**The Daily Star 10-06-2020**

# Which economic stimulus works?

Joseph E. Stiglitz Hamid Rashid

Governments around the world are responding forcefully to the COVID-19 crisis with a combined fiscal and monetary response that has already reached 10 percent of global GDP. Yet according to the latest global assessment from the United Nations Department of Economic and Social Affairs, these stimulus measures may not boost consumption and investment by as much as policymakers are hoping.

The problem is that a significant portion of the money is being funneled directly into capital buffers, leading to an increase in precautionary balances. The situation is akin to the "liquidity trap" that so worried John Maynard Keynes during the Great Depression.

Today's stimulus measures have understandably been rolled out in haste – almost in panic – to contain the economic fallout from the pandemic. And while this fire-hose approach was neither targeted nor precise, many commentators would argue that it was the only option at the time. Without a massive injection of emergency liquidity, there probably would have been widespread bankruptcies, losses of organizational capital, and an even steeper path to recovery.

But it is now clear that the pandemic will last much longer than a few weeks, as was initially assumed when these emergency measures were enacted. That means these programs all need to be assessed more carefully, with an eye to the long term.

During periods of deep uncertainty, precautionary savings typically rise as households and businesses hold on to cash for fear of what lies ahead.

The current crisis is no exception. Much of the money that households and businesses receive in the form of stimulus checks will probably sit idle in their bank accounts, owing to anxieties about the future and a broader reduction in spending opportunities. At the same time, banks will likely have to sit on the excess liquidity, for lack of credit-worthy borrowers willing to take out fresh loans.

Not surprisingly, excess reserves held in US depository institutions nearly doubled between February and April, from $1.5 trillion to $2.9 trillion. For comparison, excess reserves held in banks during the Great Recession reached just $1 trillion. This massive increase in bank reserves suggests that the stimulus policies implemented so far have had a low multiplier effect. Clearly, bank credit alone is not going to lead us out of the current economic stalemate.

Making matters worse, today's excess liquidity may carry a high social cost. Beyond the usual fears about debt and inflation, there is also good reason to worry that the excess cash in banks will be funneled toward financial speculation. Stock markets are already gyrating wildly on a daily basis, and this volatility could in turn perpetuate the climate of increased uncertainty, leading to still more precautionary behavior, and discouraging both consumption and the investment needed to drive the recovery.

In this case, we will be facing a liquidity trap and a liquidity conundrum: Massive increases in the supply of money and only limited uses for it by households and businesses. Well-designed stimulus measures could help once COVID-19 has been brought under control. But as long as the pandemic is still raging, there can be no return to normalcy.

The key for now, then, is to reduce risk and increase incentives to spend. As long as firms are worried that the economy will remain weak six months or a year from now, they will postpone investment, thereby delaying the recovery. Only the state can break this vicious circle. Governments must take it upon themselves to insure against today's risks, by offering compensation for firms in the event that the economy does not recover by a certain point in time.

There is already a model for doing this: "Arrow-Debreu securities" (so named for the Nobel laureate economists Kenneth Arrow and Gerard Debreu) would become payable under certain predetermined conditions. For example, the government could guarantee that if a household purchased a car today, and the epidemic curve remained at a certain point six months from now, its monthly car payments would be suspended. Similarly, income-contingent loans and mortgages could be used to encourage the purchase of a wide range of consumer durables, including housing. Similar provisions could apply to real investments made by firms.

Governments also should consider issuing spending vouchers to stimulate household consumption. This is already happening in China, where local governments across 50 cities are issuing digital coupons that can be used to buy various goods and services within a certain timeframe. The expiration date makes them potent stimulants of consumption and aggregate demand in the short term – when it is needed most.

With the pandemic likely to last much longer than was originally assumed, still more stimulus will be necessary. Although the United States, for example, has already spent $3 trillion on various forms of assistance, without more – and, one hopes, better-designed – measures, that money will have merely prolonged the lives of many enterprises by a few months, rather than actually saving them.

One approach that has been working in several countries is to provide assistance to firms on the condition that they retain their workers, supporting wage bills and other costs in proportion to an enterprise's decrease in revenue. In the US,

Representative Pramila Jayapal, a congresswoman from Washington State, has proposed legislation along these lines, as have several senators.

Poorly designed stimulus programs are not just ineffective, but potentially dangerous. Bad policies can contribute to inequality, sow instability, and undermine political support for government precisely when it is needed to prevent the economy from falling into a prolonged recession. Fortunately, there are alternatives. But whether governments will take them up remains to be seen.

The views expressed here do not reflect the views of the United Nations or its member states.

Joseph E. Stiglitz, a Nobel laureate in economics and university professor at Columbia University, is chief economist at the Roosevelt Institute and a former senior vice president and chief economist of the World Bank. His most recent book is "People, Power, and Profits: Progressive Capitalism for an Age of Discontent." Hamid Rashid is chief of Global Economic Monitoring at the United Nations Department of Economic and Social Affairs.