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# Congress Should Stimulate Economic Recovery By Empowering Businesses To Issue Tax-Free Debt

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Congress and the Administration continue to debate the next stimulus bill. It will be much more effective, however, if we heed the lessons from the trillions of dollars that have already been spent battling the current recession.

Some of the programs have helped individuals and businesses survive the economic lock-downs and their aftermath. But, too much of the CARES Act has wasted money. Sending $1,200 checks to Americans based on income, not whether the recession cost them their job, is not the answer.

And, even when the goals of the stimulus programs are correct – trying to ensure people and businesses have sufficient liquidity to survive the lock-downs and its aftermath – the government spends the money inefficiently and fails to help many of the small businesses that still urgently need assistance.



The current approach is also turning the Federal Reserve and the federal government into the lenders of first resort, furthering the government's control over how credit is allocated in the economy. Long-term, the large increase in debt and increased government control over the economy will compromise our growth potential.

In contrast to this government-centric approach, a more efficient stimulus program would encourage the private sector to create new lending and investment opportunities. Creating private, tax-exempt debt could help accomplish this goal.

A proposal I suggested with Rod Richardson, which we refer to as CoVictory Bonds and Loans (CVBLs), recommends a temporary program that authorizes private companies to issue tax-exempt bonds and bank loans over a two-year recovery period.

Based on the current gap between similarly rated taxable (e.g. private sector) and tax-exempt (e.g. municipal) bonds, tax-exempt borrowing would drive down most firms' costs of borrowing money through the bond markets by around 30 percent. With respect to business loans, tax-exemption could reduce the cost of debt by up to 21 percent (the current corporate income tax rate that is averted).

Based on the interest rates on new small business loans according to the Kansas City Federal Reserve, which ranged between 4.3 percent and 8.2 percent, tax exempt small business loans could range between 3.3 percent and 6.5 percent on average, while still providing lenders with the exact same after-tax net income opportunity.

Tax exemption creates a simple fiscal stimulus. It helps businesses, large and small, reduce their costs and obtain less expensive capital that will help them recover from the Covid-19 recession. The CVBL program is more inclusive than the loans that have been tried previously because these loans would be available to all businesses regardless of size. Further, while current lending programs only target existing businesses, new start-up businesses could receive funds through CVBLs. This would encourage the investment of capital into the more dynamic parts of the U.S. economy.

From a government financial perspective, the CVBL program is far less expensive per dollar of new investment than the CARES Act, HEROES Act, or whatever compromise legislation emerges from the current negotiations.

If the CVBL program allows up to five-year loan terms, then, by our calculations, $1 trillion of such debt would only reduce government tax revenues by between $30 billion to $40 billion – without adding back any tax revenue from dynamic impacts. It costs way less to stimulate private versus government investment, because forgiving the tax on interest costs way less than forgiving loan principle.

Like ordinary debt, this loan program is simple and non-distortionary, just cheaper—without taxes on interest. Importantly, the interest costs reflect current market rates allowing banks and capital markets to price in risk and therefore have an incentive to lend to smaller firms and riskier projects when such lending makes sense. Riskier borrowers would pay higher rates, but could receive the greatest benefit in terms of the biggest interest reduction versus the taxable rate.

Rules for CVBLs could also be much simpler than those that govern CARES Act loans. Price-controlled, forgivable government loans need lots of rules because they spend a lot of taxpayer money, and short-circuit normal bank incentives when lending.  By contrast, tax-exempt debt is just ordinary debt without a tax, and so does not require any additional regulations.

Since it is private debt, private institutions and investors assume the risk of these bonds and loans — if a borrower defaults, private creditors would bear the financial losses. Since private lenders and capital markets bear default risk, they are also incentivized to ensure that each loan is secure and makes sense.

To fight this recession, Congress should focus on empowering people and businesses to drive the economy forward. CoVictory Bonds and Loans would provide a highly cost-effective, easy-to-use recovery mechanism that will stimulate business investment and employment, and strengthen recovering firms.

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