Insight

Why Doesn't CARES Cost $2 Trillion?

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Executive Summary

- On April 16th, the Congressional Budget Office (CBO) released a cost estimate for the Coronavirus Aid, Relief, and Economic Security (CARES) Act.
- CBO estimated that the CARES Act would increase the deficit by $1.759 trillion over the next decade.
- This sum is well short of the publicized headline cost of over $2 trillion – the difference lies with whether businesses ultimately pay back $454 billion in loans provided in the CARES Act.

Introduction

On March 27, the president signed into law the Coronavirus Aid, Relief, and Economic Security (CARES) Act. The Act includes forgivable loans to small businesses, direct payments and tax relief for individuals, tax relief for businesses, financial assistance for vulnerable industries, additional health funding and policy, and additional assistance for financial markets. The Act is certainly the single largest fiscal intervention in U.S. history. The Act was widely reported as costing on the order of $2 trillion. But when Congress's official budget scorekeeper, the Congressional Budget Office (CBO), released an estimate of the cost, the headline figure was somewhat below the widely cited $2 trillion figure. The reason? CBO measures the cost of these loans on a present-value basis and assumes businesses will on net pay back $454 billion in loans disbursed under the program.

FCRA

As previously noted, when Congress considers loans or loan guarantees, CBO is required to follow what are known as the Federal Credit Reform Act (FCRA) rules. Under FCRA, the basic unit of measurement is the subsidy cost, which is the net-present value of all future cash inflows and outflows, discounted at term-matched Treasury rates, for a cohort of loans. These flows include the net effects of defaults, fees, and recoveries. These estimates are very difficult in normal times, and any change in any of the elements of the subsidy cost – interest rates, default rates, etc. – alters the cost. Every year, the subsidy costs of major ongoing credit programs are revised to reflect these changes, and they can be substantial.

Estimating the Cost of CARES Act Loans

Under the CARES Act, the Treasury provided $454 billion in funds for lending under the new and evolving credit regime established by the Federal Reserve. The lending is designed to broadly support businesses, states, and municipalities in addition to other relief provided in the Act. The CARES Act required that CBO estimate the cost associated with this program under FCRA and CBO determined that on a present-value basis, the program would break-even. This brings the estimated CARES cost well under the widely cited $2 trillion cost. What this means is that – net of all payments to borrowers, repayments from borrowers, defaults, and recoveries – CBO assumes the federal government will make back all $454 billion in lending authorized under Title IV with (very little) compensating interest.

Profound uncertainty attaches to this kind of forward-looking estimate that turns on so many presently unknowable outcomes. As CBO notes, terms for the lending have not been fully specified, and CBO has not fully analyzed the Federal Reserve's lending facilities. Accordingly, CBO's estimate that the taxpayer will be made whole under this program may smack of blithe optimism. But it is more reasonable than assuming the $454 billion is never repaid at all. Indeed, both very small credit programs designed to provide assistance during crisis, such as a small program to provide loans to airlines after 9/11, as well as large programs, such as the Troubled Asset Relief Program (TARP), can ultimately make money for taxpayers. While CBO's first cost estimate for TARP in its January 2009 baseline projected the program to lose substantial sums, the taxpayer ultimately was more than made whole. Moreover, as CBO observes, the Federal Reserve did not suffer losses on similar lending in 2008. CBO does not assume all businesses will be able to repay the loans. Rather, CBO estimates some will not, but net of recoveries, and income on loans that are repaid, the taxpayer will break even.

Conclusion

The CARES Act provides roughly 10 percent of gross domestic product in fiscal intervention to mitigate the effects of the COVID-19 pandemic. The Act was widely cited as costing at least $2 trillion, but CBO estimated the Act would cost about $1.8 trillion. Given the high degree of estimating uncertainty, the numerical difference isn't all that meaningful. Rather, it is important to understand how the CBO estimate differs from popular estimates. CBO's estimate that the taxpayer will break-even on CARES Act loans may appear optimistic, at least compared to a total loss, but is hardly unreasonable.