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COMMENTARY

The Coronavirus Consensus: "Spend, Spend, Spend"[*]

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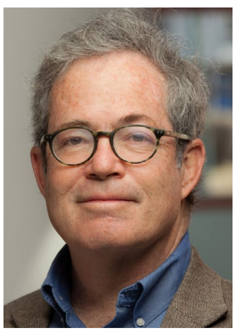

It's a Richard Nixon "We're all Keynesians now" moment (*New York Times*, January 7, 1971). The forecasts for the U.S. and global economies are dire: there has been a record number of jobless claims—over 3 million workers; in a recent review entitled "The Lamps are going out across the economy," JP Morgan estimates that the unemployment rate will double in the next three months. Some are forecasting an unemployment rate in the U.S. as high as 20% within the next year, and the forecasts are getting more pessimistic by the day. For now, the raging battles among macroeconomic schools of thought have been submerged by this onslaught of the pandemic, producing a remarkable consensus on one general principle: governments and central banks (in rich countries) should "spend, spend, spend."

And spend they will. The Federal Reserve (Fed) announced a series of expansionary policies, many of them dusted off from its Great Financial Crisis (GFC) of 2007-08 playbook: lower key Fed interest rates to close to zero and pledge to keep it there; buy "at least" $700 billion worth of U.S. Treasury and mortgage backed securities; continue its support of the short-term bank funding markets (REPO) to at least $30 billion per /**day**; provide billions of dollars in credit lines (swaps) to a select group of foreign central banks; underwrite massive markets for short-term credit between corporations (commercial paper); and underwrite money market mutual funds. One can be sure this is just the beginning, as Treasury Secretary Mnuchin calls for a $4 trillion Federal Reserve fund. And most recently, the Fed announced a Mario Draghi "We will do whatever it takes" to keep the financial system afloat. After some hick-ups, the European Central Bank (ECB), under former International Monetary Fund (IMF) managing director Christine LaGarde, pledged to "do whatever it takes" to limit the economic fall-out in Euro-zone countries from

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the pandemic, including up to 750 billion Euros of expanding Quantitative Easing (QE) and extending it to a major purchase of corporate bonds. The Bank of England (BOE) has also pledged to make large liquidity interventions into the financial markets.

Much of these central bank responses seem almost old-hat by now, reminiscent of their actions during the GFC. But where the new consensus really takes hold is in the area of fiscal policy: government taxing and spending. In the U.S., the Democrats and Republicans in the House and Senate, though differing on many important details, are headed toward implementing, with Trump's approval, a $2 trillion dollar spending package including direct cash payments to individuals and households, with Republicans holding out for a heavy dose of corporate bailouts. In Europe, even deficit maniacal Germany is increasing government spending substantially and has agreed to let the Euro-zone countries temporarily suspend their straight jacket fiscal rules that limit government budget deficits. Other European countries are following suit with large (and to be sure growing) fiscal packages.
(See the *FT* on European Responses: https://www.ft.com/content/26af5520-6793-11ea-800d-da70cff6e4d3?shareType=nongift)

This Coronavirus Consensus, in one sense, should not be that surprising. It doesn't take rocket science to recognize that when whole economies are shutting down and masses of people are unemployed and stuck in their homes, with evaporating income and wealth, and enormous excess capacity to produce oil, airplane rides, hotel stays, restaurant meals and automobiles, that the problem is a fundamental lack of income and demand: the Keynesian curse. Of course there are devastating shortages of medical supplies and medical personnel, and some supply chains have been disrupted, but the devastation to the economy is now primarily coming from the dysfunctional income-demand circuits known to every 1st year college student in a macroeconomics class (now all online).

To be sure, the problem and remedies are in many ways different from a Keynesian aggregate demand shock or financial crisis, though these are a big component of what we are facing. We face a massive health care crisis that requires a health care emergency; and we face an income support crisis that requires a gigantic increase in income support to allow people to stay at home, and not go back to work.

But a key requirement for governments remains: spend, spend, spend.

Yet despite its obviousness, this apparent consensus, temporary as it might be, has broken out of the ideological straight jacket of austerity mainstream macroeconomic thinking and neo-liberal domination only after a long academic struggle, the 2007-08 financial crisis and the relative stagnation that followed, and the domination of opportunistic Lafferite supply-side thinking in the Republican Party, of course, only when the Republicans are in the White House.

And within Keynesian and Post-Keynesian schools of thought themselves, deep differences of view have seemed to melt away as the current situation calls for apparently similar perspectives, despite important underlying differences. Clintonesque/Obamaesque neo-Keynesian economists like Laurence Summers, Jason Furman and Oliver Blanchard, who once excoriated progressives for ignoring government budget deficits and insisted on being the "adults in the room," now recognize that when demand drops off the table, and government interest rates are near zero, increasing the budget deficit in the service of reviving the economy is a good idea, even while insisting that excessive budget deficits and debt are problematic in the long run. (Paul Krugman has been more dovish on this than the others.) Heterodox economists such as Lance Taylor, James Crotty, Jamie Galbraith, and my colleagues at the Political Economy Research Institute (PERI), among many others, have long insisted on the value of government spending to help generate full employment, reduce income inequality, and generate valuable long-term public investments that the capitalists will not make on their own. As with Keynes (see James Crotty's brilliant *Keynes Against Capitalism*, Routledge, 2019), skepticism abounds here with respect to the desirability or even feasibility of running limitlessly large government budget deficits in the absence of accompanying productive, and socially desirable, public investments, even for rich countries. And then there's *Modern Monetary Theory* (MMT), led by Randall Wray, Stephanie Kelton and others who elevate the lack of concern over budget deficits and debts to a general principle for countries with "sovereign money," independent of circumstance and exigencies, save the condition of full employment (see Wray, Wray, L. Randall. 2012. *Modern Money Theory: A Primer on Macroeconomics for Sovereign Monetary Systems*, Palgrave Macmillan, for a classic statement). The validity of the MMT view as a *general* theory is highly suspect for a number of reasons, including its lack of attention to the globalization and size of highly speculative financial markets, and its lack of recognition of the special privileges the U.S. currently garners from the dominant global role of the dollar (see my *What's Wrong with Modern Money Theory: A Policy Critique,* Routledge, 2019). But, as Keynes put it in his discussion of "classical economics" in the early chapters of the *General Theory,* MMT appears to be valid enough in the *special case* of the Coronavirus economy, especially with respect to rich countries.

While important theoretical and practical differences remain among these "Keynesian groups." the conditions created by the Coronavirus are so extreme and daunting, that the areas of common ground, even if they only apply in specific historical cases such as this one, have seemed to all but disappeared as the current situation calls for apparently similar prescriptions.

These conditions include:

- Demand for goods and services (what economists call aggregate demand) are plummeting, which is creating a downward spiral of lost incomes and mass lay-offs, leading to further declines in consumer spending and a massive drop in business spending as their profits tank and excess production capacity explodes. (To students of Econ101 this is the interaction of the Keynesian "multiplier" and "accelerator".) The only counter for this is massive spending by the government to sustain the incomes and the ability of people to pay their bills.

- Orthodox economists have long argued that such massive government spending increases government budget deficits and raises interest rates, thereby "crowding-out" other spending. But interest rates have been extremely low, below 2%, for a decade; and now, the Federal Reserve and other central banks are pledging to keep interest rates near zero, and in some cases, they have fallen **below** zero.

- Orthodox economists have argued that such low interest rates and expansionary central bank policy used to keep them low would lead to inflation, or even hyper-inflation. But Keynesian economists have long understood that there is no automatic link between expansionary monetary and credit policy and inflation; much depends on the level of unemployment excess production capacity. Unfortunately, we now have these in spades. Deflation is much more likely than inflation. In fact, deflation has been stalking major economies since the GFC, and some countries like Japan for much longer than that.

- Orthodox economists have argued that high levels of expansionary monetary policy could lead to a run on the currency and a collapse of the exchange rate. But this is not a serious concern for the U.S., because the U.S. dollar is the key currency in the global economy and, in times like these, there is a huge dollar shortage: the dollar is in such massive demand that the Fed is taking extraordinary measures to provide dollars to major central banks around the world.

In short there is broad agreement among these economists, and now extending beyond the "supply-side Republicans" to even the deficit hawk self-styled "adults in the room," that now is the time for governments and central banks to spend, spend, spend.

Where the Consensus Breaks Down

But, the kind of fiscal stimulus and the uses to which it is put matter enormously. It matters for who gets helped and who pays the price, and how catastrophic this health crisis becomes. And it matters for the long-term trajectory of the economy and our democracy. The apparent macroeconomic "consensus" goes only so far, and just beneath the surface are deep, deep differences of policy and perspective that stem from the deep political and economic divisions in our society. The struggle over macroeconomic policy may not be so much about the *amount* of spending but about the *types and allocation of spending*. It is obvious that the impact of the crisis will interact with the devastating inequalities and years of destructive economic and social policies that neo-liberal economic policies by Republicans and Democrats have wrought in the U.S. and, and in its allied countries around the world. The enormous political and policy battle will involve whether fiscal and monetary policy will reinforce these inequalities or ameliorate them, in the short and in the long run.

In fact, in the U.S., these stark battle lines between the Trump Administration, its Republican supporters, and some Democrats are manifest every hour in the fight over the government's fiscal package.

It is clear to most serious observers that millions of Americans' pay checks are evaporating into thin air, and that what is immediately needed is direct cash payments to workers and families to put food on their tables and keep a roof over their heads. Analysts at Cornell University estimate that over 37 million low income workers are in industries that are directly affected by the shut-downs and demand collapses from the wake of the Coronavirus. For millions of Americans, current plans to send a one-time check of $1,000 - $2,500 are clearly inadequate in this context.

In addition, small businesses such as restaurants and other small businesses are threatened with bankruptcy as a result of the crisis. Small businesses have a huge employment footprint in the economy--by some measures they constitute as much as two-thirds of employment. If such businesses collapse, it will take much longer to revive the economy when the virus dissipates.

Elizabeth Warren, Bernie Sanders, and many other Democrats on Capitol Hill are calling for direct payments and the extension of unemployment benefits to all workers. They are also calling for regulations to prohibit evictions, suspend interest payments on student loans and make medical care associated with the Coronavirus free.

In addition, they and other Democrats are pushing for large federal payments to states and locales, most of which have balanced budget restrictions, to help them pay the unemployment insurance and medical costs resulting from the crisis and to provide direct help for small businesses.

But the Republicans are pushing an almost entirely different agenda. Rather than delivering income to families and state and local governments, they are proposing massive payments to large corporations and, through the Federal Reserve, to banks and the financial markets. As Rana Foroohar of the *Financial Times*, among others including economists at the Roosevelt Institute, the Center for Economic Policy Research, and PERI point out, this bail out, reminiscent of the bank bailouts of 2007-08, without conditions attached, and at best with hopes of "trickle-down," would be an economic AND a political disaster.

Pointing out that many airlines, and corporate America in general, have gone on a massive spree of stock buy-backs rather than preserving their income for productive investments and emergencies such as this, Warren, Sanders, Pelosi and Schumer, and other Democrats on Capitol Hill are all arguing for putting strong conditions on corporations in exchange for loans to help them get through the crisis. The key demand is for these corporations to maintain pay, health insurance and pension coverage for their employees in exchange for financial support. The Republicans apparently will not have any of this.

These issues are also crucial in the evolving policies of the Federal Reserve and Treasury. Start with the financial system itself: Central banks are spending enormous resources plugging holes in the financial system that were largely caused by their failure to adequately regulate these banks and financial institutions after the Great Financial Crisis. Speculative investments by hedge funds, asset management firms, and foreign exchange traders, most of which were not regulated after the crisis, are forcing the hands of central banks to put up trillions of dollars in support. Excessive borrowing by non-financial corporations over the last decade has made things dramatically worse. As I indicated earlier, many of these corporations borrowed huge amounts while at the same time using cash to buy back their stocks.

Treasury Secretary, Steve Mnuchin, himself a hedge fund king who profited off of the financial crisis by foreclosing and reselling houses, is now evidently proposing as much as a $4 trillion Federal Reserve/Treasury fund to underwrite the financial system. Note that these massive sums will NOT help the macroeconomy or the health care system deal with pandemic; the financial system itself does very little for the overall economy (see Epstein and Montecino, "Overcharged," Roosevelt Institute, 2018). Rather, in committing these trillions of dollars, the central banks would be simply, at best, trying to prevent finance from messing everything up even more. The regulators should have taken care of this problem a decade ago. And, at most, it will keep the financial sector afloat so that these same bankers, like Mnuchin, who profited from the financial crisis, will have plenty of liquidity to stay afloat and profit again from this one.

Such expansionary Federal Reserve policy is also designed to prop up the stock market, of both political and more importantly financial interest to the corporate elite, including the Trumps. (See the analysis of Epstein and Montecino that showed that Quantitative Easing (QE) by the Fed in 2009 and 2010 mostly helped the wealthy by raising asset prices such as stocks and bonds. The Republicans are hoping for a repeat.)

As in 2009-10, the appropriate solution is to underwrite productive and necessary functions of the financial system while not bailing out the misbehavior and adding to excessive profits and egregious incomes of the bankers. In the short run, the Fed undoubtedly needs to provide sufficient liquidity so that the financial markets do not seize up. But the government should also create direct, public utility style banking, through the postal system, non-profit financial sector, or directly through the Fed.

And in exchange for any short-term financial assistance, the Dodd-Frank financial regulations, which have been dismantled since Trump's election, should all be reinstated. And if massive support is provided, then equity stakes or even nationalizations and re-allocation of credit to socially productive investments would be promoted. (See the piece by Doug Henwood)

Global inequalities are another colossal inherited problem. The consensus of massive government spending cannot apply to poor countries because they do not have the financial or economic power to effectuate such spending. These countries would need enormous assistance from rich countries and international institutions to manage this crisis. The Federal Reserve, for example, as the issuer of the dominant global currency, the U.S. dollar, could use its billions to underwrite a fund for Coronavirus aid to poor countries, rather than bailing out the speculative financial institutions of the major capitalist economies. (For problems facing developing countries see Jayati Ghosh.)

In the Medium to Longer Term

But there are longer term issues that must be addressed as we implement the solutions we need in the short term. As James Crotty has shown in his masterful new book on John Maynard Keynes, even while Keynes was desperately fighting to save the United Kingdom from the ravages of the Great Depression, he also had his sights set on the longer term transformations that were necessary to make the economy productive, fair and sustainable. He focused on necessary public investments, fair wage initiatives, and central bank and financial policy that prevented speculation and fostered the allocation of credit for public purposes.

Progressives are arguing that policies must not only deal with the direct macroeconomic impacts on workers and poor people but must also begin to repair the deep structural flaws in our economy that underly the devastation that the pandemic is producing. Bernie Sanders has laid out a more structural vision that can be seen as building up institutions that are necessary in the longer term to restructure our economy: these include providing free Coronavirus treatment through Medicare and Medicaid; creating a Reconstruction Finance style institution to finance needed spending for housing, hospitals and health centers; using the Fed to support spending by state and local governments rather than just bailing out the big banks and hedge funds; prohibiting foreclosures; eliminating interest on student loans, among many other needed structural changes.

Many have proposed readying plans for a Green New Deal, to make employment generation and green transition the center piece of the recovery plan as the crisis dissipates.

In short, the apparent consensus on the immediate need to "spend, spend, spend," is a good step in the right direction. But it leaves completely open what the money should be spent on, through what institutions it should be delivered, and in the service of whom. It leaves open what institutions will be built and enhanced as we deal with this problem. Perhaps most important, what precedents and power dynamics will be set up in the process? Will the response further entrench the Trumpists in the weeks ahead? Or will we lay the groundwork for the mobilization of more progressive political forces. We will all have to remain vigilant and active to push these responses in the progressive direction.