Economic Stewardship in Times of Crisis

By Andy Green and Christian E. Weller November 2, 2020

The COVID-19 pandemic has illustrated what happens when the government fails to deliver on what Americans expect and need. Americans believe that it is the responsibility of the U.S. government to keep its people safe and sound, invest for the future, and be good stewards of taxpayer dollars and well-regulated markets—in short, to create a fair system that gives everybody a shot at the American dream. Sadly, in recent years, the federal government has failed on most of these issues, as the concurrent public health crisis and deep recession wreak massive hardship for millions of families.[1] Unsurprisingly, Americans are frustrated across the board, with 69 percent stating in a recent poll that the United States is on the wrong track when it comes to fiscal policy management.[2]

Budgets reflect values. And the Trump administration has shown its cards clearly regarding the federal budget. Three years ago, rather than actually address the dual problems of slow productivity growth and massive economic inequality, the administration, then-Speaker of the House Paul Ryan (R-WI), and Senate Majority Leader Mitch McConnell (R-KY) rammed through Congress a massive tax cut, one that was heavily weighted toward the largest corporations and the wealthy. The legislation, known as the Tax Cuts and Jobs Act (TCJA), was packed with budget gimmicks intended to mask its significant costs.[3] In the process, it kept income and wealth inequality at record high levels and left unaddressed many issues that plagued families long before the pandemic: low wage growth, high health care and education costs, and growing indebtedness. Yet today, in the face of a devastating pandemic, many of the same congressional leaders are delaying the next legislative package of economically essential coronavirus relief on the grounds of the very deficits that the TCJA helped create.[4] This is despite the overwhelming economic and popular consensus that fiscal policy must do "whatever it takes" to address the pandemic and take far bolder actions to build resilience in the face of coming climate shocks and systemic inequalities.[5]

Putting bare-knuckle politics aside, this issue brief considers how U.S. policymakers should assess fiscal policy in the era of COVID-19—and for at least the foreseeable future beyond the pandemic. In short, responsible fiscal policy in today's economic reality may be best demonstrated by a government that serves taxpayers by investing in higher productivity, more financial security, expanded opportunity, and greater worker power; by securing inequality-reducing revenues; and by protecting the economy against likely financial, climate, and public health crises.[6]

Investing in the future

The Center for American Progress' recent research on budgets and fiscal policy focuses squarely on how policymakers can secure productivity growth, expand opportunity, and reduce inequality.[7] Pursuing these goals can help create a virtuous cycle, whereby faster growth in the present, equitably shared, contributes to faster growth in the future. These investments are a top priority; when they are made with an eye toward increasing productivity growth and expanding opportunity, the stronger economy can itself make paying any interest on those investments easier. Consider the example of when doctors take out loans to attend medical school: Their higher future earnings from a lucrative career make it easier for them to pay off incurred loan debt.

Investments in education, research, and infrastructure are just a few examples of taxpayer dollars that government puts toward future productivity and that yield expanded opportunity and reduced inequality. The combination of faster productivity growth and more economic equality will ultimately translate into a lower burden on taxpayers for any debt-financed investments. More people will have higher incomes than would otherwise be the case, increasing federal government revenue in the process. This does not mean that deficits will pay for themselves, but deficit-financed, well-designed investments will substantially lighten the load of the additional debt. The GI Bill that financed education for millions of veterans after World War II; the interstate highway system; government research that helped build the internet; federal research funding for pharmaceutical research to eradicate diseases and find new treatments; and the construction of the Tennessee Valley Authority, which broke the utility monopolies and lowered energy costs for millions of families and businesses, are just a few examples of investments that yielded productivity returns far beyond their upfront costs.[8] However, it must be recognized that too many of America's past investments have excluded people of color, undermining the broadly shared prosperity essential for long-term fiscal responsibility.[9]

Governments are not households

Analogies to household borrowing are unavoidable tools for helping people understand financial matters, but they have significant limitations and even downsides when it comes to truly appreciating the operation of government borrowing. In particular, households often face obstacles in borrowing the money necessary to invest in their own futures, as the example of student loans amply highlights. They also have finite life spans where they borrow money to invest in education and housing early in their career; increase their earnings and savings if all goes well; and eventually enter retirement. Households typically aim to pay off all or most of their debt by the time they retire. Limited access to affordable debt and finite investment horizons mean that households cannot fully address all their needs and are left with a lot of financial risks. For example, many households, especially African American and Latinx households, end up with significant high-cost student and auto loan debt early in their careers, hampering their ability to buy a house or start a business.[10]

The federal government, in contrast, can borrow on highly favorable terms to finance necessary investments and has a much longer time horizon. It can thus address large, known but longer-term risks by temporarily increasing its borrowing. The federal government can borrow on more favorable terms for a number of reasons, including the size of the U.S. economy, the dollar's role as the global reserve currency, and the role of public debt as the foundational asset of the financial system

for liquidity, credit pricing, and other purposes. The federal government's capacity and necessity to borrow are not only far larger than those of households but also fundamentally different. It can address key challenges such as borrowing and spending to counter the boom-and-bust cycles of the economy, for example, by supporting households and businesses hurt by the pandemic. It can also respond to financial, public health, and climate crises in its fundamental role of protecting people, boosting financial stability, and increasing productivity growth. When addressing federal budget matters, policymakers therefore should be cautious in using household analogies that drive questions such as, "Where will the money come from?" or "How will we pay it back?"—not because those questions cannot be asked or answered, but because the answer in the governmental context is so different from the answer in the household context.[11]

Protecting the country in times of national crisis—such as wars—has historically justified exceptionally heightened levels of debt, usually expressed as a ratio of debt held by the public to gross domestic product (GDP). And in fact, while wars waste a great many things—not the least of which is life—they have also resulted in productivity booms that are due in part to government investment in technological and manufacturing capacity and to productivity innovations that arise from what are commonly extremely tight labor markets during those periods.[12] Indeed, the years following World War II saw the nation's biggest boom in middle-class opportunity for workers—not including, by intentional policy design, Black workers.[13] Public debts as a percentage of GDP declined as the economy grew more quickly, a reasonable level of worker wage growth and inflation were maintained, and the wealthy paid their fair share in taxes.

Today, the pandemic-related economic crisis, systemic racism, and climate change all pose similar existential crises, and each demands a similarly robust response—one that increases technological and manufacturing investment and tightens labor markets by addressing the nation's needs.[14] Recent economic research highlights in particular the importance of investing, including through short-term deficits, to support workers' productivity growth and a more equitable distribution of economic resources. This combination of faster growth and more equality could allow the nation to avoid the economic scarring that can come when a crisis dislocates workers for extended periods.[15]

The pandemic-related economic crisis

The country is suffering from a deep and prolonged recession that is hurting families and businesses. Even though GDP growth rebounded from July 2020 to September 2020 and recovered most of the ground lost in the preceding months, people had 10.7 million fewer jobs in September 2020 than in February 2020, and the employed share of people ages 25 to 54 was only 75 percent—far below the 80.5 percent share in February and below any levels recorded from 2011 to 2019.[16] Moreover, the labor market recovery is showing signs of slowing. Financially strapped households are already out of options when it comes to paying their bills. The U.S. Census Bureau reports that 15.1 percent of renters had fallen behind on their rent at the end of September.[17] The widespread and lingering economic pain from the recession will eventually hurt all kinds of businesses and further slow the recovery, unless Congress quickly enacts another large and well-targeted fiscal stimulus.

The COVID-19 pandemic presents precisely such a case for a robust fiscal response to save lives and prevent the kind of sustained job loss that occurred for too many workers in the years following the 2008 financial crisis and Great Recession, when fiscal austerity returned far too soon. The International Monetary Fund recently praised fiscal policy for doing "whatever it takes to save lives and livelihoods" as countries go through COVID-19 lockdowns, but it continued to emphasize the importance of smart investment:

> *When the health crisis is contained, the emphasis will shift to exiting from exceptional government interventions and to ensuring the sustainability of public finances while building resilience against future shocks and addressing preexisting challenges such as inequalities and global warming.*[18]

In the aftermath of the COVID-19 pandemic, the United States will need to make significant investments to support job creation in so many hard-hit communities; build small-business opportunity nationally, especially in communities of color where the racial wealth gap has left families vulnerable to the dual onslaught of the public health crisis and the deep recession; address the climate crisis and so many other problems that have been neglected for far too long; and much more.[19]

Empowering workers to advance responsible fiscal policy

Empowering worker power to collectively secure fair wages would also support the advancement of responsible fiscal policy. Because unions help raise wages, they support both economic security for workers and higher productivity, both of which have positive fiscal impacts.[20] More fundamentally, worker power is important because unions have proved to be powerful tools in focusing workers on their essential interests as citizens in a democracy.[21] Vibrant multiracial unions have also been essential to countering the threats of racism and racial division, which are proving to be dangerously powerful forces that undermine the very tenets of the United States' economic and national strength nearly every day in President Donald Trump's America.[22]

Systemic racial inequality

Consider systemic racial inequality. The protests against police brutality this summer have once again laid bare how any federal government response addressing the massive inequities highlighted by the pandemic will need to wrestle with the persistent and widespread racial wealth gap. The gap between Black and white families' wealth serves as a key example. Black households typically own a fraction of the wealth of white households. In 2019, the last year for which data are available, the median wealth of Black families amounted to $24,100, or 12.8 percent of white families' median wealth of $188,200.[23]

This lack of wealth has left Black families especially vulnerable in the pandemic as they are more likely to experience layoffs[24] and higher health care costs due to a greater exposure to the coronavirus.[25] They have fewer resources to cover the loss of income and higher health care costs, resulting in greater financial vulnerabilities and fewer opportunities to invest in their children's remote learning.[26] The pandemic thus made an already massive economic inequality much worse.[27]

Federal efforts to shrink the Black-white wealth gap must be part of any responsible fiscal policy and need to take several forms. First, the federal government should do no harm and avoid a return to fiscal austerity. Aggressive reductions in public services hurt many people of color in two ways: They lose access to stable, well-paying jobs with decent benefits that are often unavailable to them in the private sector, and they lose vital services in health care, education, transportation, and other areas.[28] Next, the federal government needs to address the persistent exclusion of Black entrepreneurs and inventors from federal funding for research and development.[29] Third, the federal government must make direct investments in raising wealth for Black families so that they can enjoy the same economic opportunities as white families. These direct investments can include regular savings for children until they reach age 18, commonly known as baby bonds; debt-free college; easier access to low-cost, low-risk savings options; and full enforcement of anti-discrimination and civil rights legislation in mortgage and housing markets.[30] Without such investments, a large and growing share of the population will continue to face much harder and more widespread financial struggles than is the case for white families, and persistent and systemic inequality will continue to hamper inclusive, broad-based growth and drive social fracture and conflict—all of which is deeply harmful to fiscal policy.

Climate change

Climate change's economic impacts are similarly stark. Communities of color will be the hardest hit when it comes to the effects of the climate crisis, but those impacts extend widely across the economy and all the way to the most powerful: The risk of a climate change-driven financial crisis grows every day that markets and regulators refuse to act on climate change.[31] Already, weather-related natural disasters have taken thousands of lives and cost nearly half a trillion dollars in the past three years alone.[32] This year's fire season was so intense in the West that the skies of major American cities were darkened in broad daylight.[33] Farmers, ranchers, fishermen, and others in the agricultural sector are feeling the pain of nature's punishingly fast changes.[34] The necessity of an overwhelming response on climate—one focused on a 100 percent clean energy target, a worker-centered approach, and environmental justice—grows more pressing by the day.[35] Indeed, precisely because there is no silver bullet, trillions of dollars in federal investments need to be deployed across a wide range of initiatives—including research and development; safe and healthy infrastructure; worker and community transitions; rural conservation and sustainable agriculture; and special efforts to target communities that have historically carried an unfair burden from pollution. This is critical to addressing the existential challenge that is the climate crisis.[36]

Ultimately, smart investments that enhance productivity and protect people and the planet are fundamentally in furtherance of responsible fiscal policy in that they bolster the economic, social, and environmental foundations for growth and prosperity.

Raising revenues and reducing inequality

This is not to say that structural deficits do not pose potential economic risks over the long term. As such, policies that undermine the country's revenue base heighten those risks. Unfortunately, the mistakes of recent years have added up.

In particular, the 2017 TCJA was predicated on cut-and-grow mythology that has time and again been proved wrong. The law also ignored independent scorekeepers and relied on budgetary gimmicks, leading it to be deficit-financed and have an effective price tag well north of the roughly $2 trillion official price tag should core features of the law get extended.[37] The bulk of those funds were redistributed upward, going to the wealthy and to the largest, most profitable corporations, which have used their tax cuts not to invest in job creation or workers through new economic capacity or productivity, but instead to finance share buybacks and mergers and acquisitions.[38] Quite simply, the tax cuts were a missed opportunity to make productivity-enhancing investments to build America's future.[39] And while billed as tax reform, the bill left untouched some of the most wasteful tax expenditures—such as the private equity so-called carried interest loophole. It even created some large new ones, such as the 20 percent deduction for business income earned through pass-through entities, the foreign-derived intangible income deduction that actually contains incentives to offshore production, and the opportunity zone tax shelter that provides extraordinary capital gains reductions for the wealthy but few guardrails to ensure that the investment funds benefit existing populations in underserved communities.[40]

More broadly, greater revenues are needed not only to support economic investments in middle-class job creation, climate change mitigation, and more, but also to play a role in directly reducing inequality. A return to more progressive rates of tax on high incomes, capital gains, and wealthy estates; stronger tax enforcement, especially with respect to the wealthy; and more are all important tools to create a fairer tax system.[41] Closing irresponsible business loopholes, such as the pass-through tax loophole, and reversing the tax cuts for corporations that have brought corporate revenue well below historic and international norms are equally critical to countering the extraordinary accumulation of wealth and power at the very top.[42] These changes will also generate more revenue to support vital programs that many American families need for their financial security and to enjoy equal economic opportunity.

Advancing prudent financial regulation

The 2008 financial crisis and the Great Recession laid bare the connection between the banking system and fiscal responsibility: Not only did millions of Americans lose their jobs and homes, but the public debt and the Federal Reserve System's balance sheets both rose dramatically. Essentially, America saw the socialization of much of the private sector debt that the banking system and capital markets had created but mismanaged, while unemployment and the real economy slowdown caused more fiscal outlays and a collapse in federal and state tax revenue.[43] None of this was news to experts, who for years understood that financial fragility has strongly negative impacts on employment and macroeconomic outcomes, which in turn further exacerbates weaknesses in the financial system.

Unfortunately, COVID-19 presents the risk of another financial crisis that requires sustained attention in order to avoid it.[44] Critical funding markets broke down in March, and the Federal Reserve System has deployed extraordinary levels of emergency lending to support the financial system, corporations, and municipalities, acting in ways that even exceed what was done during the 2008 financial crisis.[45] Moreover, banks remain exposed to homeowners who cannot pay their bills, to commercial real estate owners whose incomes depend on renters and small businesses that cannot pay the rent, and to other losses that may ripple through the economy. At particular risk are financial institutions and markets exposed to an increasingly highly indebted corporate sector, which includes an oil and gas industry that has struggled for years.[46] If these issues are not addressed and financial risks become too large, the costs of a financial crisis fall squarely on the taxpayer, not only through the immediate draws on the federal government safety net but also through the real economy implications for recessions: a macroeconomic slowdown, more unemployment, fewer revenues, and higher expenditures.

As the negative interaction between real economy downturns and financial sector fragility can produce unexpectedly large outcomes for employment and other macroeconomic variables, fiscal responsibility during the COVID-19 economic crisis demands a prudent approach to financial regulation.[47]

Prudent financial regulation puts the real economy first

In simple terms, prudent financial regulation starts by ensuring core components of the financial system are regulated to take the risks necessary to serve their important real economy functions and not more. These include deposit-taking and lending for banks; securities underwriting and customer-focused trading for securities firms; and business and consumer insurance services for insurance companies. Banking organizations, for example, should not be engaged in taking high-risk, swing-for-the-fences bets on the ups and downs of the market, which do little more than fill the bonus pools of traders and executives at the expense of their customers and clients.[48] All financial firms should maintain robust buffers in the form of loss-absorbing capital and high-quality liquid assets to help them weather the inevitable storms in the financial markets.[49] Additionally, specific financial products and the markets in which they may operate—be they consumer loans, securities, derivatives, or otherwise—should be transparent and well-regulated to protect consumers and investors; to ensure fair and efficient markets for all market participants; and to otherwise support the maximum possible long-term alignment between those markets and the public interest, such as relating to worker empowerment, climate change efforts, racial justice, and more general environmental, social, and governance (ESG) matters.[50] In essence, prudent financial market regulation is a way to ensure that the federal purse will not be unduly taxed by another foreseeable and preventable crisis.

To date, many of the reforms to bank capital, risk-taking, swaps, consumer protection, and more put in place by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 have helped to insulate the financial system from the pandemic's economic impacts.[51] Yet the Federal Reserve Board and other financial regulators have chipped away at the Dodd-Frank Act's capital and other regulatory foundations in the years since its passage, exposing taxpayers to heightened risks of failed banks.[52] Real-time choices made by regulatory leadership matter, too: Irresponsible capital releases for dividends or share buybacks, amazingly, were permitted to continue well into the beginning of the pandemic lockdown.[53]

Although the situation appears calm at the moment, continued attention is critical, as financial markets seem to be pricing in far higher losses in the corporate sector than they normally do.[54] Additionally, the failure of Congress to pass sufficient fiscal support for families, small businesses, and states and local governments presents a continued risk to the financial system.[55]

Nor do the immediate risks to the financial system end with COVID-19. As was highlighted in a recent unanimous report by a climate-related risk advisory committee to the U.S. Commodity Futures Trading Commission, the already present harms of climate change, and the ensuing risks of a climate-related financial crisis, only make it more urgent that financial regulators get their houses in order.[56] Key tools to address this challenge include enhanced climate-related corporate transparency, including the emissions financed by the financial sector; bank stress tests and capital regulation; transparency regarding ESG approaches by asset managers and asset owners; and a range of tools to promote the clean energy transition and small-business resiliency.[57]

Conclusion

Despite all the mistakes and wastefulness of recent years, America retains extraordinary fiscal advantages. The dollar remains the global reserve currency, and U.S. debt forms the foundation of the financial system and central banks around the world. In fact, in an era of low inflation and secular growth challenges, fiscal capacity may be far more robust than previously fathomed.[58] But that does not mean it should be wasted. Instead, America's taxpayer dollars should be deployed to create jobs, boost productivity, and address long-term challenges—and in doing so, secure America's economic growth, social inclusion, and, indeed, fiscal strength. Paired with an approach to revenues that reduces inequality and a prudent approach to financial regulation, this would be a truly different path forward than the reckless one that America has been traveling—because at the end of the day, a responsible approach to fiscal policy means having a government that is accountable to, investing in, and faithfully protecting the American people.

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