Money in the Time of Coronavirus
D. Awrey, Here We Go Again? Not Really

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The global pandemic unleashed by the coronavirus has inadvertently shone a spotlight on the design of some of our most important monetary institutions. It has also revealed widespread misunderstandings about how these institutions work—especially in times of crisis.

In response to the escalating economic fallout of the coronavirus, central banks in the United States and elsewhere have used their emergency lending authority to mount a series of important policy interventions. On March 12th, the Federal Reserve announced that it will make available up to $USD1.5 trillion in liquidity support—that is, loans—to primary dealers through its existing term repo operations. On March 15th, the Fed then announced that it would reduce its target interest rate to a historic low, reactivate its crisis-era USD swap lines with other major central banks, reduce borrowing costs for banks at its discount window, and eliminate bank reserve requirements. Treasury Secretary Steven Mnuchin, meanwhile, announced that he would ask Congress to remove legal constraints, introduced under the 2010 Dodd-Frank Act, on the Fed's emergency lending authority to non-bank financial institutions.

The stated rationales for these interventions are "to address temporary disruptions in Treasury financing markets" and "support the flow of credit to households and businesses". More generally, giving central banks the legal authority to undertake these types of interventions is designed to advance two fundamental policy objectives. The first is to prevent dislocation within private money markets from triggering the failure of otherwise healthy banks and other financial institutions, along with the consequent withdrawal of lending, deposit-taking, and other key financial services. The second is to provide an effective counterweight against potential reductions in the aggregate money supply that might otherwise trigger a deflationary spiral characterized by a broad-based decline in prices, economic output, and employment. In a world where the vast majority of our money consists of short-term liabilities issued by private financial institutions, giving central banks this authority represents an important public bulwark against the intertwined threats of financial and monetary instability.

Yet to a great many observers, these latest interventions have evoked an instinctive response: *here we go again*. Just as they did during the financial crisis of 2007-09, the Federal Reserve and Treasury Department are bailing out Wall Street whilst letting Main Streets across America fend for themselves. This response reflects a number of more substantive objections, voiced by commentators across the political spectrum. Perhaps the most common objection is that the Fed's interventions represent a subsidy to banks and other financial institutions—one not generally available to other commercial enterprises, let alone the general public. Others point to the jarring disconnect between the speed and scale with which the Fed has taken action to "rescue the stock market" versus the Trump Administration's slow, and to date far more modest, response to the underlying public health crisis. Yet others worry that the Administration will use any expansion of the Fed's emergency lending powers to advance its own private political and economic interests. These objections reflect a growing sense of déjà vu, along with frustration that we have somehow failed to heed the lessons of the last financial crisis.

These objections are all valid and, given the devastation wrought by the last crisis, understandable. In light of the present circumstances, however, they are also misplaced. On the first objection, few would seriously deny that these interventions are not subsidies. In theory, banks can now borrow at the Fed’s discount window at 0.25% for 90 days and immediately turn around and invest the proceeds in risk-free 3-month Treasury securities currently yielding 0.28%, 3-year Treasury securities yielding 0.58%, or 30-year Treasury securities yielding 1.56%. That’s easy money. Yet the real question is not whether these interventions represent a subsidy, but whether this subsidy advances important and socially desirable policy objectives. Given that the counterfactual is a full-blown financial crisis alongside the existing public health crisis, the answer would appear to be a resounding yes. Indeed, there is a strong argument that it is precisely these types of exogeneous demand shocks that should be amongst the least controversial uses of the Fed’s emergency lending authority. Put bluntly: this is what the Fed was built for.

On the second objection, the fact that the Fed has responded relatively quickly to contain the potential economic fallout from the coronavirus seems like misdirected criticism. Ideally, of course, the Fed’s interventions would be accompanied by complementary fiscal policy measures. Yet while Congress may still take action in the coming days, its failure to do so reflects the current level of political dysfunction in Washington—dysfunction in which the Federal Reserve has admirably played little or no role. Nor, similarly, can the Fed prevent President Trump from running roughshod over the Emolument’s Clause. Ultimately, the idea that the Fed should not throw out a life preserver simply because there is an idle coast guard cutter anchored a few miles offshore seems like a remarkably short-sighted rescue strategy. It is not the Fed’s fault that it has become the only game in town.

Perhaps even more importantly, these objections are fundamentally mistimed. As distasteful and unjust as it may often seem, the Fed’s emergency lending authority reflects the logic and structure of our current monetary system. That system relies on banks, money market funds, and wholesale money markets to provide the vast majority of the money circulating within both the financial system and real economy. It is the fragility of these private markets and institutions, along with the potential impact of their failure on both financial and monetary stability, that ultimately necessitates the type of public backstop that is now under the spotlight. Undertaking the type of comprehensive structural reforms that might enable us to credibly rollback the Fed’s emergency lending authority is simply not possible in the thick of a crisis.

Against this backdrop, what the present crisis is revealing is our failure to use the *last* crisis as an opportunity to ask more fundamental questions about the type of monetary institutions that we, as a society, really want. Instead, we tinkered around the edges of the existing monetary architecture: imposing new constraints on the Fed’s emergency lending authority without asking whether these constraints would be credible in the absence of more meaningful structural reforms targeting systemically important banks, wholesale money markets, and other components of the so-called “shadow” banking system. Both logic and historical experience suggest that the answer would be no—and the current crisis is very much validating this prediction. As we begin to look beyond this crisis, the key insight may therefore be that the time has finally come to reevaluate, and potentially reimagine, the structure of our monetary system.

The good news is that there is no shortage of proposals for structural reform. Some of these proposals, such David Andolfatto and Jane Ihrig’s call for the Fed to create a standing repo facility, are designed to strengthen institutional support for the existing monetary system. Others, such as the proposal by Morgan Ricks, John Crawford, and Lev Menand to permit the public to open accounts at the Federal Reserve, envision far more fundamental changes to the nature of money and banking. Yet others attempt to grapple with the recent emergence and enormous growth of the shadow payment system and the risks posed by the resulting reappearance of bad money. My goal here is not to debate the relative merits and drawbacks of these proposals: although I sincerely hope that this roundtable, and justmoney.org more generally, will become a platform for doing so. Rather, it is to highlight that the current crisis may afford us with an opportunity to take this debate to a wider audience, to raise awareness of the importance of monetary design and, perhaps, to build momentum toward a new and better monetary consensus.