Fiscal Policy in a Time of Crisis
How should free marketers respond to the coronavirus crisis?

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Key Takeaways

- **Congress is poised to act, but not all action will make things better**
- **Relief that is timely, targeted and temporary is preferable to other types**
- **Beware of premature attempts at "stimulus" instead of immediate aid**

BACKGROUND

Reeling from the unprecedented coronavirus outbreak, the United States—and indeed, the world—looks fundamentally different than before. Government officials are obviously eager to "do something" to calm the tumultuous economy and provide relief for their constituents, and while skepticism is always warranted when they get this urge, the current environment indeed calls for swift and direct action, some of which has already been taken. Responding to the sudden and drastic change in the country's economic situation requires laying out a general framework for evaluating potential remedies and a broad menu of acceptable options.

PRINCIPLES

Given the dynamic and fast-moving context in which policy is being discussed, it is important to establish and stick to the following general principles:

1. We have an imperative to act, and acting is not inconsistent with our values. To varying degrees, federal, state and local governments are forcing large segments of the economy to shut down. It's for this reason that there is no ideological inconsistency in urging that the government make those affected businesses and workers whole. Opposing relief outright is economically foolhardy and logically indefensible.

2. Stimulus and relief are separate goals. There is considerable discussion about which actions should be taken, but it is important to remember that in the period immediately after an exogenous shock, our primary goal is not to stimulate; it is to relieve. Millions of Americans are out of work or otherwise underemployed and lack the ability to pay their rent and mortgages, buy food, pay for prescriptions and so forth. Providing for their immediate needs may help forestall a larger economic crash, but is a separate goal than attempting to stimulate a recovery.

3. There will still be a tomorrow. While a true emergency situation may not allow the time to make perfect fiscal tradeoffs, they must eventually be considered. A critical factor in determining whether a proposal is worthwhile is to ensure that it is substantial, but not permanent. Accordingly, proposals should be evaluated according to the following rubric:

Significant and Permanent	Significant and Temporary

Insignificant and Permanent	Insignificant and Temporary

Policymakers should aim to identify policies that fit into the top-right quadrant. Naturally, programs that have a minimum effect may still be worthwhile to pursue as part of a larger package, but they also risk missing the "forest for the trees" at a time when broad action is necessary. Partisans may look to take advantage of the current situation to push through unrelated agenda items, but building new programs or making permanent changes to existing ones just increases the odds that the size, scope and costs of government will continue to grow after the initial crisis has passed—at a time when we can afford it less than ever.

WHY NOW IS DIFFERENT THAN BEFORE

More than anything else in our lifetimes, the Covid-19 outbreak typifies an external shock to the system that government has a role in responding to. There is nothing in our collective memory that provides a comprehensive blueprint for addressing the current situation, because nothing in modern world history compares to this event. **While Congress no doubt has mislabeled many bills passed over the last decade as "emergency" or "contingency" spending, it's important not to ignore a true emergency when it arises.**

A strong and targeted government response is not in conflict with larger, holistic concerns about the economy and the bad actors that have motivated past opposition to bailouts and big spending. For instance, the 2007-08 financial meltdown was a banking crisis that resulted out of years of deliberate and poor decisions. Many rightfully opposed government bailouts that rewarded risky behavior. While certainly worsened by the mistakes of various governments worldwide, the present situation could not have fully been foreseen, nor could it have been prevented in any reasonable manner. Government actions after the fact cannot "reward" the virus or make it likelier to happen again.

As Jim Antle recently wrote in *The American Spectator,* "This is not the product of malinvestment, and the need for government assistance of some sort does not pose the same moral hazard. If anything is an exogenous shock to the economy that ordinary citizens and businesses have little power to protect themselves against, coronavirus is it."

WHY RELIEF MUST TAKE PRECEDENCE OVER STIMULUS

Estimates right now are that roughly 84 million Americans are in their homes. Of those, some are people who will continue to be paid and work remotely without interruption, while others are essentially being forced out of work as we speak. In the early days of the crisis, nearly a million people were filing for unemployment per day, a number that may rise even higher.

All evidence is that the sharpness of the related economic decline will be greater than both that experienced after 9/11 and at the height of the 2007-08 financial crisis. For example, the *Washington Post* reported that: "Bridgewater Associates [...] says the economy will shrink over the next three months at an annual rate of 30 percent. Goldman Sachs pegs the drop at 24 percent. JPMorgan Chase says 14 percent."

However, unlike in some previous crises, the current problem does not lie with aggregate demand, but with the unexpected shock to the system. For this reason, policy ideas should aim to provide short-term relief, not stimulate the economy. As George Mason University economist Tyler Cowen put it, our goal in the short-term is to "scale down economic activity in a rapid way to keep people at home, but without devastating the physical, cultural, or organizational capital that will be needed to restore growth and normality."

THE ECONOMICS AND POTENTIAL SOLUTIONS

Policymakers now find themselves in a race to provide for Americans' basic needs, prevent businesses from shutting down and stop a larger crash from beginning. While nobody truly knows the appropriate size of the response—Bridgewater Associates has estimated the potential corporate losses from the current crisis at more than $4 trillion—the uniqueness of the current situation demands action.

The first major goal is to stop the pain that Americans are facing. With millions out of work and unable to provide for themselves or their families, Congress simply must pass swift relief measures. **Policy goals at this juncture are not to re-stimulate demand, but rather to tide people over until calmer economic waters are possible.**

The second major goal is the survival of businesses, so that the current economic decline does not become permanent. Former Federal Reserve Chair Janet Yellen stated, "If businesses suffer such serious losses and are forced to fire workers and have their firms go into bankruptcy, it may not be easy to pull out of that."

Therefore, it is helpful to consider the three distinct categories of fiscal policy currently on the table: (1) Support to workers; (2) Support to businesses; and (3) Everything else.

Support to Workers

There are two main ways to get support directly to workers: targeted relief and large-scale cash payments. Recent reports have suggested policymakers are considering each as a substitute for the other, but there is no reason this needs to be the case.

Targeted Support—Unemployment insurance is the most direct way of assisting workers immediately in need, along with other pre-existing programs like SNAP and sick leave. Increasing benefits for workers via these programs takes advantage of an existing structure that makes it theoretically easier to get funding out the door. For example, Americans already receiving SNAP assistance could easily have additional funds added to their EBT cards within a matter of a few days.

However, in a crisis of this scale, such programs may not be sufficient. First, in the case of unemployment insurance, workers must already be laid off and must file for assistance. This takes time. Without explicit changes by lawmakers, such aid also misses whole categories of modern workers including part-time, self-employed, gig or contract laborers. Nevertheless, targeted relief is the first and best line of defense in the current crisis situation.

Cash Payments—In an ideal world, government assistance would be directed immediately to those specific individuals who need it; however, in practice, targeting such support effectively is difficult. For this reason, cutting checks to everyone may be the quickest solution when a rapid response matters the most. In a crisis situation, cash is king. Uncertain times make more traditional approaches like tax breaks less impactful, since Americans will still need resources to pay for their immediate expenses.

Cash payments provide a way to get money to Americans, especially in the lower and middle classes, and can be undertaken more than once if necessary until it's clear the economic engine of the country is not at risk of structural collapse. They also bring the added benefit of actually reducing fraud, since checks are distributed equally to all, rather than to a subset. Critically, they also have less of a chance of bringing about a permanent change and growing government once the crisis has passed.

Opponents of cash payments argue that their less-targeted nature undermines their effectiveness and makes them less preferable to other potential means of support. While this critique is true to a point, direct and repeated cash payments can inject stability in a rapidly changing economic emergency, and maintain autonomy by allowing recipients to decide for themselves how best to spend the money.

Regardless of whether every recipient needs the cash equally at the time it is received, a fast-changing economic crisis makes the policy wiser than it might be in other situations, and the benefits are likely to pay dividends regardless. It is also for this reason that means testing, while usually a good idea, is less appropriate in the context of temporary relief.

Business Support

Aid to individuals in the current crisis is necessary but not sufficient for reducing the short-term existential threat to the American economy. Aid given to individuals, particularly unemployment insurance and paid sick leave, does not reduce the substantial costs that will arise if small businesses are not able to operate and pay their expenses during the crisis period—in fact, the most compassionate option in such cases would be to lay workers off so that they qualify for unemployment, creating a host of future rehiring costs.

Aid to small and medium-sized businesses could help alleviate this situation. As with aid to individuals, support for businesses can also take multiple forms, some preferable to others. Bailouts to large corporations with cash reserves or carve-outs to special interests should not be tolerated. These corporations are able to easily get loans because monetary policy actions thus far taken by the Federal Reserve have ensured adequate liquidity. What is discussed here is general relief to ensure workers do not have to be laid off.

Loans—Low- or no-interest loans to business are an important first line of defense, because they allow access to capital in the short term. Unlike grants, loans also allow businesses to theoretically decide whether they truly need the money to pay for their immediate employee-related and other expenses.

However, they are far from a sufficient solution in a sharp crisis like the economy is currently experiencing.

For one, they put companies in a more-difficult position once the crisis ends. Taking on more debt, even if it's obtained without interest, makes it less likely that companies will be able to ramp production back up once the coronavirus pandemic is under control. Many businesses would likely be left with no choice but to lay off workers or would otherwise take steps to reduce productive capacity. While it is important to increase loan opportunities for companies that need capital, this is unlikely to be effective by itself in a truly deep economic crisis.

Direct Support—A more substantial solution has been laid out by Berkeley's Emmanuel Saez and Gabriel Zucman. The economists propose that the government serve as a "buyer-of-last-resort" to businesses in need of funding to pay for their immediate expenses. More importantly, such a system serves as compensation to businesses that the government itself shut down.

The goal is to allow businesses to continue to pay workers instead of laying them off, thereby avoiding the future costs of rehiring. In Saez and Gabriel's words, "The death of a business has long-term costs [...] The government [...] can alleviate economic hardship during the epidemic and prevent the direct output loss from causing lasting damage to the economy. In other words, the government can prevent a very sharp but short recession from becoming a long-lasting depression."

It's important to note that this is probably true only for a limited period of time. If the economic downturn continues to deepen, the public finance implications of continuing to fund private sector businesses would probably be more than the system could bear. As Saez and Gabriel further note, only then would costs remain "manageable and business decisions [not be] affected. It would not fully offset the economic cost of the coronavirus."

Bailouts—It's important to distinguish such a "payer-of-last resort" program from bailouts, slush funds and other discretionarily directed loans and guarantees for favored businesses. Such slush funds, like bailouts, make little sense conceptually in a crisis environment, and providing funding only to select companies or favored industries is an inappropriate response. Like individual aid, any business assistance should be broad in orientation.

Even if one is not inclined to believe that bailouts are, to paraphrase Milton Friedman, "always and everywhere an inappropriate response," it should be obvious that these types of actions will do very little to solve the most-immediate crises. Aid to businesses should never be made available in one form to specific businesses and another form to others. Both bailouts and corporate welfare put the government in the position of picking winners and losers at the expense of providing relief equitably when it is most needed.

Other Assistance

It should go without saying that this is not the time for pet-projects or pork; Congress is notorious for sliding unnecessary items into emergency, must-pass legislation under ordinary circumstances. But there are other forms of fiscal relief that have been proposed that all should play a role to varying degrees in the current crisis.

Most immediately, funding for hospitals and healthcare providers who are increasingly strapped for resources is a worthy expense, though this makes more sense from the standpoint of slowing down the pandemic than from addressing the broader macroeconomic picture.

Similarly, state and federal authorities have already begun experimenting with long-sought-after licensing and regulatory relief as they face a dire situation that has forced them to. Everything from allowing alcohol delivery to permitting MD's to practice across state lines should remain on the table even after the crisis passes, particularly as countless workers find themselves seeking new and nontraditional employment that can be hampered by a burdensome licensing or regulatory state.

Payroll tax relief and other tax reforms are typically an important tool in many economic crisis situations; however, their role in the current pandemic is limited, since the goal is generally to keep many Americans from working in the short-term. These tax-related remedies have the potential to assist in jumpstarting the economy once the immediate threat of coronavirus is past and the economy is ready to heat up again.

It also goes without saying that many of the discussed solutions should be meant to bolster efforts, both fiscal and otherwise, already being undertaken in the states—not to serve as a replacement for them. Just as it makes sense for the federal government to take an all-hands-on-deck strategy, it should see its role as similar vis-a-vis the states.

State budgets are particularly susceptible to sharp economic downturns, both because of declines in revenue and increases in outlays, as demand for assistance programs increases alongside the unemployment rate. These state budget issues are beyond the scope of this analysis, but any federal relief package would be wise to consider the impact on states as they administer federal programs.

WHAT ABOUT TOMORROW?

In the current, fast-changing economic environment, it is important to realize that federal spending and deficits are going to rise no matter what. While we can (and should) point out that such crises are the reason why we should not run deficits when times are good, that realization does not make these specific needs any less valid in an extremely bad time.

The economic crisis in which the world now finds itself is perhaps one of the few instances when substantial government spending is warranted and inevitable. With millions being forced out of the labor market, immediate actions to lessen the pain and avoid a bigger crash are valuable. The role for free-marketers and fiscal conservatives is clear and important: Not to lament unavoidable spending, but to ensure it happens in a non-permanent way that allows for reforms once this emergency has passed.

And we should note that all of these assessments are, in fact, predicated on an understanding that the immediate crisis will pass—that the worst will be over within no more than two quarters. While we cannot say for certain whether that will be the case, it is clear that the sorts of measures discussed here cannot be sustained for much longer than that point—and if policymakers attempt to do so, they risk causing more harm than relief.

Now is a difficult time to call for offsets to new federal spending, and the imperative to act quickly to avert an extreme economic downturn does not mean that lawmakers cannot and should not take procedural actions that could lessen these concerns when the crisis ends. One way to guard against unnecessary long-term costs would be by creating what might be referred to as an "emergency assistance account" that would cover the immediate and long-term effects of these proposed extraordinary fiscal measures.

The risk of a public debt crisis is, of course, very real once the current coronavirus crisis is abated, and it's critical that no matter the current need for federal action, national emergencies must not automatically lead to permanent debt increases. Congress could address these concerns through an enforceable fiscal rule that would require future savings in return for the current emergency measures. Whether this is politically feasible at the current moment is questionable and unlikely to happen, but all lawmakers would be wise to avoid the path of rectifying one economic crisis by creating another.

Ultimately, tomorrow still matters, and while it might seem like this current situation will last forever, it will not. One day, whether in weeks or months, the world will emerge and begin to pick up the pieces from the most unprecedented event of our lifetimes. Right now, it is not feasible to avoid deficits and rising debt as lawmakers struggle to adapt, but small actions can make an enormous difference in the future. Ensuring that relief is targeted to those who need it, arrives in time to forestall even worse impacts, and ends when the immediate crisis has passed is the best way to ensure the country can move forward and begin to recover from the enormous challenges that will face us for years to come.

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