In Times of Crisis, How to Prevent an Economic Meltdown and Avoid Privatizing Profits and Socializing Losses

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***"The test of our [moral] progress** is not whether we add more to the abundance of those who have much, it is whether we provide enough for those who have too little." —**Franklin D. Roosevelt** (1882-1945), 32nd American President (1933-1945); (in his 'Second Inaugural Address', Wed., Jan. 20, 1937).*

***"The best way to destroy the capitalist system** is to debauch the currency. By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens. … By this method they not only confiscate, but they confiscate arbitrarily; and, while the process impoverishes many, it actually enriches some." —**John Maynard Keynes** (1883-1946), British economist, 1936.*

***"Our economic leadership does not seem to be aware** that the normal functioning of our economy leads to financial trauma and crises, inflation, currency depreciations, unemployment and poverty in the middle of what could be virtually universal affluence —in short that financially complex capitalism is inherently flawed." —**Hyman Minsky** (1919-1996), American economist, 1986.*

Here we go again: Another financial bubble burst and another financial crisis threatening to disrupt the real economy! This time the trigger is the health pandemic of the coronavirus crisis, the most serious in a generation, which is paralyzing the real economy and triggering crashes in the financial sector.

The crisis and public measures to fight it (drastic travel restrictions, social distancing, worker quarantines, etc.) have provoked a major global economic meltdown and perturbed supply chains domestically and around the world. Moreover, they have profoundly shaken financial markets already vulnerable, after years of easy money policies and round after round of so-called 'Quantitative Easing' (QE) by central banks, which have encouraged unsustainable debt levels by pushing interest rates down at historically low levels, irresponsible large fiscal deficits by governments during prosperous times, which have enriched the very rich, and runaway unregulated financial speculation that have had the same result.

An oil supply glut worldwide has now produced an additional deflationary bias in the world economy, which will be difficult to reverse. To top it all, there are countries that are presently run by inexperienced and/or incompetent leaders.

As a result, the world is presently going through a convergence of health and economic crises that creates a perfect economic storm, for which many countries are not prepared at all to handle.

In the United States, for example, only two years ago, in 2018, **President Donald Trump** fired his top health official (Rear Adm. Timothy Ziemer) who was responsible for the response to pandemics, and he was not replaced. He then shut down the White House National Security Council's entire global health security unit in charge of preparing for a global pandemic. In so doing, Mr. Trump forgot the precautionary principle in government, which requires preparations to face unforeseen events.

During such a severe health and economic crisis, which touches some people more than others, governments that sometimes create problems are the only collective instruments to fight it in the most ethical way possible.

Of course, besides taking the required measures to prevent the virus crisis from spreading and preventing panics, governments must take, on the economic and financial fronts, some fiscal, regulatory and monetary steps to prevent a deflationary downward spiral of economic activity and to stabilize the financial system. They must, above all, prevent human suffering and help workers, families and communities under financial strain.

What should governments do and not do to minimize the impact of the supply shock and of the demand shock presently hurting their economies?

1- First of all, government priority has to be to get out of the virus health crisis as soon as possible, and to provide medical care and assistance, while preventing shortages. Measures have to be taken to fight the infectious disease and alleviate human suffering, but also to prevent price gouging and other instances of corruption.

Lessons from previous virus outbreaks (Ebola, SARS, H1N1, etc.) can be a guide to action.

The coronavirus (Covid-19) crisis is presently the main cause of economic disruptions and hardships, and traditional monetary and fiscal macroeconomic policies are not geared to solving that type of problem.

2- The second priority is to save the economy from collapsing, and from entering into a deep recession or even into an economic depression. The first step, which is already taken to some extent, is for central banks to make sure that there is enough liquidity in the financial system to keep the latter functioning. This means that they must inject as much liquidity, i.e. cash, as needed to prevent bankruptcies in cascades of otherwise creditworthy and solvent companies, and to allow credit to flow freely.

But it is not acceptable for the government to tap public money to alleviate private banks and private companies' cash-flow problems. This must not be done at the public expense and to enrich owners of capital, but according to sound business practice. Advances must be guaranteed loans, secured by a bank's or a company's assets, physical assets or shares, —and to be repaid at a future date. That is the only way to avoid taxpayers being fleeced by private improvident and risk-taking operators whose motto is "*let's privatize profits, but socialize losses*."

3- However, it must be recognized that monetary policy as such is largely ineffective in correcting a *supply shock*. It cannot restore perturbed supply chains or prevent companies from stopping production and employment when there is no demand for their products or services. And, it cannot solve a *demand shock* by simply cutting interest rates, which are already low, when people's incomes are falling and consumer confidence is absent, or when consumers are unable to get out and spend because they are quarantined.

Moreover, negative real interest rates, the result of attempting to boost economic growth through financial means, as has been tried in Japan and in Europe, are bound to create important economic problems down the road. They are fundamentally deflationary.

They hurt savers and retirees and they contract effective demand from this important group of consumers, and they exert a negative pressure on prices. They also pose a threat to the financial viability of pension funds and insurance companies by forcing them to invest in riskier financial assets. They also encourage companies to invest in projects that would not been profitable otherwise.

4- As a preliminary conclusion, therefore, let us say that from an economic, political and social perspective, injecting liquidity in the economy is not 'a whether or not question' during a crisis, but it is how it should be done.

More than a century and a half ago, British economist and banker Walter Bagehot (1826-1877) spelled that out clearly when he wrote that in a time of economic and financial crisis, a central bank must discount heavily, i.e. lend as much money to institutions in need as necessary against collateral, toavoid cascading defaults and bankruptcies.

But this must be done at "punitive rates of lending" in order to avoid enriching distressed banks and their owners with public money, and to create a *moral hazard* by encouraging foolish risk-taking, with the knowledge of being bailed out in case of trouble.

What does it mean in practice? It means that in a time of crisis, the central bank or the Treasury must lend as much money as necessary, but the weaker and the more risky the collateral is, the higher the lending rates must be.

That is a lesson that was not totally followed in the U.S. during the 2008 subprime mortgage crisis when the Fed increased its balance sheet from $870 billion in 2007 to $4.5 trillion by 2015, (a more than a five-fold increase), in order to save some mega banks from bankruptcy by relieving them of their bad debts. The purpose, of course, was to prevent the financial system from collapsing under the weight of a mountain of mortgage-backed securities that had turned sour. But it ended up enriching the already very rich at the expense of the rest of the population.

There is unanimity among economists about the need for fiscal policy responses to the crisis

The need of strong fiscal responses, to help people and companies, especially small and medium-sized businesses, is obvious. But, by what means, at a time when fiscal deficits are already high?

Hundreds of thousands of workers are being temporarily laid off, many with no severance. They find themselves suddenly without paycheques, because their employers cannot produce and sell their goods or services. The criteria and requirements to qualify for unemployment insurance benefits could be relaxed in order to make more unemployed workers temporarily eligible.

But all individuals and families, to different degrees, may see their financial situations deteriorate during the crisis. This is both an economic and social problem. Helping those individuals and families who are the most in need of urgent assistance poses a logistic problem for governments.

For one, some laws or directives by the relevant level of government could be adopted to protect the most vulnerable people from being evicted from their lodgings during the crisis. Small landlords are also facing mortgage payments and would have to be compensated for lost rents.

The simplest fiscal way to quickly deliver cash payments to people in need would be to mail monthly checks of a few thousands dollars to taxpayers whose income in 2018 was below a certain amount, say $50,000, in order to provide them temporarily with a basic guaranteed income to bail them out during the coming months.

The proposal made by **House Speaker Nancy Pelosi** to provide emergency government funding (two-thirds of wages while away from work) to reimburse lost paychecks for those workers who are self-quarantining and are missing work or losing jobs amid the outbreak, goes in the same direction. This could be done through the channel of employers or through the Social Security Administration.

There are, however, logistical problems with any simple solution. Indeed, it is not everybody who has a full-time job, a tax record and a mailing address. Some people are self-employed, some are retired, some are seasonal or part-time workers, and some have income too low to file an income tax return. Some are homeless. They could be left out of direct financial assistance if direct assistance is used, even though they are probably among those who need help the most.

For example, there were more than half a million homeless Americans in 2019. These people would have to be reached and helped through different approaches. The number of children in needy households must also be taken into consideration. Possibly, municipalities or other community organizations could serve as aid distributors.

Proposals to resort to payroll tax cuts would not address the problem properly since such taxes are only paid when employees are still working! Similarly, providing direct financial assistance to people with incomes as high as $198,000 a year, as Republican Majority Leader of the U.S. Senate **Mitch McConnell** has proposed, would be both very costly and unethical.

Whatever the channels used, some direct fiscal assistance from the government has become a necessity, considering the declining incomes of many workers laid off during this crisis.

For example, if federal and state governments in the U.S. were to inject in the economy, this year, an amount equal to about 30% of the Gross Domestic Product (GDP), this would mean a combined effort of $US 6 trillion.

In Canada, if federal and provincial governments were to do the same, their combined efforts to sustain the economy would amount to some $CAD 550 billion. This is much more than what is under consideration in either country.

We must add that the Covid-19 pandemic is worldwide and that countries should cooperate to stabilize international trade, in order to facilitate an orderly return to prosperity once the health issue has been resolved.

Conclusion

There is no doubt that all efforts should be devoted to stopping the coronavirus pandemic in its tracks. This is an absolute public health priority.

However, in so doing, all must also be done to repair the heavy damage inflicting on the economy by distortions in the supply chains, by workers being laid off in droves, and by deflationary financial crashes, so that the economy can rebound quickly when things get back to normal. And since this is a worldwide crisis, the more international coordination to lay the ground for a quick return to prosperity, the better it will be.

For one, governments should not refrain from relying on monetary, regulatory and especially fiscal policies to inject liquidity and financial assistance where it is needed. However, this should not be done in a way that ends up "*privatizing profits, while socializing losses*."

Secondly, it must be said that over the last forty years or so, there has been a curious politico-economic system, which has been imposed upon the people in some countries.

It has translated into being a harsh capitalist system for most of the people and an accommodating socialist system for the owners of capital and the super rich. After the current catastrophe, I do not think that people are going to tolerate such a system much longer.

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This article was originally published on the author's blog site, Dr. Rodrigue Tremblay.

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