Private CoVictory Bonds & Loans

A COVID Stimulus Proposal For Rapid Recovery & Default Risk Reduction

Definition and Summary: Private CoVictory Bonds & Loans (CVBLs) would be private debt in the form of bonds or loans, exempt from federal, state and local taxation on interest income. They deliver a leveraged tax cut designed to reduce borrowing costs by about 30%, raise return on equity, and so attract investment to both tax exempt debt and taxable equity. They provide a highly cost-effective, easy-to-use COVID-19 recovery mechanism, that both stimulates business investment and employment, and, by strengthening recovering firms, reduces default risk on federal loans that might otherwise go bad, and increase the federal deficit. They also deliver a level playing field investment accelerant that works evenly, economy-wide, for every sector, because debt financing is useful to every business sector. Further, they provide a valuable means to lower interest rates, and provide extra liquidity, at a time when the Federal Reserve has spent its ammo by taking federal interest rates to near zero, and can't go further. But some businesses, especially those in hardship, still pay much higher interest rates. CVBLs would supply the greatest benefit, in terms of largest interest rate reduction, to these struggling firms.

CoVictory Bonds & Loans accomplish two major goals: (1) accelerated COVID economic recovery; (2) default and deficit risk reduction. They would be authorized for issuance economy-wide only during a short, specified recovery period, perhaps 2 years, to incent early investment, as soon as possible.

Rules can be very simple:

- Tax exempt debt is just ordinary debt without a tax, and so does not need more regulation than ordinary debt. Banks will normally impose their own restrictions, to ensure that each loan is secure and makes business sense. Tax exemption will not change that fundamental caution.
- Illustrative parameters: Maximum CVBL term: 5 years. Total program cap: $1 Trillion, available 2 yrs.
- Rough estimate of direct tax expense: $33 billion spread over 5 years.
- Legislators can expand these limits if needed. At a tax cost of 3.3¢ per $1 of investment, it is cheap.
- Should we exclude any kind of debt? In general, any debt that results in more investment, jobs and business activity would be useful to stimulate in recovery. Ideal for private infrastructure finance. Commercial and real estate bonds and loans for medium and small firms would be useful. Banks could usefully be allowed to bundle CoVictory Loans for public sale as CoVictory Bonds.
- Perhaps credit card debt, savings interest, or margin loans, may be less important. Some large public corporations may already enjoy very low interest rates, or aid from Fed bond buying programs.

Highly Cost-Effective and Participatory: Not only will private CoVictory Bonds & Loans help reduce deficits from loan defaults, they are more cost-effective and participatory than nearly any conventional incentive. As a leveraged supply-side tax cut, they cost less than regular equity side investment tax cuts, municipal bonds, or tax credits like the ITC. They give up tax revenue where returns are low (average US return on debt: 3.67%) but harvest it where returns are high (average US return on equity: 13.63%). If we assume those returns for a new business, financed with 50% CVBLs, 50% taxable equity, then the government would take in roughly 370% more tax revenue on equity profits than they forgo on the tax-exempt debt.[1] By attracting both debt and equity investment, they offer more ways for every investor, large and small, to participate, versus municipal bonds and complex market-constricting tax credits that mostly only benefit bankers and the super wealthy. Instead of using many such conventional incentives, a patchwork of separate subsidies for each industry, CVBLs offer a universal, easier-to-use, better-value deal for all stakeholders, that can also help decrease federal tax expense and deficits in our current crisis.

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[1] Calculation: 13.63/3.67 = 3.714. Assumes the same tax rate on all returns for simplification. Data as of January 2020: (http://people.stern.nyu.edu/adamodar/New_Home_Page/datafile/wacc.htm)