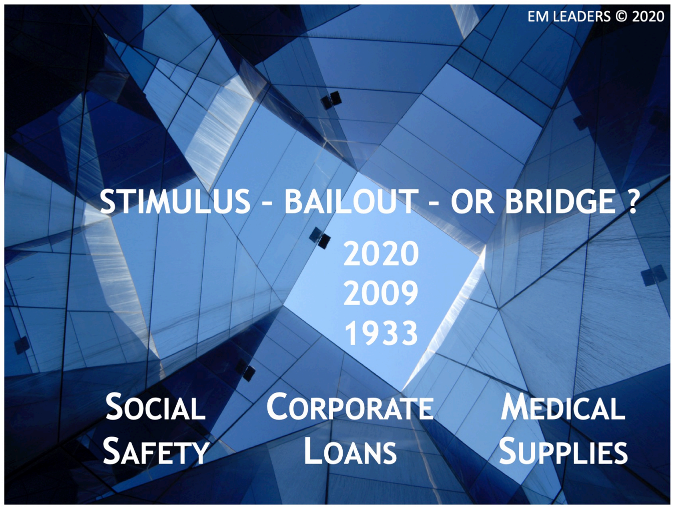
STIMULUS, BAILOUT, OR BRIDGE ?



The US Congress is planning a $1.8 trillion recovery program aimed to cushion the impact of the pandemic over the next ten weeks. How does this proposed program compare to previous rescue programs and what choices are debated in Congress? Would a broader bridge-loan program as proposed by Sorkin be more effective than the traditional stimulus plus bailout package?

2020 Recovery Program

The proposed size would be about 8% of GDP as compared to 10% of GDP the US spent in 2009 and 14% of GDP that China spent in 2009, assuming that the ten-week program is fully disbursed and no further stimulus is needed later in the year. Such a massive program should be well designed and be grounded on historical lessons.

The current package has four components of similar size: medical supplies and grants up to $450 bn, small business loans and grants up to $350 bn, direct grants and social safety net grants up to $500 bn, and corporate and state loans up to $500 bn. The budgetary cost could exceed 5% of GDP and government debt could reach a record 120% of GDP. There appears broad consensus on the urgent need for stimulus but a debate on whether bridge-loans would be more effective than corporate bailouts.

2009 & 1933 Comparisons

The US package in 2009 included $700bn from the Bush EESA and TARP programs in Oct 2008 and $787bn from the Obama ARRA program in Feb 2009, which were widely considered successful despite some debate on corporate bailouts. US public debt increased from 64% to 92% of GDP by 2010 and further to 110% of GDP today.

The Chinese stimulus package of 2009 exceeded $580bn or 14% of GDP, about equally distributed to government spending, local government subsidies, and bank lending. Most of the stimulus package was allocated to infrastructure. China’s corporate debt increased by 15% of GDP in 2010 and over 60% of GDP during the past decade, and China’s overall debt now stands at a record 300% of GDP.

In comparison, FDR's New Deal in 1933 was estimated at $650bn at today's prices or 40% of 1929 GDP, and US government debt had increased over 30% of GDP by 1939. However, FDR invested heavily into infrastructure, social security safety nets, and industrial and labor policies that were transformative after the depression.

Current Policy Choices

The massive proposed recovery package of 8% of GDP is similar to 2009 and 1933 interventions, although it is intended to cover only ten weeks and may need to be increased over the summer. There is broad agreement to pay for medical supplies and state and local needs as well as to support millions of unemployed people. But there is a major disagreement within and between parties about the proposed $500 bn loan package that would be disbursed at the discretion of the Treasury Secretary, which has been labeled as "bailout slush-fund" for favorite industries.

Airlines, tourism, and automotive industries would be the primary beneficiaries, as they account for over 30 million jobs and about 10% of GDP, and all are struggling. The current program envisages new loans of $50 bn for airlines, covering about three months of lost revenues, adding to $80 bn of airlines' current debt. On the same scale, for example, GM could request loans of $30 bn, Disney up to $20 bn, Marriott up to $5 bn and Carnival up to $5 bn. BUT, would executives spend these injections on employees or debt service, on re-financings or even stock buybacks? Would there be a commitment to maintain 90% of pre-crisis employment through the end of 2020?

A better alternative would be the so-called Sorkin bridge-loan-proposal that has been endorsed by the US Chamber of Commerce: any company, large or small, could receive a zero-interest government bridge-loan covering six months of revenues, to be repaid over five years, with the 90% pre-crisis employment condition, no re-financings and no buybacks. The total loans may exceed $10 trillion but its overall cost, even after some defaults, would be less than under the currently proposed recovery bill. But it would be bolder, broader, quicker and more equitable.

Republicans have long disliked bailouts, but lobbyists are pushing hard for government loans to their industries, and they have leverage with the upcoming election. Democrats have for decades not seen today's leverage and they are pushing hard for transformative changes to the social safety net. Everyone understands that action on this recovery bill is urgent but nobody likes to endorse bailouts and most experts distrust loan discretions of the Treasury Department. A privately run bridge-loan program that prioritizes employment and is backed by government guarantees would be more efficient. Let's see whether Congress is up to this challenge.

http://emleaders.com/pdf/EML-stimulus-2020.pdf