Money in the Time of Coronavirus

S. Omarova, Crises, Bailouts, and the Case for a National Investment Authority

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Saule T. Omarova, Cornell Law School

The COVID-19 crisis is unlike any other we've seen so far. An effective response to this massive crisis requires massive coordination and redeployment of the nation's financial, physical, technological, and human resources—not unlike a full-blown war effort. Currently, however, the U.S. lacks an institutional mechanism for an economic mobilization of the type it undertook during the Great Depression and both World Wars of the last century. There is presently no institutional analogue to the New Deal-era Reconstruction Finance Corporation (RFC).

Without such a permanent federal agency, the country must rely on ad hoc crisis-containment measures that are notoriously politicized, messy, and prone to corrupt influences. It's already clear that neither the U.S. Treasury nor Federal Reserve are equipped to manage and oversee the implementation of the multi-trillion emergency relief package approved by Congress. And significant misuse and misallocation of federal relief are bound to have disastrous long-term financial, economic, and political consequences.

To manage this process, we need an RFC-like institution. Having a permanent institutional platform for coordinating the national crisis response, including bailouts of private companies, would help to ensure that these emergency measures are executed in an efficient, transparent, and democratically accountable, and socially just manner.

My colleague, Bob Hockett, and I have long advocated creation of a National Investment Authority (NIA) as a modern version of the RFC. Our original focus was on the NIA's role as the federal instrumentality functionally located between the U.S. Treasury and Federal Reserve and tasked with implementing a long-term strategy of national economic development. At the heart of this strategy is the NIA's proactive use of financial tools to channel private capital into transformative public infrastructure projects, with a view to facilitating socially inclusive and sustainable growth of the American economy. Led by the NIA Governing Board (the NIA Board), an independent federal agency structured similarly to the Federal Reserve Board, the NIA would lever private investment in public goods through federal grants, loans, guarantees, securitization, and large-scale private equity-style asset management.

Although not originally envisioned as such, the NIA is perfectly suited for taking on the RFC-worthy task of managing the nation's response to the COVID crisis. The NIA would be well-positioned to coordinate nationwide production mobilization efforts, oversee financial bailouts, and manage post-bailout public stakes in private companies. Below is a brief outline of how that regime would work.

Production Mobilization

Most urgently, the NIA would act as the principal manager of federally appropriated funds for purposes of organizing the crisis response on the national scale. NIA’s dedicated asset-management teams will work with other federal, regional, and local authorities, medical professionals, and other relevant parties to identify specific bottlenecks in the supply chain of critically needed products, prioritize concrete action items, and organize financial and other resources needed to scale up or repurpose individual facilities’ production capacity.

Putting the NIA at the center of this mobilization campaign will facilitate and optimize what would otherwise be an impossibly difficult process. It will concentrate key resources and decision-making powers in the hands of an agency specifically designed to conduct business much like a private equity firm. Neither the U.S. Treasury nor Federal Reserve are able to act inside private firms and markets in a similarly direct way.

Bailout Process and Oversight

While direct public financing of private business entities is often a necessary part of crisis response, neither the Fed nor the Treasury are equipped to manage that process. Outsourcing management of the federal government’s bailout-related assets to Blackrock, the world’s largest private asset manager, is a stark reminder of that institutional gap.

The NIA will be a publicly-owned Blackrock equivalent. Working with the Treasury, it will coordinate emergency assistance to, and manage public stakes in, private companies. The NIA’s professional asset-management teams will allocate funds, negotiate the terms of assistance, and run the portfolio of public assets—strictly with a view toward maximizing the public’s overall welfare.

The NIA would lever its regional offices and expert teams to work closely with the authorities, businesses, and communities on the ground to conduct simultaneous emergency public investment auctions across the country.

The NIA Board would set transparent and uniform guidelines for choosing individual recipients of public investment, determining the amount and structure of each such investment, and imposing specific conditions on each recipient. The NIA’s overarching goal would be to provide support to businesses and organizations of all sizes and types, specifically to stimulate economic activity and to prevent/minimize loss of jobs and income in all communities.

Accordingly, the NIA guidelines would mandate maximizing payroll retention and uninterrupted provision of social services to employees and communities as part of any bailout package. For large corporations, the NIA would also condition emergency assistance on specific changes to their dividend and stock buyback policies, executive compensation structure, and corporate governance—with a strategic view toward correcting systemically destabilizing structural imbalances in the U.S. economy

The NIA’s auction policies and procedures would seek to eliminate potential conflicts of interest, favoritism, outside interference, etc. Working closely with the Treasury and the Federal Reserve on coordinating the bailout process with the broader financial and monetary stability goals would provide an additional checks-and-balances mechanism.

The NIA’s assistance award decisions would be fully documented and subject to audit by the Government Accountability Office (GAO) or special federal audit panels. The NIA Board would also be required to provide regular public reports to Congress and the Treasury on the status of its public capital support programs. Finally, Congress can mandate additional public oversight the NIA’s bailout management process (including appointment of a special Inspector General, etc.).

In theory, the Treasury or the Federal Reserve can structure their emergency bailout efforts in a similar fashion. In practice, however, it is extremely difficult to ensure the necessary degree of uniformity, transparency, and integrity across multiple bespoke bailout facilities, managed by multiple public and private agents. The NIA’s strong statutory mandate, specialized expertise, and organizational accountability would render the entire process more transparent, fair, and susceptible to effective public oversight and input.

Managing Public Assets: The “Golden Share” Option

The specific form of emergency public investment in a troubled company—an outright grant of money, a loan, guarantee, or purchase of a particular type of preferred or common stock — will vary on a case-by-case basis. However, in certain cases—for example, where public capital injections are particularly substantial (either on an individual or an aggregate industry basis), or where the recipient-firms provide critical public goods or services (finance, transportation, energy, healthcare, etc.)—it may be desirable for Congress to mandate that the NIA receive and hold, on a permanent basis, a special “golden share” in each such firm.

In the 1980s-1990s, golden shares were used by governments around the world—including the UK government under Margaret Thatcher—to reserve exclusive rights to control key business decisions by newly privatized companies in strategically significant industries. Elsewhere, I proposed the "golden share" regime for systemically important financial institutions, as a macroprudential tool. But this instrument can be easily adapted for purposes of structuring public stakes in bailed-out entities.

In brief, the "golden share" regime would work along the following lines.

The "golden share" would entitle the federal government, represented by the NIA, to receive a specified economic interest in the firm (under the terms negotiated by the NIA as part of the bailout). It would also grant the NIA, as the sole holder of the federal government's golden share, special, exclusive, and nontransferable corporate-governance rights in the relevant firms. The golden share could not be redeemed or eliminated other than by an Act of Congress.

The NIA would occupy a permanent seat on the firm's board of directors. The NIA's primary fiduciary duty, however, would run directly to the American public. In this role, the NIA would have two distinct modes of operation:

- Ordinarily, the NIA would perform mainly observational functions. While not interfering with the company's routine operations, the NIA would actively monitor corporate actions with a view to preventing the company or its shareholders from circumventing the conditions of the bailout funding. The NIA's affirmative vote would be required for corporate decisions authorizing significant stock buybacks and dividends, outsourcing or elimination of jobs, changing executive compensation, adopting aggressive tax-planning strategies, and other actions potentially inconsistent with public capital support.

- Upon the occurrence of specified triggering events—including corporate actions inconsistent with bailout conditions, significant deterioration in the firm’s financial condition, or signs of a systemic crisis—the golden share would be “activated,” and the NIA would assume the role of the firm’s “manager of last resort.” From this position of corporate control, it would be able to take fast and direct action necessary to protect public interest: make concrete operational changes, redeploy resources, and so forth. Once the danger subsides, the golden share would revert to its (relatively) passive state.

Importantly, in an emergency situation similar to the COVID-19 pandemic, the NIA would be able to use the golden share trigger to assume its production-mobilization role, discussed above.

While it may be possible to structure the public stake in bailed-out entities as a special class of common or preferred shares that carries similar rights and powers, the proposed golden share is far more effective for purposes of protecting the public’s interests in a corporate setting. A streamlined and flexible tool of corporate control, it can be quickly scaled up to enforce compliance with bailout conditions—and to ensure that private firms benefitting from public support do not abuse that advantage going forward.

Enhancing Accountability: A Public Interest Council

To enhance the NIA’s democratic accountability, Congress should establish a special Public Interest Council (the Council) representing an explicitly public interest-oriented perspective in matters within the NIA’s ambit. A detailed proposal for designing this type of a public accountability regime can be found here.

The Council would comprise academic experts and public interest advocates, all of whom are independent of both the financial industry and regulators. Congress would appoint members of the Council for staggered terms, based on publicly solicited nominations.

The Council would play primarily an advisory and evaluative role. It would submit mandatory reports to Congress, containing its assessments and non-binding recommendations for improvement of the NIA’s performance of its statutory functions.

This institutional channel for inserting public interest into the NIA’s accountability and decision-making structure would serve as an important check against excessive private-sector influence or political incumbents’ overreach.

Ultimately, public accountability is the key to understanding why we need the NIA in the time of Coronavirus. We need the NIA to ensure that the crisis is managed in a transparent and democratically accountable way, so that the American public is protected from the deadly effects of corruption and ineptitude. A permanent federal instrumentality with a clear statutory mandate, organizational depth, and institutional expertise in capital allocation and asset management would serve as an urgently needed—and presently missing—tool of mobilizing the nation's productive capacity and putting our public money to good use.

For an issue brief further outlining the case for an NIA, see here.