



Relief Fund Allocation Is No Place to Play Politics

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INVESTMENT IN RELIEF PACKAGE AIMED AT ECONOMIC STABILIZATION

The Coronavirus Aid, Relief, and Economic Security (CARES) Act gives the Treasury Department and Federal Reserve the authority to invest at least \$850 billion to stabilize the economy, prevent business failures, and encourage businesses to retain employees on their payrolls until the public health crisis passes. However, there is a potential risk that capital allocation decisions will be intentionally or inadvertently distorted based on private firms' social preferences rather than the needs of the public.

Among the powers the CARES Act grants are (1) an expansion of Small Business Administration loans that can be made by banks and other lenders approved by the SBA administrator and secretary of the Treasury and (2) the ability for the Treasury Department to invest over \$450 billion in facilities administered by the Federal Reserve for the purpose of providing “liquidity to eligible businesses . . . related to losses incurred as a result of the coronavirus.”¹

Under this program, the Federal Reserve will be able to purchase securities and other obligations directly from businesses or on the secondary market and make direct loans to businesses.² The secretary of the Treasury is also directed to implement a program that provides funds to banks and other lenders to make direct loans to certain businesses.³ Additionally, the Federal Reserve will have broad discretion to establish a “Main Street lending program” that the secretary of the Treasury may use his authority to invest in.⁴ The CARES Act also allows the Treasury secretary to designate private actors, including banks and stockbrokers and dealers, to act as financial agents of the United States to help respond to the crisis by performing “all reasonable duties the Secretary determines necessary to respond to the coronavirus.”⁵ Finally, the Federal Reserve has announced several additional liquidity facilities and tapped an outside firm to manage them.⁶

This special edition policy brief is intended to promote effective ideas among key decision-makers in response to the COVID-19 pandemic. It has been internally reviewed but not peer reviewed.

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RISK OF INAPPROPRIATE CRITERIA IN INVESTMENT DECISIONS

The CARES Act as currently proposed places some limitations on the eligibility and conduct of fund recipients.⁷ However, it provides relatively little guidance on what criteria should guide lending decisions on the part of the government or its agents, leaving the Treasury secretary and Federal Reserve with significant discretion,⁸ albeit limited by the general purposes of the statute.⁹

One question is how much discretion the banks, lenders, and other financial institutions that work with the Treasury Department and the Federal Reserve will have in determining what loans to make or assets to purchase under these programs. This question is potentially important because banks, other lenders, and securities firms have in recent years begun making decisions for social reasons in addition to or in place of economic ones. For example, banks have recently refused to do business on social grounds with various industries including firearms, private prisons, and fossil fuels, sometimes with an eye to de facto regulating downstream markets through the provision of financial services.¹⁰ Given the significant supports provided to banks through public policy, this type of decision-making is potentially fraught even if the bank is only using “its own money.”¹¹

It is more problematic, however, if agents of the government filter credit allocation decisions through a social policy lens when using money provided by the government for the purpose of supporting the economy and stabilizing employment. In this case, the financial institutions’ job is to help cushion the blow of a public health emergency and prevent the loss of jobs, not use their position to influence the composition of the US economy.¹² There is a potential risk that financial services firms, especially large firms that have significant national scale and advanced technology—and therefore are most likely to serve as government agents or recipients of government funds intended to be invested—may intentionally or inadvertently harm legal businesses owing to those agents’ existing policy preferences against certain businesses.¹³ Such an outcome would run counter to the purpose of the CARES Act’s massive investment of public money into the economy.

NEED TO CLARIFY CRITERIA FOR INVESTMENT DECISIONS

Consequently, the secretary of the Treasury and the Federal Reserve should clarify that political or social preferences, as well as reputational risk concerns,¹⁴ are not valid criteria to use when evaluating whether to allocate capital pursuant to the stated objectives of the CARES Act. Rather, consistent with the purpose of the program, lenders should be required to assess capital allocations purely on whether such an allocation is consistent with the intent of the program as well as traditional underwriting concerns, to the extent those criteria are not superseded by the risk-prevention and sharing provisions of the law and any relevant guidance from regulators. In the current moment, financial institutions are clearly serving as agents of the government and conduits for public policy. This position should not intentionally or inadvertently result in a distortion of the flow of aid to reflect their political or social preferences.

ABOUT THE AUTHOR

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NOTES

1. Coronavirus Aid, Relief, and Economic Security (CARES) Act, H.R. 748, 116th Cong. (March 27, 2019), Sec. 1102, 4003(b)(4), 4003(a), available at <https://www.congress.gov/bill/116th-congress/house-bill/748/>.
2. CARES Act Sec. 4003(b)(4)(A-C).
3. CARES Act Sec. 4003(c)(3)(D).
4. CARES Act Sec. 4003(c)(3)(D)(ii).
5. CARES Act Sec. 4003(g).
6. Dawn Lim, "Federal Reserve Taps BlackRock to Purchase Bonds for the Government," *Wall Street Journal*, March 24, 2020.
7. For example, the Federal Reserve programs the Treasury is empowered to support will be subject to Section 13(3), which requires that recipients not be insolvent. 12 U.S.C. 343(3)(B). See CARES Act Sec. 4003(c)(3)(B); see also CARES Act Sec. 4003(c)(3)(A)(ii) (placing restrictions on the conduct of recipients of Federal Reserve programs).
8. See, for example, CARES Act Sec. 4003(c)(1)(A).
9. See, for example, CARES Act Sec. 4003(a).
10. Brian Knight and Trace Mitchell, "Private Policies and Public Power: When Banks Act as Regulators within a Regime of Privilege," *New York University Journal of Law and Liberty* 13, no. 1 (2020): 67-69; Hannah Lang, "Banks Urged to Follow Goldman's Lead on Fossil Fuel," *American Banker*, February 19, 2020.
11. See generally Knight and Mitchell, "Private Policies and Public Power."
12. The CARES Act does have some programs to help specific industries, but those are outside the scope of this paper.
13. This risk may be more acute given the need for social distancing, since smaller banks may not be as accessible as a practical matter, given more limited technology options.
14. In fact, there may be a significant reputational risk if a bank or other financial institution is seen as playing politics with relief funds.