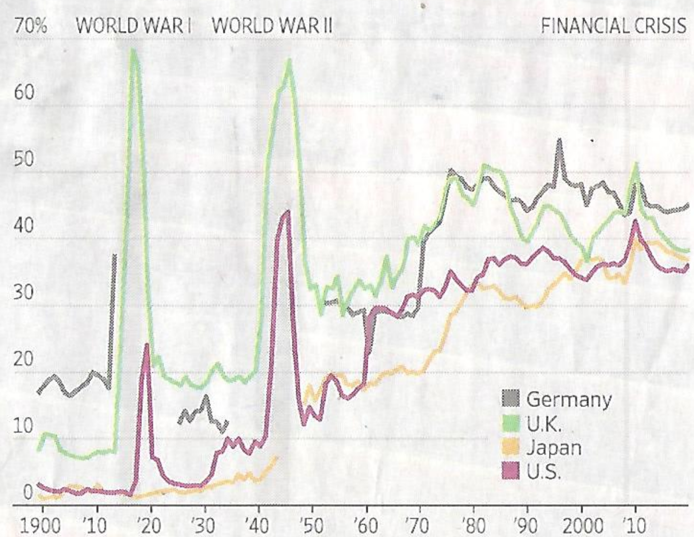
THE OUTLOOK | By Tom Fairless and Jason Douglas

4/13/20

Spending Grows in Virus's Wake

Government spending as a percentage of GDP



Note: Data not available for Germany (1914–24, 1935–49); Japan (1944–46); Figures for 2019 are estimates; Japan estimates 2018–19

Source: International Monetary Fund
Kathryn Tam/THE WALL STREET JOURNAL

World leaders from President Trump to President Emmanuel Macron of France and Queen Elizabeth II of Britain have invoked the wartime spirit as they rally citizens to defeat the new coronavirus.

Like the great wars of the 20th century, some analysts and historians think the current crisis could fuel a new era of big government in which public officials control more of the levers of the economy, for better or worse.

"National institutions tend to get significantly better funding during wartime, and it's very difficult to reverse that when people are used to it," said Tony Travers, a professor of government at the London School of Economics who advises the U.K. government.

During World Wars I and II, government spending rose sharply in the U.S., U.K. and other countries to finance wartime production and research, and it remained higher after fighting ended.

To be sure, wartime analogies only go so far. People and businesses are hunkering down, not mobilizing for combat, and nations aren't fighting one another but a common enemy—the virus.

But as the pandemic has escalated, Western governments have made economic interventions long considered unthinkable outside wartime: They have pledged astronomical sums to support stricken businesses and workers, cajoled or ordered chunks of industry to shut down or switch production to essential goods, seized control of supply lines to procure vital equipment, and considered making investments in key sectors such as airlines.

Major central banks have pledged to buy nearly unlimited amounts of sovereign debt to backstop government borrowing. Meanwhile, world powers are in a technological race to find a vaccine.

When the crisis is over, "it will be very hard for any government not to increase spending on health" or to fund new areas such as medical research and vaccine production, said Mr. Travers.

A similar shift happened after the depravations of World War II, when countries like the U.K. pushed up taxes to finance sweeping new safety nets, including universal health care.

In the U.S., "the virus could improve prospects for some aspects of social safety nets, such as in health care," said Maurice Obstfeld, a former chief economist at the International Monetary Fund who teaches at the University of California, Berkeley.

Some decisions go even further than World War II, with governments around the world directly supporting the pay of millions of idle workers.

"You won't necessarily have big government programs, but you could have extensive intervention" in economic areas deemed critical, such as trade, Mr. Obstfeld said.

Policy makers are realizing that in public-health emergencies, as in wartime, worries about budget deficits go out the window, said Mark Harrison, emeritus professor of history at Warwick University and an author of books on the economics of both world wars.

In the U.S., government debt could soon rise to 130% or 140% of gross domestic product, versus around 100% last year and higher than after World War II, when debt reached around 120% of GDP, estimates Mr. Obstfeld.

Such a burden is only sustainable if interest rates remain low. That has been aided by central banks, which have recently lowered rates and switched their focus from controlling inflation to directly supporting governments and businesses.

The Federal Reserve and European Central Bank recently introduced open-ended bond-buying programs that echo the Fed's actions during and after World War II, when the central bank committed to pin long-term government-borrowing costs below 2.5%.

The Fed's actions "are as close to monetary financing of the deficit as we have come" and risk some inflation down the road, said Mr. Obstfeld. High inflation after World War II helped the U.S. government reduce its debt as a share of economic output, without actually paying it down.

The analogies are imperfect. During World War II, allied nations including the U.S., the U.K. and the Soviet Union gave over as much as half their national output to producing aircraft, warships, weapons, and other materials and equipment essential for the war effort, said Adam Tooze, a professor of history at Columbia University whose work has focused on war and financial crises.

The goal of policy makers now, unlike in wartime, isn't to reorient the whole economy toward fighting the virus but to do almost the reverse, Mr. Tooze said: Shut most of it down to prevent spread. Using idle factories to make face masks and ventilators is worthwhile but would account for a tiny fraction of GDP, in contrast to the vast resources mobilized to fight a war.

And while major economies grew rapidly at the start of World War II, they are now shrinking. That means governments need to do more with less money, triggering an explosive rise in borrowing.

The scale of new deficits suggests governments won't be able to control their debts through spending cuts, as the U.K. and other countries did after the financial crisis.

"It's hard not to see higher taxes," which is linked to a bigger state, Mr. Travers said.