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ALTERNATIVE MACRO POLICY RESPONSE FOR A PANDEMIC RECESSION

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As a number of countries witness the emergence of second and third waves of rising COVID-19 infections and test positivity rates, the prospect of (re)imposing business activity restrictions and varying degrees of quarantine is becoming increasingly germane (and for some countries, already a reality). Although current political conditions in the United States make a coordinated federal public health response unlikely, it is worth examining how we might better approach the economic policy arm of a COVID-19 crisis response should a comprehensive lockdown become necessary. Toward that end, I will set out an alternative approach to the economic problems raised by the pandemic, different from both the mainstream approach and some Keynesian-inspired policy responses.

Since the outbreak was first announced in China and met with a rigid local quarantine, the initial focus (at least among the mainstream economists featured on major news programs) was on the reduction in production due to disruption of global supply chains, which put pressure on supplies and prices. When contagion started to be visible in Europe, and then in the United States, leading to suspension of nonessential production activities, the discussion quickly shifted to the collapse of demand problem as workers were furloughed or dismissed. So, the emphasis shifted from an inflationary spiral to a recession or depression problem, or both. The dominant

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policy discussion was around the most appropriate remedies for the supply bottlenecks and failing demand. With the recent financial crisis in mind, most recommended financial support measures similar to those employed after 2008: higher government deficit spending and low or zero interest rates to offset the declines in output and to support demand. The Federal Reserve moved quickly on interest rates and expansion of its balance sheet, while Congress produced multiple "stimulus" packages to offset the loss of income and employment due to the pandemic. Keynesian Democrats joined Cheney Republicans to argue that there was nothing to fear from deficit spending and expanding national debt. This was the wrong place to start, and led to the wrong policy response, because it was based on a mischaracterization of the problems facing the economy.

There was an alternative point of departure and method of analysis—one rooted in the concepts of uncertainty and expectations. Quite early on, developments in China made it clear that the analysis of the coronavirus was a case of absolute, complete, and total uncertainty as to its nature and impact. Keynes had already pointed out that the natural response to a case like this would be to presume that tomorrow would be much like today, that is, to refer back to something that you know. And this is what happened. References were made to the experience of SARS (severe acute respiratory syndrome) and MERS (Middle East respiratory syndrome) and to their respective death and contagion rates, which were contained at what were thought to be manageable values. The official response was "do not panic, we know that SARS and MERS were eventually controlled, so we really do not have to be too concerned." Further, as was initially thought with MERS, there was no confirmed person-to-person contagion. With no idea what the virus was or what the impact was going to be, the natural response was that it would be like the past, so the first order of business was to prevent panic—which, outside of China, was quite easy as there was no real evidence of the virus's presence before February.

As evidence in China accumulated, the transmission and mortality rates turned out to be much higher than what was expected; this evidence was reinforced by the subsequent spread and mortality in parts of northern Italy. As the physical evidence of overcapacity in hospitals and morgues emerged from Wuhan and then Lombardy, it became necessary to form new expectations. Forecasters started to model the prospective evolution of infection and mortality based on parameters to reflect this new reality, and the numerous model projections of the spread of the disease quickly produced estimates that exceeded capacity of potential treatment facilities. The panic was as much due to the fear of insufficient hospital beds and ventilators as to the potential explosion in the death rate.

But the basic parameters of these models, such as the now famous R_0 (the rate at which the virus is passed through the population, pronounced as R-naught) and the mortality rates, were just best guesses and were initially thought to be much higher than historical norms. And more importantly, reporting from China raised the suspicion that, unlike the earlier episodes, there was clear evidence of asymptomatic viral shedding and person-to-person contagion (paradoxically, both had been characteristic of the 1918 flu pandemic, but there was no historical memory) that called into question the R_0 estimates. If you do not know how many people are infected and spreading the disease before showing symptoms, you cannot know the spread rate. The same was true for the death rate, since asymptotic spread means that the real death rate will be much lower than recorded (the denominator will be much higher than reported when as many as 25–40 percent of the infections are asymptomatic). And this miscalculation was aggravated by the initial "do not panic" response, which allowed the spread to ramp up largely unseen. As we now know, the virus had been identified in November 2019 and was already extensive in China and Europe by December and in the United States by January.

This meant that the parameters required for the model projections were not only uncertain, they were unknowable until full-scale testing determined asymptomatic infection and transmission rates. This problem was further aggravated in the United States by the fact that test kits were in short supply, defective, and only offered to those demonstrating clear symptoms. So, two months after the official Wuhan announcements, uncertainty was complete and total, and it appeared that health services would be wholly insufficient to provide even minimal treatment.

In these conditions, the only available medical response was to take physical measures to stop transmission—full-scale lockdown appeared to be the only way to avoid a pandemic. The policy problem was no longer how to manage the impact on the economy to avoid recession, but it was to influence R_0 to stop contagion and the breakdown of the health system. The economic problem became the management of expectations in pursuit of one objective: move $R_0 < 1$. The recession was thus the collateral result of active policy decisions to achieve that objective. Nonessential employment had to be suspended. It was not the result of cyclical movement in demand—it was imposed on the economy. The problem was to ensure that the lockdown could be maintained until the objective was achieved. And this presented another unknown. In Wuhan, the lockdown started at the end of January and was relaxed in April—around three months. This suggested that the cost of fighting the virus would be something less than a quarter of GDP in lost income and production, depending on how rapidly the subsequent resumption of activity could take place.

Many economists responded with traditional recession-fighting policies, not realizing that the economic problem was not to provide stimulus to offset the "recession," but to ensure that the economy could sustain the likely GDP and employment losses under lockdown. There was no possible "stimulation" response—stimulus does not kill the virus, and money is far less useful if you are sheltering in place, relying on uncertain home deliveries, and prefer to save because of fear of prolonged unemployment. Job guarantee programs are not useful if the point is not to work, i.e., if the employment loss is imposed. Guaranteed basic income programs do not work if you have to provision by frequenting public spaces.

What had to be done was to make sure that everyone managed to survive the pandemic, which meant staying quarantined at home in order to avoid public contagion and overcrowded hospitals. And, in the aftermath of the mistakes made with stimulus packages used in response to the Great Recession, it was important that the government stimulus should be done in an equitable manner, to ensure it did not make income and wealth inequality worse.

The solution thus called for a different page from the New Deal response to the Great Depression of the 1930s: building confidence that the threat could be overcome. It is now recognized that there was no formal blueprint for a New Deal when Roosevelt took office, and indeed many of the policies implemented were borrowed from the Hoover administration. But Roosevelt recognized the need to provide a sense of confidence and security, to free decisions from the fear of fear itself. Thus, he moved to restore confidence in the banking system via rapid legislation; he moved to restore confidence by providing income through the myriad employment programs and finally a blueprint for recovery. Ira Katznelson notes that what "observers and commentators" of the dilemma facing the incoming administration shared was:

> an understanding that theirs was a time when uncommon uncertainty at a depth that generates fear had overtaken the degree of common risk that cannot be avoided.... When deep uncertainty looms, the ability to choose is transformed.... Measurable risk generates worry. Unmeasurable risk about the duration and magnitude of uncertainty spawns fear.... Under conditions of fear.... people develop a heightened mindfulness and self-awareness about the constraints on free action, and take, as a central goal, the desire to restore a higher degree of coherence and certainty; that is, they try to reduce deep uncertainty to ordinary risk. (Katznelson 2013, 33)

Given the loss of income and employment that follows from a strict lockdown—the only rational response to the virus—Katznelson's restoration of "coherence and certainty" is precisely what would be required. A sense of safety and security, of a clear path to exit from the threat of disease and unemployment, must be created to combat the fear and uncertainty of employment loss. How could it have been done? It should seem quite clear that neither guaranteeing income nor providing government employment would work. Lockdown means not working, not working means no demand for labor, and staying home means you do not have the possibility of spending much anyway. What was required was a guarantee not of income but of survival, of what we may call "social provisioning." The first thing is to make sure that if everybody stays home, and even if they lose their jobs, they will have enough to eat and survive without fear and the constraint that follows income loss.

The United States has a minimum system of state-provided unemployment benefits and food support (known by the acronym SNAP [Supplemental Nutrition Assistance Program]), which provides provide food security for low-income families. One possibility would have been to support everybody's income by expanding these programs to everyone classified as nonessential and subject to lockdown. These are cash-transfer programs that require the ability to use income for provisioning in the public market. However, the essence of the lockdown means suspension of the market mechanism, the labor market, the consumption market, and public activity. Providing income transfers requires provisioning through participation in the market; if there is no market, then it cannot work. Provisioning must be provided by a central organization—by the government.

Here is where the New Deal comes in again. A food-distribution organization—some sort of Civilian Conservation Corps (CCC)—would have been required to make sure that everyone was provided with enough to eat. In most large cities, restaurants donate their excess supplies to food banks and other nonprofit agencies. It is obvious that in the shutdown, restaurants cannot operate; the supplies that they would have bought would become redundant. Here was excess supply that could provide food security—if only it could be organized and distributed. In the event, it took press reports that excess food production from the countryside's producers was being trashed before a system was set up to channel it to the unemployed through nonprofit agencies and soup kitchens. The first order of business should have been the reorganization of the food-service sector into a food-distribution sector—social provisioning to ensure a minimum subsistence and survival to everyone in lockdown. Hebert Hoover did this for Belgium in the First World War (Nash 1989), so it clearly could have been done in place of sending everyone $1,200 to chase down nonexistent goods on empty store shelves, benefiting speculators who profited from shortages and creating incentives to break quarantine in search of supplies.

The next measure would have been to look at other types of expenditure. If you are a good Keynesian economist or stock-flow modeler, you know that every income is an expense, and if you know your national accounting, you know that production creates income and expenditure to take off that production. The stimulus response was a focus on incomes only—costs and sales were forgotten. A more sensible approach would have looked at the need for a balance between costs and incomes in the lockdown. If the firm is not producing, it is not earning; variable costs go down and it does not need a government loan to support employment if workers have to stay home. If households receive government-distributed subsistence (food, medicine, etc.), they do not need wages from employment to survive.

In the shutdown, there are also fixed costs that have to be met, for both the family unit and firms—rents, mortgages, leases, etc.—which create insecurity if they are not paid. However, it is not necessary to provide income transfers to ensure that these payments are dealt with. Fair burden sharing of the costs of the crisis implies that the rational approach is to suspend all fixed cost payments. A successful lockdown requires every economic unit to have minimum costs and minimum income, but to be assured of surviving the lockdown period in a condition to recommence normal activity. Thus, suspending financial operations to avoid unnecessary increases in debt levels, which would be carried over to the recovery period and create repayment difficulty, is the order of the day to support and maintain social provisioning. Government support and finance, along with organization of the production and distribution of subsistence, are required—not the provision of incomes to maintain capital values.

There is no reason why rental income or capital income should have preference over labor income. If everyone qualifies for social provisioning, the landlord gets food security just like the furloughed production worker. Here is the key to the idea of an equitable distribution of the burden of fighting the pandemic. Capital incomes and capital values have to be treated the same way as human capital and labor incomes. Household nonessential workers are losing, say, three months of income; so should all other wage- or capital-income recipients. Everyone should shoulder the capital loss created by the reduced flow of income, both human and financial.

The basic principle is to stop all flow costs. Since everybody's cost is somebody else's income, we do not have to give anybody money to cover those costs or offset the lost incomes. Capital incomes must share in the costs of fighting the virus. This means not only that we suspend trading in capital assets, but that the incomes of all corporate administrative and management personnel are eliminated—they would also rely on the subsistence provisioning. That is the way we can try to equitably share the cost of the shutdown. This would also mean that the government would not have to engage in massive deficit spending aside from the support of social provisioning. The government would have to engage in a certain amount of organization; for those who argue that it is difficult to act sufficiently quickly, refer back to the Roosevelt administration's first 100 days. It took about a month to set up the CCC, which provided employment for 300,000 young men in support of environmental projects (see Bremer 1975). In this case, we are not really interested in the impact on jobs and income, but more broadly in decisive action to set up an organization and management in record time. What is needed in this case is not government money—government did not need to spend a great deal in order to solve this problem. What is needed is to get the government to provide an equitable means for sharing the costs of quarantine, and to make sure that particular sectors and categories do not pay a higher price than others.

In the 2007–8 crisis, the government bailed out the banks and the management of private corporations, but let households lose their homes. Instead of an equitable distribution of capital loss, there was a capital transfer. This time was supposed to be different. But it looks very much the same in the United States. There was stimulus support for banks and firms, and this was supposed to maintain jobs—for workers the companies did not want or need. Should one be surprised that the job retention effect of these programs was extremely low? The major impact of the stimulus was to expand government debt and produce fee income for the financial institutions managing it. And what of the income transfers and unemployment benefits? It is telling that household savings hit record levels during the quarantine period. While the personal saving rate rose from 8 percent of disposable income in February to over 33 percent in April, the majority of households continued to face financial distress and food insecurity doubled, because of the inefficient and inequitable distribution of government income support measures.

Is the resulting increase in government debt and deficits a problem? We all know (or at least ought to) that it really does not make that much difference. There are any number of Keynesians who support the debt-financed government stimulus because, they argue, these deficits do not matter—and they do not. However, if they are unnecessary, then there is a very big political cost, because every time the government deficit increases the debt, Congress attempts to cut essential services—which are precisely the things that are needed in order to respond to the crisis at the federal level.

In this regard, the real problem is on the state level, where governments have been responsible for most of the healthcare costs. Since state governments run on a legally imposed balanced budget principle, the eventual response is going to be cuts in state government expenditures that comprise the income and employment of those essential workers on the forefront of the fight against the virus. Medicaid and education—the basics that we need—are going to be cut as a result of the mistaken emphasis on stimulus.

But there is a much simpler argument against the use of stimulus to offset a policy-induced recession. Consider Keynes on the appropriate role of government expenditure:

> if our central controls succeed in establishing an aggregate volume of output corresponding to full employment as nearly as is practicable, the classical theory comes into its own again from this point onwards. If we suppose the volume of output to be given, i.e. to be determined by forces outside the classical scheme of thought, then there is no objection to be raised against the classical analysis of the manner in which private self-interest will determine what in particular is produced, in what proportions the factors of production will be combined to produce it, and how the value of the final product will be distributed between them.... Thus, apart from the necessity of central controls to bring about an adjustment between the propensity to consume and the inducement to invest, there is no more reason to socialize economic life than there was before. (Keynes 1936, 378–9)

Those who justify additional deficit-financed stimulus expenditures with arguments about the unimportance of government debt rely on the first part of the argument, but overlook the fact that the market system—which is presumed to function to allocate these expenditures to produce output and employment—would no longer function under a strict lockdown, since the very response to the pandemic would shut down the labor market and suspend private decision-making. Rather than federal expenditure, the appropriate policy is the "necessity of central controls"—in order to offset the consequences of rising unemployment that have been created by central controls suspending the market mechanism. If we take Keynes at his word, the response to the pandemic should have been not only central controls on aggregate output, but central controls on the determination of production and distribution. Without the latter, the former is likely to be ineffective as a response to the pandemic, or is the equivalent of Keynes's well-known reference to burying bank notes in the ground: better than nothing, but not efficient in fighting the virus. Better would be a comprehensive food distribution system, building hospitals, and providing loans to businesses operating outside the market mechanism.

If the objective is to eliminate virus contagion and it requires shutting down the economy, there is no need to support full-employment income through government expenditure. The problem is rather to provide the appropriate redirection of production and an equitable burden-sharing in which social provisioning is assured. Debt, deficits, and transfer payments are not part of this. Central control of the market should be the goal. Relying on the crippled market mechanism cannot do it. If you fight a war, this is what has been required in the past.

There is of course the problem of the essential workers and those who manage to remain employed while in quarantine to consider. This is part of the problem of equity. Since it is difficult to suspend these incomes, the appropriate solution would be a progressive tax on the incomes of home workers, who can telecommute without loss of income, to be used as a supplement to the incomes of essential workers in the sanitary support sector, offsetting the increased contribution and risks incurred in fighting the spread of the virus. As a metaphor, the idea is for the economy (like Snow White) to fall asleep, while the trusty essential workers manage the fight against the coronavirus. Once R_0 is sufficiently reduced, the economy can resume without unacceptable disparity in the distribution of the lockdown's costs.

As we all know, this response to the crisis—strict lockdown combined with direct social provisioning—was not taken, and the four government stimulus plans have expired (those in support of incomes and employment payments) while those providing loans/grants to businesses have not been fully utilized. The increase in government deficits and debt has led to the expected reaction of a growing unwillingness on the part of Republicans in Congress to authorize additional programs to prevent a relapse of the economy, even as the COVID-19 infection rates increase and sales and employment have again started to weaken. If anything, the call among many Republican senators is for debt reduction rather than further economic support. Economists have started to predict a tsunami of unemployment for the end of 2020. Yet this misses the main obstacle to successful recovery in the event of elimination of the pandemic.

Recall that Hyman Minsky's theory of financial fragility is based on the relation between cash inflows and cash outflows. In these terms, the stimulus packages provided limited cash inflows to firms (the payroll protection programs) to meet cash outflows to households (cash transfers and increased unemployment benefits). But this provided no inflows to meet cash outflows for debt service. Thus, for most economic units, cash inflows were below cash outflows, even with the stimulus programs, and firms and households were either delinquent in debt service or had to find alternative financing. As the current stimulus plans expire, and in the absence of replacement, this financing gap will only increase. This gap has been financed on the one hand by Fed policies of buyer of last resort for government and private-sector liabilities, and on the other by the increased borrowing of the nonfinancial corporate sector, financed by bank lending or the issue of new debt in the bond and equity markets.

In Minsky's terms, the pandemic's initial impact was to increase the number of Ponzi units in the economy—those borrowing to meet shortfalls in financing costs. The stimulus response measures, based on increased lending to said units, meant even more Ponzi financing. Think of the transportation sector, in particular airlines, which are only out of bankruptcy court because of government support and the issue of new debt. The stock market continues to boom, interest rates remain near zero, and debt issuance continues to rise, without any near-term prospect of increased cash inflows to meet the increasing debt service ratios. This will be the next Minsky moment; the other side of the coming wave of unemployment will be a tsunami of write-downs of the assets held by banks and the investing public.

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