

Matthew Fienup
Revised April 9, 2020

The (so-called) Stimulus

Considering both the actual stimulus packages passed by Congress and the potential fiscal and monetary responses, we conclude that the U.S. government can do little to reduce the severity and length of the Coronavirus Recession but can do much to prolong it.

Monetary policy was already on a crisis footing. Policy makers failed to unwind extraordinary interventions undertaken during the last crisis, including ultra-low interest rates, interest paid on bank reserves, and a distended Federal Reserve balance sheet. The failure of the Federal Reserve to normalize monetary policy eight years ago means that the Fed is relatively impotent as it confronts the current situation. The Fed has already exhausted conventional tools, and we are still so early in this crisis. We shudder to think what unprecedented, poorly-understood, and impossible to unwind interventions monetary policy-makers will try next.

The promise of fiscal policy is little better. In particular, the government seems to be fighting the last crisis, not the one in front of us. The Great Recession saw massive mortgage defaults which drove a collapse of consumer demand. We are currently experiencing a collapse of supply, as countless small businesses are shuttered as a result of social distancing orders. This supply shock threatens to precipitate a small business default crisis. Addressing the potential tsunami of business defaults should be the primary focus of policy makers.

Instead, the \$2 trillion stimulus package, signed into law on March 27, places a large emphasis on providing fiscal stimulus to individuals and households, in particular those who have been laid off or furloughed as a result of government-mandated business closures. On one hand, the government is ordering a reduction in economic activity in order to slow the transmission of the coronavirus. On the other hand, the government is running a multi-trillion deficit in the hope of lessening the dramatic impact of business closures on the U.S. economy. Government-mandated business closures and government issued stimulus checks stand in direct contraindication. The effect of cutting a government check to needy Americans will be limited as long as many of the businesses where people spend money are shuttered. And any stimulation of the economy resulting from these checks will undercut the Government's goal of slowing the spread of disease. As Harvard economist [Robert Barro recently noted](#), "In the current environment, we do not *want* to offset the 20 percent fall in GDP through inflationary fiscal policies; we want to stop the virus's spread."

Putting money in to people's hands will also not prevent the widespread collapse of small businesses that will happen if shelter-in-place orders are still active in 6-8 weeks. After that, workers will not have jobs to return to once the spread of disease has slowed. A small business lending program represents the most promising provision of the massive stimulus package. But we worry that the Federal government is too cumbersome to get funds into business owners' hands in time to prevent widespread business defaults. We also fear, as former Fed Chair [Janet Yellen recently noted](#), that a surge in business debt will reduce hiring and investment by businesses for a long time to come, hindering any recovery.

To our dismay, within minutes of the stimulus package's signing, [cries had already begun](#) that [the package](#) was [not big enough](#). We agree that the so-called stimulus is likely to fail to revive economic activity but NOT because it isn't big enough. It is likely to fail because monetary policy makers bound their own hands before the crisis began and because fiscal policy priorities stand in direct opposition to public health priorities.