

Fiscal Consequences of the US War on COVID

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How were “Wars” Financed

	taxes	bonds	money
World War I	20.8	74.6	7.0
World War II	30.2	46.0	10.1
COVID-19	4.0	38.1	45.1

What is “Money”?

- Recall gov't PVBC:

$$W_0 = \frac{R_0}{1 + R_0} M_0^S + \sum_{s=0}^{\infty} E_0 \left[z_{0,s+1} \left(T_{s+1} + \frac{R_{s+1}}{1 + R_{s+1}} M_{s+1}^S \right) \right]$$

- Money is a special asset that earns seigniorage
- True for currency (cash)
- Mostly true for World War II money (bank reserves earned zero)
- **Not true** for COVID financing: **interest-bearing money**

Alternative Definition of Money

- Money is liabilities of the central bank (as opposed to the Treasury)
- Still tricky: technically the CB bought government bonds, so just an intermediary
- Need to think about separating budget constraints
- Need to think why it matters

Accounting for Interest Payments

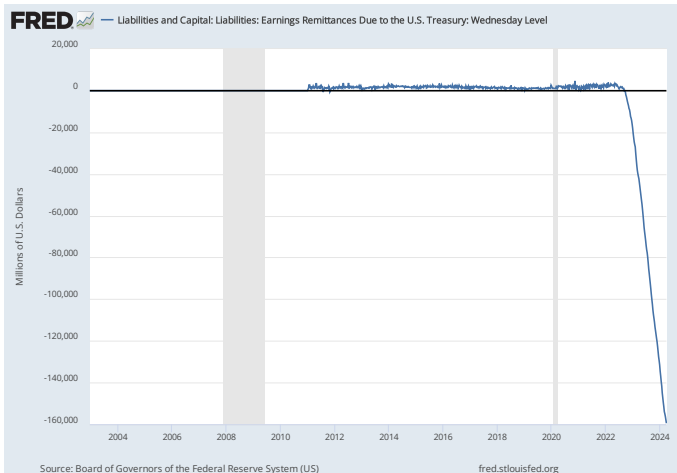
- Bassetto and Butters:

$$(R_t - \pi_t)B_{t-1}$$

- Hall and Sargent:

$$\sum_{j=1}^N D_{j,t-1} \left(\frac{1}{1 + R_{j-1,t}} - \frac{1}{1 + R_{j,t-1}} \right)$$

Deferred Asset



Pattern and Comments

- Up to early 1990s, no big primary deficits during peacetime.
 - Something snaps after that, but remember that real rates are trending down
- Wars financed with mostly debt
- Permanent government expansion after wars
 - True on spending side, but not tax side this time