Save Capitalism From the Cares Act

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A surreal bipartisanship prevails in Washington. Everyone wants to spend, spend, spend. Senate Majority Leader Mitch McConnell, who aggressively fought President Obama's 2009 stimulus package, was delighted the other day to announce a fiscal stimulus more than twice as large. Democrats are pushing for more.

Are we all Keynesians now? Or have we all embraced the so-called Modern Monetary Theory, which suggests that when an economy is below its full potential, we can print money to finance any deficit without provoking inflation? No. The answer is much simpler. We are all experiencing the effects of combining a real crisis with powerful lobbying.

With 20% of Americans locked in their homes, nearly all air travel canceled, and the global supply chain disrupted, you don't need to be a Keynesian to think the government should intervene. But that doesn't mean the Cares Act—an acronym for Coronavirus Aid, Relief, and Economic Security—is wise. The last thing we need at this moment is a Keynesian stimulus. Since the lockdowns constrain supply, stimulating demand would lead only to a rise in prices.

Besides helping the medical effort, government intervention should offer financial help to people who can't work, and it should preserve the production capacity of the U.S. economy. The greatest resource most companies have is their teams of employees. If they dismantle those teams because of the pause in the economy, production capacity will be lower at the end of the pandemic.

Only $377 billion of the $2 trillion package is directly targeted to this goal. These are loans to small firms (fewer than 500 employees), which are forgivable if the funds are spent on payroll, rent, mortgage interest and utilities. By using 2017 census data (the most recent available), we calculated the total expenditures in payroll, interest expenses and rents of U.S. small firms amounts to $258 billion a month. Unless the Trump administration introduces criteria for selective targeting, the money allocated in Cares will run out in a month and a half. Designing the conditions for such targeting isn't easy, since every requirement will slow the money's deployment and speed is of essence. Thus, we fear that the administration will soon come back to Congress with a new request for money.

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The need to help individuals and small firms has provided cover to the largest corporate subsidy program in U.S. history. Under intense pressure from lobbyists, the Cares Act allocates $510 billion to support loans for large businesses. A small chunk of this money ($56 billion) will be used directly by the Treasury to grant loans to airlines and other "strategic" firms (read: Boeing). The Treasury will then confer the rest ($454 billion) to the Federal Reserve to absorb losses the Fed might incur in lending to firms in the private sector.

The expectation is that the central bank will leverage this money 10 to 1, enabling it to lend up to $4.54 trillion to companies. That sum is more than all U.S. commercial and industrial loans outstanding at the end of 2019 ($2.35 trillion) plus all the new corporate bonds issued during 2019 ($1.41 trillion). Thus, if this capital is all deployed by the Fed, and at rates that will surely crowd out private capital, all capital allocation in the U.S. in 2020 will be done by the Federal Reserve System, not by the capital market. This is the largest step toward a centrally planned economy the U.S. has ever taken. And it socializes only losses. Profits, when they come, remain private.

There needs to be far more transparency, governance and accountability around the Fed's deployment of trillions of dollars in the real economy. Policy makers also should make the $510 billion program for large companies similar to that for small firms, but with tougher conditions. Again using 2017 census data, we calculated the total expenditures in payroll, interest expenses and rents of all U.S. large companies to be $392 billion a month.

Yet not all large companies are idle. Amazon is doing great, and so are Google and Facebook. Overall, large businesses are likely to be hit less hard than the U.S. economy overall. Goldman Sachs forecasts a 24% drop in this coming quarter. Even if the large companies were hit in proportion to the overall downturn, the cost of replacing their wages, rents and interest would be only $94 billion a month. So the $510 billon would last almost half a year.

The urgency of the moment facilitated a giveaway to vested interests. Now that the Cares Act is law, policy makers need to find ways to impose restrictions on how the money is deployed. It isn't only a question of fiscal prudence; the nature of American capitalism is at stake.

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