The Biggest Stabilization Mistake in the Pandemic

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The biggest mistake in the COVID-19 Pandemic is the toleration of budding sociopaths' refusal, in the face of overwhelming evidence, to wear masks. The biggest handicap, closely tied to the biggest mistake, is Donald Trump as President. The hapless reality-TV star did not skip a beat in transferring his bumbling self-absorption from serial business bankruptcies to the White House. This Blog, however, is about macroeconomics and effective macro policy, not the alarming incidence of sociopathy in the United States. This post summarizes the biggest stabilization mistake in the Pandemic. It is useful to recall that the problem was predicted in earlier Blog analyses of COVID instability.

Earlier posts have summarized the GEM pandemic-instability model, which is rooted in the Project's extreme-instability theory. Shani Schechter and I constructed the original model in 2009 to help advise the Fed on its response to the Great Recession. This look back has two parts. First is a reiteration of the model-identified stabilization-policy priorities. The second elaborates on the prior identification of the most likely mistake today's policymakers will make.

<u>GEM Model Stabilization-Policy Priorities</u>

Begin with the central fact that the current instability crisis will persist until effective vaccines are developed, mass produced, and distributed. Given that, the interrelated, most critical stabilization strategies are:

- The U.S. Treasury should replace wage income lost to the Pandemic.
- Public subsidies should also be used to prevent business bankruptcies in response to efforts to mitigate the pandemic.
- Stabilization authorities – the Federal Reserve, Congress, and the Executive Branch – should adhere to the principal lessons learned in 2008-09. Go big and go fast.
- All the additional federal debt resulting from the massive government spending to mitigate the human and economic cost of COVID-19 should be purchased and held by the central bank.

GEM analysis indicates that those objectives, if effectively pursued, would manage pandemic stabilization risks. Consider each in turn.

First, replacement of wage income is a no-brainer. It is both ethical and provides a good deal of the support for aggregate spending that is sufficient to stabilize an economy reeling from collective and personal virus mitigation effects.

Second, we know that mass liquidity bankruptcies would grievously damage lifetime financial paths of millions of households as well as disastrously forcing macro-recovery dynamics to accommodate the painfully slow, painfully arrogant justice system's liquidation processes. In circumstances of extreme instability, debt dominos do double duty. The immediate effect is to aggravate weakness in total nominal spending. Subsequently, as already noted, the resumption of growth is badly hindered, similar to the drag experienced in the aftermath of the Great Recession, by the extent to which bankruptcies and associated debt problems are slow to be resolved.

How well we achieve income replacement and bankruptcy prevention will powerfully influence the course of the post-vaccine economy. At the onset of the pandemic, fiscal and monetary policymakers properly assigned high priority to both. The apparent loss of that focus during the time needed to develop, mass produce, and distribute an effective vaccine has been extremely irresponsible. There is more on this below.

Third, the U.S. central bank can create money. In the circumstances of any extreme instability that threatens depression, that is a super-power. The GEM Project has identified the Fed's crucial responsibility to prevent a breakdown of the financial system's capacity to support aggregate demand when confronted with nonstationary contractions of total spending. In a pandemic, that responsibility can extend to direct support of total spending.

The fourth priority is particularly relevant in a pandemic. If successfully pursued, it avoids trillions of dollars of federal debt being sold to domestic or, worse, foreign investors. The structural risks with which the proposed Fed buy-and-hold strategy would be dealing are obvious, including the crowding out of important safety-net and other social-service spending.

Biggest Mistake

This quote is from an earlier post: “What is today’s greatest economic policy risk to sufficient demand? If the 2008-09 crisis is a useful guide, the most damaging problem will be the reluctance of Congress to spend enough, getting bogged down in its quest for partisan advantage.”

In reverting to the pursuit of partisan political goals, Mitch McConnell and Senate Republicans appear determined to burden the nation with an unnecessarily slow and difficult economic recovery. In hypocritical and reckless deference to plans to contest the next midterm and Presidential elections on “fiscal responsibility”, the Republican Senate simply doesn’t care how much the absence of effectively sized stimulus damages the country.

After the election, McConnell reasserted that a bill larger than $500 billion is “not a place I think we’re willing to go.” The Project indicates an adequate number is four-times that amount. The Republican blueprint would reduce enhanced unemployment benefits and aid to businesses damaged by virus-mitigation efforts. while omitting another direct payment and assistance for strapped state and local governments. The hypocrisy of the reborn deficit hawks who simply dismissed the trillion-dollar increase in the federal debt associated the Trump tax cut is on full display.

Much more important, the McConnell approach recklessly violates the policy principals that have, so far, largely prevented the income loss and bankruptcies that would greatly exacerbate the enormous distress caused by the pandemic and will significantly slow the economic recovery from the pandemic shutdowns. Income lost will not be sufficiently replaced. Savings will be depleted, and the bankruptcies will surge. Slowly resolved debt problems will then burden and slow the economic recovery much the way they did after the Great Recession. The distribution of an effective vaccine is within reach. In the interim, is it too much to ask Mitch McConnell to care about more than his Republican caucus? If he decided to widen his scope of concern, he could take an adequate stimulus package to the Senate floor for a vote, where the vote passing it would be veto-proof. More generally, wouldn’t it be good to reintroduce representative government into the U.S. Senate, Aren’t people tired of minority rule by legislators – the Republican-caucus majority – whose views badly align with most Americans?

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