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COVID-19 financial relief: Where's the money coming from?

By Steve Bakke May 11, 2020

The coronavirus stimulus bill (CARES Act) will put money in the hands of individuals and organizations. The program will inevitably grow and it's too soon to make predictions about how it all will be funded. Two large programs are the Paycheck Protection Program ("Paycheck") and the Main Street Lending Program ("Main Street"). My goal here is to predict and express my opinion on how those two emergency loan programs will be funded.

"Paycheck" loans will be forgiven by the SBA if organizations meet employee retention requirements, while the "Main Street" loans will be handled a little differently. 95% of these loans will be purchased from lending banks and held by the Federal Reserve. That may sound familiar. At first glance, it's similar to the quantitative easing ("QE") measures used by Obama's administration.

The Federal Reserve manages the money supply, it doesn't borrow money – that's the Treasury's job. The Federal Reserve's Congressional mandate is to maximize employment while controlling inflation. Quantitative easing ("QE") is part of the Fed's frequently used "open market operations." Other Fed tools include adjusting the fed funds rate, the discount rate, and bank reserve requirements.

In this analysis I'll reference two separate procedures. First, the Federal Reserve can simply add liquidity to banks via a computer entry. The other is quantitative easing whereby the Fed adds liquidity by purchasing financial assets from banks. During the QE activities of the last administration, the Fed purchased U.S. Treasury debt and mortgage-backed securities from banks. Both procedures increase the money supply and stimulate the economy by flooding banks with capital. "Balancing the books" with taxes or borrowing isn't usually necessary.

Using the Fed to expand the money supply isn't unique to progressive administrations. In 2009, Chairman Ben Bernanke, when asked about funding the $1 trillion 2008 bank bailout, explained: "It's not tax money. The banks have accounts with the Fed much the same way that you have an account with a commercial bank, so to lend to a bank, we simply us a computer to mark up the size of the account…It's much more akin to printing money than it

is to borrowing…We need to do that because our economy is very weak and inflation is very low."

We don't yet know how much of the CARES Act stimulation will employ tactics like I described above. Will some loans be repaid as were the 2008 bank bail-out loans, or will we see the more permanent "easing" characteristics of the last administration? We know that most "Main Street" loans will be purchased by the Fed, and I predict they will be substantially repaid, thereby reversing inflationary "money printing" characteristics. On the other hand, "Paycheck Protection" loans will be mostly forgiven, suggesting this might end up being a permanent expansion of the money supply. We can't yet be sure.

The economic shutdown is history. Given that reality, do I support providing significant financial relief? If I do, how would I suggest paying for it? Should funds be provided from taxes, government debt, or by using money supply management by the Fed?

Aggressive emergency money supply management during financial crises has been used, and will be again, by administrations representing both parties. Regarding America's current financial emergency, managing the money supply can be a productive tool for emergency stimulation when unemployment is high and inflation is low, but those measures must be temporary and limited.

Use of monetary management techniques to fund portions of the CARES Act is something I endorse. The Fed's ability to prudently manage the money supply when the country faces an existential financial threat such as accompanied this pandemic is a valuable tool. I believe that's how we will fund portions of the CARES Act. At least for some programs, e.g. "Paycheck" and "Mainstreet" loans, we may find that neither taxes nor issuance of new debt is triggered. If debt is triggered, quantitative easing can mitigate some of its negative effects.

The recent announcement of aggressive U.S. Treasury borrowing doesn't invalidate my predictions. Banks will purchase some of the new Treasury obligations and I believe it's likely the Fed will employ QE techniques by purchasing some of the Treasury obligations from those banks. We'll have to wait and see.