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How to Treat the Financial Symptoms of Covid-19

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The coronavirus pandemic is in danger of sparking a financial crisis. Stock-market plunges and volatility are reminiscent of September 2008. Strains are showing in credit and money markets.

What's going on? Economic fundamentals are good. This is not 2008, when risky mortgage investments blew up. Yes, it is likely that large parts of the economy will have to shut down for a few months. But once the virus is contained, the economy should turn right back on again, as it does after long holidays.

But an economy can't turn on and off like a light switch. Shut-down businesses must still pay debts, rents, payrolls and taxes. People who lose income have to pay rent, mortgages and consumer debt, on top of food and daily expenses. Our economy runs on a river of debt, and the debt clock keeps ticking when the economy shuts down.

Had everyone kept a few months of cash around, things would be fine. But many did not. Now we are seeing the beginnings of a scramble for cash, as people and businesses try to sell assets or borrow. But who is buying? And who is lending? Banks can't make new loans to companies and people with no income.

Money troubles spread like a virus. When a business cannot pay, its creditors, employees, investors and banks are in trouble. And if people worry that banks and other institutions are going to fail, they run to get money out—and we have a crisis.

If a wave of businesses fail, those businesses aren't around to turn back on again. People who are fired need to find new jobs. Bankrupt businesses need to reorganize and find new owners, managers and employees. Businesses that can reopen must find suppliers. And everyone needs credit. All this takes time and resources and drags down the economy.

A pandemic can turn quickly to a financial crash and a long recession, not a V-shaped pause. That's the scenario spooking markets, and it should spook all of us.

What to do? Clearly the central goal of policy should be to keep businesses alive so they are ready to turn back on again. They must be able to keep rather than fire employees, to call them back quickly, and to help those employees pay bills and keep their health insurance. Now is not the time to carve up businesses in bankruptcy court.

Federal money is on its way. On Tuesday the administration proposed a nearly $1 trillion stimulus. But the economy needs a wiser deployment of limited resources than just a cash dump.

First, not even the U.S. government has infinite resources. Its unique ability to borrow even when nobody else can borrow, and to promise eventual repayment by taxation, is a treasured but finite resource. When a crisis comes in which even the Treasury can't borrow, we are in for a true catastrophe.

Second, this isn't the last virus. What we do now sets the precedent for what we will do in deadlier pandemics to come. Overall, our society will transfer savings from those who have it to those who need it, via markets, Treasury debt, taxation or force. But we must do it in a way that allows savers to reappear in the next crisis, to buy Treasury bonds, forbear loans and provide liquidity.

Lending is better than transfers. Since loans must be paid back, larger amounts can go where needed. Small Business Administration loans are a good start. But most business and most employment is large business. Large firms are often even more cash-poor and in hock to nervous creditors, and they are harder to replace or revive if they fail. Lend with the head, not the heart. "People" might seem more worthy than "corporations," but we need corporations to hire people when it's over.

Forbearance is important. Banks and creditors should not immediately shut down a nonpayer. But they have to be allowed to forbear by their regulators, their own creditors, and their own fiduciary responsibility, and to borrow or pass forbearance up the line.

The Fed can make sure large markets stay liquid. But it shouldn't mistake price drops for illiquidity. Those who need to sell in a crunch must be able to sell quickly but get a low price, so that those who kept some cash handy will do so next time.

These are micro interventions, not macro. Lowering the fed-funds rate doesn't help much if natural caution or regulations forbid lending to cash-strapped businesses. Stimulus will do no good. You can't shop, or travel, when stores and airlines are closed.

People need help too, and our politicians have figured that out. Once again, loans are better than gifts. Rather than give each of us $1,000, allow us to borrow a fraction of last year's income from the Internal Revenue Service and repay when we file our taxes. That provides more money to those who need it, and helps those even with large debts not to default. Allow penalty-free withdrawals from retirement accounts. Social-program rules must be stretched. If people have to lose a job to get help, we tempt the employer to needlessly fire them, and they and the employer are not ready to start up again fast.

Beware the temptation to rob Peter to pay Paul. For example, if companies are forced to pay sick leave, that might be the cost that sends them over the edge, or leads them to fire rather than furlough employees. Unpopular or large firms don't necessarily have deep pockets.

Changing micro rules and regulations is much harder than macro stimulus. Thousands of rules need to bend to help thousands of businesses and millions of people. It would all be easier if there were a pandemic economic and financial plan in place. Sadly, 12 years of stress tests and economic crisis planning never considered the possibility of a pandemic. Let us get a better economic plan in place for the next one.

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