businesses, 3) minimize layoffs by subsidizing the payrolls of businesses that retain their staff, 4) provide generous unemployment and safety net assistance to those who have already been laid off, and 5) empower the Federal Reserve to lower interest rates and guarantee liquidity for the financial system.

Not surprisingly, Congress couldn't resist stuffing some pork into the federal response, and the \$1,200 rebates for most adults (plus an additional \$500 per child) are poorly targeted and likely to be distributed too slowly. Yet with 3.3 million jobless claims in one week, more than four times the previous record, Washington is wise to fire all its guns at the free-falling economy. Allowing industries to collapse could likely turn a temporary, sharp, V-shaped downturn into an extended depression, not to mention create a humanitarian crisis as millions of families lose their livelihoods. This crisis is not the fault of families or businesses; the government ordered an economic shutdown and has an obligation to compensate its victims.

A key question is how long the economic shutdown is sustainable. The combination of federal emergency assistance and plummeting tax revenues is adding approximately \$1 trillion per month to the national debt. To put that in context, America has run *annual* deficits exceeding \$1 trillion only four times (2009 through 2012) in its history. The CARES Act is designed to last approximately three months, through mid-June. At that point, Washington continuing to borrow \$1 trillion per month, and pushing the 2020 budget deficit to a share of the economy unseen since the height of World War II, has three main drawbacks.

First, Washington's borrowing capacity may eventually become constrained. Today's near-zero interest rates suggest a substantial ability to borrow. But \$1 trillion per month for several months (while other nations are also borrowing heavily) may eventually begin to shrink the pool of available savings, leaving the Federal Reserve to monetize more of the debt. While there are no current signs of such challenges, the government is entering uncharted territory.

A second concern is that even generous federal aid may not be sufficient to save the number of businesses that would be necessary for a strong recovery.

Finally, at some point, depleted inventories and constrained supply lines could bring shortages of basic goods. The economy is much like a patient: The longer the illness continues, the more long-term damage arises that can prevent a full recovery.

Thus, it is critical to reopen the economy as soon as it can be done safely. Public health is the first priority. After all, many workers will not return to their jobs if they feel they are in danger, and reopening too early can risk a second pandemic wave while [extending](#) the economic

downturn. That said, an extended depression would have its own catastrophic effects on the well-being of families. Nobel Laureate Paul Romer [has suggested](#) that wide-scale testing and protective equipment could eventually make it safe enough to reopen parts of the economy before COVID-19 has been completely eradicated. Several former Food and Drug Administration commissioners have produced a [roadmap](#) as well.

Whenever the economy reopens, Washington will likely need to spend more to bail out state and local governments that face their own financial ruin, and also may not be able to resist a 2009-style Keynesian stimulus bill.

In addition to recognizing the strong federal economic response to the pandemic, it is worth examining Washington's slow public-health response. Some opportunists have classified the federal government's lack of pandemic preparedness as proof of a long-term conservative campaign to starve the government of resources and a case for government nationalization of healthcare and other sectors.

Such a viewpoint is absurd. Washington spends \$4.5 trillion annually, and public-health spending has [surged](#) since 2000. The federal government failed not because it is too small, but because it is not smart. Better planning would not have cost any more money. The few billion dollars necessary to expand the healthcare system's emergency capacity and purchase more equipment would have added up to a rounding error in the federal budget. The problem was a lack of imagination, planning, and coordination — not funds. In fact, other countries with government-run healthcare systems have struggled as well.

The United States built a sprawling government that tries to do everything for everyone and ends up doing very few things well. Political leaders are elected based on grievance politics. Congress has been reduced to a debating society that abandons its responsibility for basic planning and oversight. Washington failed to prepare adequately for a terrorist attack on U.S. soil (9/11), the collapse of the New Orleans levees (Hurricane Katrina), the implosion of the mortgage market (Great Recession), and now, a major pandemic. Congress wasted a 10-year economic expansion by adding [\\$9 trillion](#) in new debt, bringing the total debt to \$23 trillion and leaving less fiscal room to respond to real crises.

Washington was caught flat-footed on the health front, yet its economic response has represented a strong policy consensus. The next three steps are to defeat the pandemic, reopen the economy, and then bring true priority-setting, preparedness, and accountability to Washington.

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