Paying for the COVID-19 Catastrophe

On March 27, Congress passed and the President signed a $2.2 trillion economic stabilization bill. It was by far the largest money bill ever enacted into US law. That bill followed two previous, smaller—but hardly inconsequential—bills for the same purpose, and was itself followed by a fourth trillion-dollar bill. On top of those bills, the Federal Reserve will facilitate trillions of dollars of new lending; but noting the issues not yet addressed, the Congress has begun arguing over a fifth bill.

No one is counting all that money. Nor should they. You do not worry about your cellphone bill when your stalled boat starts taking on water, just out of sight of shore.

Unfortunately, though, this is not just a cellphone bill. This is a potential 25 percent increase in a public debt that is already far too large. After decades of bad behavior—and some bad luck—the US was already setting debt-burden records for peacetime. Now the US is sailing totally off the charts—with near certainty that the debt burden will exceed the record highs of World War II in mere months, not years. And there is zero prospect that anything like the post-war economic bounce will boost the country out of the debt hole.

WHAT IS A PRUDENT NATION TO DO?

This brief provides a plan to address the rapidly increasing debt—at the appropriate future hour—which could free policymakers to make sound decisions and head off even worse economic outcomes from the catastrophic impact of the COVID-19 pandemic. It first addresses why policymakers must take actions that increase the debt to keep the economy afloat under these unprecedented circumstances. It then offers a plan toward long-term fiscal soundness that would prevent the recovery from the pandemic from undermining the federal government’s ongoing fiscal standing by:
1 Segregating the new debt (incurred from recovery costs and financing) from normal government finances into a single separate financial entity (probably organized as a public corporation);

2 Financing the recovery debt with bonds of the longest maturity—a 40- or even 50-year maturity if possible—even longer than the longest 30-year bonds the Treasury sells today; and

3 Paying the interest through an addition to current revenues—a tax increase—that would be cleanly segregated from other revenues.

The nation must not halt its economic recovery efforts, but policymakers must prepare for the consequences and consider their options. Also, financial markets understandably act on expectations. Investors who buy 30-year bonds today must consider the future behavior of the borrower. And right now, the truly unprecedented weight on the federal budget is straining those expectations.

So even though now is not the right time to impose a payment mechanism for the incremental debt caused by the recovery effort, it is not too early to consider what that mechanism should be. And as the markets are asked to purchase that debt, widely held expectations that the burden will be managed responsibly will only help the financing of the extraordinary but necessary cost of economic recovery.

BACKGROUND

The pandemic has left the United States with a virtually unprecedented problem—a 100-year catastrophe. The only comparable episode in modern history is the so-called “Spanish flu” of 1918, in what was obviously a very different world. An easily transmitted pathogen of considerable virulence has been let loose upon the entire world. One hundred years ago, with less knowledge and fewer and weaker tools, public and private actors could do little, and so the pathogen did its worst. Today, we have learned from that bitter history.

As a result, the nation has taken painful steps dictated by public health, closing down places where people congregate to reduce the spread of the disease. This includes shutting down many places of work including retail stores, eating and drinking places, theaters and stadiums, hotels, and, notably, travel—and therefore much of commerce—in an effort to reduce transmission of the disease across the country and around the world.

The economic consequences of this shutdown have been catastrophic. Total retail sales in the US fell by 16.4 percent—almost one dollar in six—between March and April (and late March was already affected by the shutdown). But within that average decline, sales at clothing stores fell by 46.3 percent; eating and drinking places by 23.6 percent; and department, furniture and appliance stores by more than 25 percent, caused, surely, by both the general economic downturn and fear of the disease.

However, just as we have learned about public health remediation from the Spanish flu, so we have learned of economic damage control from the Great Depression of the 1930s, and the “Great Recession” following the financial crisis of 2008. A surprising political consensus holds that fiscal policy must make the private sector—both businesses and
households—whole for the losses. The views of policymakers of different parties today differ only in degree, whereas in the Great Depression and even in the more recent financial crisis, there were differences of kind.

That is why multiple recovery laws costing cumulatively trillions of dollars have been enacted so quickly. These efforts (measured against the size of the economy) far exceed those of the 1930s and following 2008. This effort may or may not be sufficient for robust and early recovery; much depends on developing prophylactics and vaccines for the virus, and the development of verifiable immunity (which in turn depends on large-scale and reliable testing). More may be needed, but the recovery expenditure already has been enormous.

These expenditures aimed to keep body and soul together for households, and labor and capital together for businesses. Beyond the human tragedy, families who cannot pay their bills now will make neither good producers nor good consumers when the pandemic ends. Likewise, if businesses are to reopen and contribute to an economic recovery, they must remain in business.

These expenditures (and tax reductions) are essential. But they wreak havoc with the federal budget. Many public policy experts were more than troubled by the soaring public debt even before the pandemic. The January 2020 Congressional Budget Office (CBO) nonpartisan budget baseline projected that the debt held by the public would reach 98.3 percent of GDP by the end of 2030, near the historical peak of 106.1 percent.
at the end of World War II (see Figure 1).\textsuperscript{9} The US economy was poised for spectacular growth at the end of World War II and quickly reduced that record debt burden. The US economy is in a very different place today, with a slowing labor pool due to an aging baby-boom generation (in contrast to the troops coming home), intense foreign competition (in contrast to US commercial dominance post WWII), and household balance sheets decimated by the pandemic (in contrast to a population of wartime savers). The current economy has no prospect of a post-World War II-like boom. Today’s debt burden is deep-seated.

Now, on top of the ongoing baseline debt disaster that the nation faced pre-pandemic comes all of the relief legislation, the revenue “drought,” and added spending (unemployment benefits, Medicaid expenses, and so on) that would have occurred even without that new legislation. That is even more debt to be serviced by a now-smaller economy. CBO’s numbers now suggest that the debt could be as high as 108 percent of GDP in 2021.

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\textbf{DEBT REMAINS A BURDEN AND A RISK}

Sovereign interest rates today are extraordinarily low by historic standards, in the United States and in many countries around the world. And they are likely to remain low, given the weak economic demand in the wake of the global pandemic and the consequent “flight to quality.” However, low interest rates are already built into the dire debt projections.

And those low rates must be put into deeper context. Interest rates at the end of May of this year were under 0.2 percent for the three-month Treasury bill and well under 1 percent for the 10-year Treasury note, far below rates during the stronger growth years in the 1990s and 2000s with levels from 3 to 5 percent.\textsuperscript{10} The problem is that with a public debt at over 100 percent of GDP, interest rates only one percentage point higher (and rates one point higher would still be historically low) would quickly add one percent of GDP to the federal government’s net interest obligations. (Roughly one-third of the public debt outstanding today will mature and must be refinanced within one year, and another one-third within five years (see Figure 2), not to mention all of the new debt that must be sold continuously in the coming months, which would immediately be caught up in any higher interest rates.) With federal revenues now at only about 16 percent of GDP, outlays of an additional 1 percent of GDP would be a nontrivial increment to the government’s budget, raising an already excessive deficit alarmingly.\textsuperscript{11}

How likely are interest rates to rise? Again, consumer demand is anemic, so rates will not be pulled up tomorrow by demand for credit. To be sure, inflation (and interest rates) could be pushed higher by costs. The pandemic has caused interruptions in supply; global value chains have been broken, requiring cost-increasing substitutions in materials and components; and some production facilities have become hotspots for the virus. So inflation is conceivable, though surely muted without demand.
But again, context and a comprehensive view are essential. The debt burden, expressed in scale with the size of the economy, is going nowhere but up. At whatever point in the future interest rates should rise and for whatever reason—and we all hope for sooner, and because of stronger economic growth—the debt will be there to drive up the budget’s net interest costs. Ignoring the problem will not make it go away.

Furthermore, an excessive debt is a permanent and continuous drain on national saving and a corresponding drag on investment and economic growth. While all Americans hope for a reinvigorated economy to restore widely shared prosperity, there is no reason for public policy to stand thoughtlessly in the way.

And finally, an overextended budget and an oversized debt will hinder the US response to any future emergency. Today, the world financial markets seem willing to provide this nation with a virtually unlimited supply of credit, despite our prepandemic budgetary profligacy. The reason, we are sometimes told, is that every other nation has behaved as badly as we have and been subject to the same global pandemic, and that because of our natural advantage as the world’s largest economy, we are “the best-looking horse in the glue factory.” However, we should not forget that the next emergency may not be visited equally on every nation; it may be a natural disaster or a national security emergency to which only the US can respond. What will happen if the world begins to doubt the creditworthiness of the world’s largest economy and the supplier of the world’s reserve currency? No one knows. And no responsible person should want to find out.

Such concerns may deter policymakers from taking actions that increase the debt but are necessary to keep the economy afloat. If that should occur, both the economy, immediately, and the debt, ultimately, will suffer. Having a plan to address the rapidly increasing debt—at the appropriate future hour—could free policymakers to make sound decisions and head off even worse economic outcomes.

Figure 2
Maturity of existing debt

- Matures in over five years: 30%
- Matures within one year: 29%
- Matures between one and five years: 41%
In sum, the US debt bomb may (or may not) be on a very long fuse; but that fuse is not infinite, and it causes pain as it burns. Responsible and prudent policy makers, as they fight the fire of the global pandemic, should consider how they will respond to the debt challenge once the pandemic is contained and the economy is stabilized. In fact, the world financial markets likely will look more optimistically upon the United States over the coming potentially turbulent years if our nation has a considered plan to manage our extraordinary burden of debt.

**APPROACHING A SOLUTION**

First, to solve the problem we need to measure its size.

The economy has been dragged to a veritable standstill, with about 40 million new unemployment insurance claims in just 11 weeks. But with public and private sector leaders at work on a safe and responsible plan to start reopening the economy, it is possible to take an early view—admittedly with considerable uncertainty—of the ultimate economic cost.

A reasonable assessment is that when all the dust has settled, the nation will have lost the equivalent of all of its production over a period of three months, that is, 25 percent of our annual GDP. That is an enormous pothole for our economy to strike. To minimize the damage as we hit it, policy must fill that pothole as quickly and fully as possible.

If the federal government must spend or cut taxes to fill that immense hole, it must do so by that 25 percent of our annual GDP (measured as of the beginning of the pandemic). And so that amount is how much the nation must borrow, or how much additional debt it must incur, to provide that relief. And that amount takes our already swollen debt—almost 80 percent of GDP—almost immediately to about 106 percent of GDP, akin to the peak reached at the end of World War II.

How can the nation borrow that much money? And how can the Treasury service that debt, that is, pay the interest on it going forward?

If the nation piles this additional debt on top of the excessive debt that we already have accumulated and are still accumulating, it will seem unbearable to many Americans. And if it seems unbearable to the financial markets, then in the most meaningful sense, it will be unbearable. So instead, the nation should segregate that debt from what it has already accumulated.

And in fact, the recovery effort has no connection to the everyday activities of government. If the federal government were to demonstrate the will to address this extraordinary expense, financing it in the markets would be much easier. Therefore, it makes perfect sense to segregate the financing of this debt from normal government finances, and to create a fully dedicated mechanism to pay for it. That will require several distinct changes in budgeting behavior.

To begin this rethinking, consider that the novel coronavirus is of a scale unknown to any living American. It is far beyond SARS, MERS, or the annual flu in its communicability (including its asymptomatic contagion); spread globally before it was widely recognized; and has apparent high lethality (though less than SARS or MERS), higher than the polio
outbreaks in 1916 and the early 1950s and comparable only to the Spanish flu of more than 100 years ago.14 It has been described as a “once-in-a-century pathogen,” and it truly is.15 For that reason, it makes perfect sense to finance the extraordinary necessary recovery efforts over the long term or even over the period of a lifetime.

Interest rates today are very low, and the financial markets have shown themselves willing to consider very long-term securities. Taking the pandemic’s once-in-a-lifetime character and the patience of today’s financial markets together, there is considerable merit to consolidating all of the debt undertaken because of the current crisis in a single separate financial entity (probably organized as a public corporation) and financing it with bonds of the longest maturity—a 40- or even a 50-year maturity if possible, even longer than the 30-year Treasury bonds that are the longest the Federal government sells today.

What would that mean in dollar terms? The all-in cost of our estimate of three months’ worth of output—25 percent of GDP as of early 2020—is about $6 trillion.16 At 3 percent interest rates, which by today’s standard would seem high, that would incur annual interest costs of about 0.75 percent of the GDP, or about $180 billion. If policymakers segregate this amount from the current budget, it is clearly manageable.

And how to raise that money? For credibility and to prevent future manipulation, the nation must raise that amount in a fashion that would be additive to current revenues—a tax increase—that would be cleanly segregated from other revenues. That approach would minimize the temptation to double-count the money and fund a spending increase elsewhere in the budget.

And as much as some would long for the alternative, spending cuts will not work. All existing spending is part of the current day-to-day budget. Any spending cut would easily be attributable back to the general fund at some future date, and therefore would arouse continuing temptation to spend on something else instead. That would defeat the purpose of providing an iron-clad commitment to service the new debt. Furthermore, no reduction in an existing general-fund program could be guaranteed to continue over decades. For example, congressional and White House promises of future appropriations and Medicare reimbursement cuts have been made repeatedly but have also been repeatedly reneged upon.17

Furthermore, the federal government must take on a rock-solid contractual obligation to deliver the new revenues to the public corporation that would issue the bonds to pay for the cost of the recovery. This would prevent future Congresses and Presidents from snatching the revenues to fund their own priorities for “just a year or two” or permanently.

And ideally, the amount of revenue raised should increase as the economy grows, and that revenue growth must be dedicated solely to retiring bonds gradually and fully over their 40- to 50-year maturity. This would make the federal government’s commitment even stronger. Once the pandemic is behind us, the total cost of the recovery effort will have been incurred and would not increase further. Because that principal amount will be financed with long-term, fixed-interest-rate bonds, the interest cost also would not increase in the future. If the revenue inflow could increase in dollar terms, then the gradual increase in revenues over and above the debt-service cost could be used to
repurchase and retire bonds early. That, in turn, would further reduce the debt-service cost. Ideally, that flow could be sufficient to retire all of the bonds by the time of their maturity. The incremental cost of the recovery from the once-in-a-lifetime pandemic would be paid over a lifetime, and the tax would be automatically extinguished once this debt is fully repaid.

WHEN?

The federal government’s recovery initiatives today are filling the pandemic pothole in the path of the economy. It is absolutely clear that this is not the time to impose a new burden on the economy through either tax increases or spending cuts and thus dilute the stimulus from the recovery effort. The financing approach described above is for another day, after the pandemic has been vanquished.

However, financial markets understandably act on expectations. Investors who buy 30-year bonds today must consider the future behavior of the borrower. And right now, the truly unprecedented weight on the federal budget is straining those expectations.

So even though now is not the right time to impose a payment mechanism for the incremental debt caused by the recovery effort, it is not too early to consider what that mechanism should be. And as the markets are asked to purchase that debt, widely held expectations that the burden will be managed responsibly will only help the financing of the extraordinary but necessary cost of economic recovery.

If policymakers can approach this challenge in a rational way, planning for the future, accepting responsibility, and implementing sound policies when the time is right, the United States can maintain its economic leadership and reestablish prosperity for all.

CONCLUSION

The nation must tackle the expanding debt that threatened our economy even before the pandemic. CED’s earlier Solutions Brief entitled Is There Life After Debt? presented a sound program to do that. However, the pandemic has created a new challenge.

This Solutions Brief suggests that this new challenge is best approached using separate, special purpose measures. A first step toward long-term fiscal soundness would be to prevent the recovery from the pandemic from undermining the federal government’s ongoing fiscal standing. Segregating the cost of the recovery, financing it with long-term debt, and providing for its servicing is the best way to do that. But it is only a first step; true and comprehensive fiscal responsibility must follow.
Endnotes


3 The House has passed its own approach (Introduced in House; “Health and Economic Recovery Omnibus Emergency Solutions Act or the HEROES Act,” May 12, 2020), but the Senate has refused to take it up.


7 Guidance for those steps was offered by the Centers for Disease Control.

8 Monthly Retail Trade, United States Census Bureau.


10 Selected Interest Rates, Board of Governors of the Federal Reserve System.


16 The official $21.5 trillion estimate of the 2020 first quarter gross domestic product can be obtained at “Gross Domestic Product,” Bureau of Economic Analysis, US Department of Commerce.

17 The Bipartisan Balanced Budget Act of 1997 promised automatic Medicare spending cuts if costs exceed the “sustainable growth rate” (Marilyn Moon, “An Examination of Key Medicare Provisions in the Balanced Budget Act of 1997,” The Commonwealth Fund, September 1, 1997), but after years of postponements, the cuts were eventually repealed without ever taking place by the Medicare Access and CHIP Reauthorization Act of 2015 (Public Law No: 114-10, “Medicare Access and CHIP Reauthorization Act of 2015,” e. Similarly, future appropriations cuts promised by the Budget Control Act of 2011 (“Testimony on Discretionary Spending,” Congressional Budget Office, October 26, 2011), but those caps were waived and ignored year after year.

SUSTAINING CAPITALISM

Achieving prosperity for all Americans could not be more urgent. Although the United States remains the most prosperous nation on earth, millions of our citizens are losing faith in the American dream of upward mobility, and in American-style capitalism itself. This crisis of confidence has widened the divide afflicting American politics and cries out for reasoned solutions in the nation’s interest to provide prosperity for all Americans and make capitalism sustainable for generations to come. In 1942, the founders of the Committee for Economic Development (CED), our nation’s leading CEOs, took on the immense challenge of creating a rules-based post-war economic order. Their leadership and selfless efforts helped give the United States and the world the Marshall Plan, the Bretton Woods Agreement, and the Employment Act of 1946. The challenges to our economic principles and democratic institutions now are equally important. So, in the spirit of its founding, CED, the public policy center of The Conference Board, will release a series of 2020 Solutions Briefs. These briefs will address today’s critical issues, including health care, the future of work, education, technology and innovation, regulation, China and trade, infrastructure, inequality, and taxation.