HOW CAN MONETARY AND FISCAL POLICY HELP STRUGGLING WORKERS AND FAMILIES?

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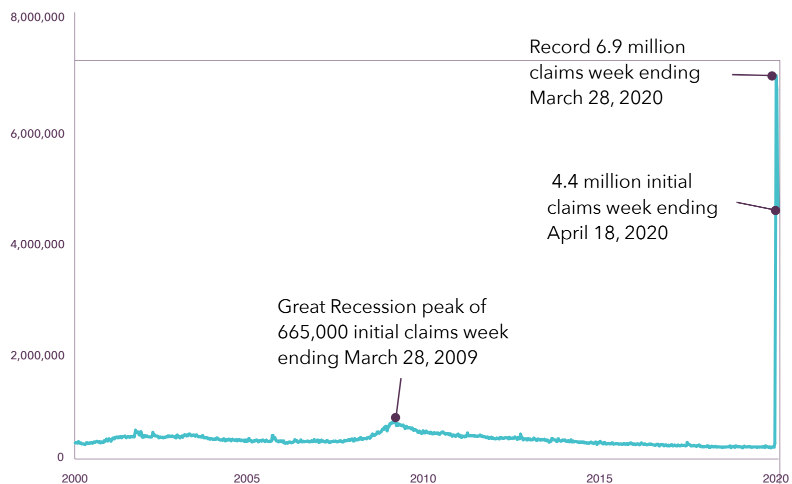
INTRODUCTION

The U.S. is facing a public health and economic crisis the likes of which we haven't experienced in over 100 years. In an attempt to stem the spread of COVID-19, state and local governments have shuttered large segments of the economy, especially services and hospitality. Additionally, many other sectors are experiencing dramatic drops in demand, resulting in mass unemployment. While this economic slowdown is critical to stamp out the virus, the ripple effects could threaten the entire economy for years after the quarantines end.

This crisis may be unprecedented, but the reality of the economy remains the same. **The economy is made up of working people, and now more than ever, we must focus on ensuring that workers and families are safe, healthy, and stable through this crisis, and make sure that the economy is strengthened and made more resilient for the long term.**

UNEMPLOYMENT INSURANCE CLAIMS HAVE SPIKED TO NEVER BEFORE SEEN LEVELS

INITIAL WEEKLY UNEMPLOYMENT CLAIMS, JANUARY 2000 TO PRESENT



Source: U.S. Department of Labor

Imagine a working woman with two children and a good job. In ordinary times, most of her paycheck goes to housing, health insurance, food, transportation, basic clothes, school supplies, and other necessities, but she has a bit left over each month for restaurant meals or new toys for the kids. If her paycheck goes up, her demand for these extras goes up too, and she may start thinking about a bigger apartment or other changes. By contrast, if she has less money in her pocket because of a layoff or unexpected medical bill, or even if she's just nervous about the future and decides to cut back, her demand for goods and services drops. **If the same thing happens millions of people at once, aggregate demand drops: people in total spend less in the economy.**

This can then cause job losses, losses in wages and hours, and a pullback in investment, as businesses reduce their production because they have fewer customers. This causes the economy as a whole to contract, creating a recession.

Normally we want to end a recession as quickly as possible with policies that get workers back on the job. However, unlike previous downturns, we want this contraction to occur and we want workers to remain home for as long as public health experts tell us is necessary to stop the transmission of the COVID-19 virus. That is why Congress must ensure that struggling families and communities receive substantial relief while large swaths of the economy remain shuttered.

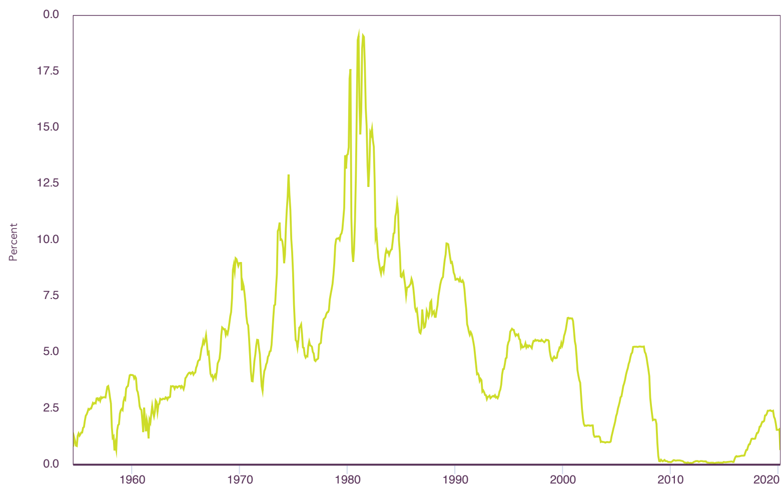
The public sector must marshal resources to manage the threats to families and communities from drops in demand through monetary policy and fiscal policy. Both are critical tools that must be deployed rapidly and strategically and must continue until our economy is through this crisis and on sure footing. Fiscal Policy includes government spending and the collection of taxes and is conducted by Congress and the President. Monetary Policy on the other hand is conducted by the Federal Reserve. The Fed can reduce the interest rates banks face so they can lend to businesses and consumers more cheaply. Both of these measures can help increase demand in the economy. As we will discuss below, utilizing one does not take away from the other. In order to keep our country running, the government will need to leverage all the tools in its arsenal.

MONETARY POLICY

Monetary Policy is management by the central bank (here in the United States that's the Federal Reserve or "Fed") of the amount of money circulating in the economy, generally through control of interest rates. When interest rates are low, businesses and consumers can borrow money cheaply, increasing the cash in their pockets and leading to more spending and investment. They can also directly save money on debt they already have, as when people get lower monthly mortgage payments through refinancing, which directly affects their spending ability. In this way, low interest rates can increase aggregate demand in the economy, hopefully kicking off a virtuous cycle of recovery and growth.

The Fed mostly intervenes to affect the interest rate that banks charge each other for overnight loans between their Fed reserve accounts, known as the "federal funds rate." If you have heard that "the Fed has cut interest rates to zero," that refers to the federal funds rate, not the interest rate being charged, for example, on mortgages. But when banks can borrow reserves more cheaply, they can loan money cheaply to businesses and households and still make a profit, so reductions in the fed funds rate do reduce interest rates in the real economy.

EFFECTIVE FEDERAL FUNDS RATE



Source: Board of Governors of the Federal Reserve System (US) fred.stlouisfed.org

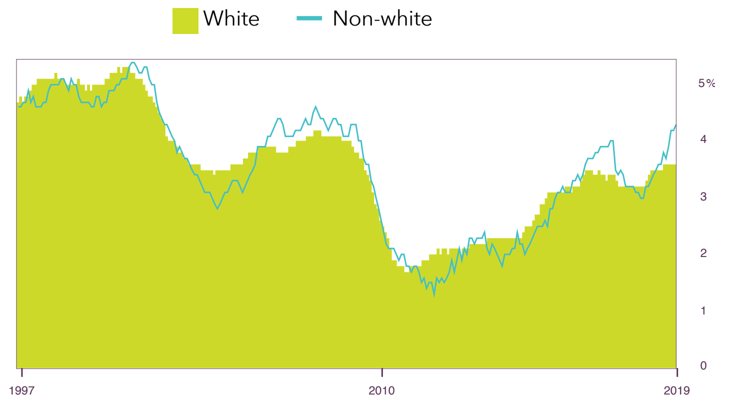
In order to further drive mortgage rates down and **help get money to households—the Fed has recently begun directly purchasing hundreds of billions of dollars in mortgage-backed securities** (the way that banks sell mortgage loans to investors) employing a method known as **quantitative easing (QE)**. This helps to get banks lending, knowing that someone will be willing to buy the loans after they are made.

The Fed is also charged with ensuring liquidity in financial markets. **Banks have to maintain "liquidity," by ensuring that they have enough cash to cover their day to day transactions.** This need for liquidity was the reason for the Fed's decision to inject $1.5 trillion into the banking system in March, by offering banks a kind of loan called a **"repurchase agreement,"** or "repo." Banks often get short-term cash through overnight transactions in which they sell assets (like bonds) to another bank, but simultaneously sign a contract to repurchase the asset at a later date—essentially creating a loan secured by the asset. **In order to help keep banks liquid so they can keep lending, the Fed has decided to give up to $1.5 trillion in cash to banks in exchange for Treasury bonds that the banks promise to repurchase at a later date.**

Engaging in quantitative easing and the repo market intervention are not bank bailouts. In both cases, while the Fed is giving out cash, it is getting high-quality debt in return. In the case of QE, these are straight purchases done on the open market. In the case of repo agreements, they are subsidized loans (because the Fed isn't charging as high a repurchase price as the market would—that's the whole point) but they are loans nonetheless, and they are secured. If the bank can't pay them back, the Fed gets to keep the bonds.

For a decade progressives have been calling for lower interest rates and more aggressive pushes by the Fed to ensure that demand is high and job and wage growth are strong, and these kinds of creative tools are going to be a critical part of monetary policy during this crisis and the recovery to come.

WAGE GROWTH
TIGHT LABOR MARKET DRIVES HIGHER WAGES—ESPECIALLY AMONG NON-WHITES



Source: Atlanta Fed • Note: Monthly median wage growth, 12-month moving averages

FISCAL POLICY

Fiscal policy is government spending and the collection of taxes. In ordinary times, government spending provides huge value to the economy by providing things like public schools, infrastructure, social insurance, and all of the other things governments can provide that private markets can't. In economic downturns, fiscal policy has a special role to play, both to increase aggregate demand broadly through deficit spending, and to provide targeted relief to the workers and families most affected by the downturn.

The government can run a deficit by incurring debt—generally by selling bonds that pay interest to bondholders over time and are paid in full after some term of months or years. These bonds are issued by the Department of the Treasury, and if you have ever owned a "savings bond" you have owned U.S. government debt. Since the federal government has a long history of paying its debts it is able to borrow funds at very low interest rates. This is especially true during recessions, when investors don't expect to make a lot of money on their investments and are often looking for a safe place to put their money.

When the economy is contracting, government spending is one of our most important tools to increase demand and help struggling families. Big increases in deficit spending to fight recessions are known as fiscal stimulus because they "stimulate" the economy, or give it a jolt! Stimulus packages put money into the hands of households and businesses through direct spending (building large projects, purchasing and distributing more goods, hiring more workers to provide more services, etc.), direct payments (increased cash benefits like Social Security, TANF and SNAP, or sometimes just new checks) and tax cuts. These measures increase aggregate demand when they are paid for with borrowing—the government borrows money cheaply and spends it or gives it to people who will. These measures also, if structured well, relieve human suffering and directly create value for the future economy. For example, bolstering the social safety net has a multiplier effect that reverberates throughout the economy. The USDA found that every $1 increase in SNAP benefits results in a $1.54 increase in GDP. The American Recovery and Reinvestment Act (ARRA), which was passed in 2009 to prevent the Great Recession from tipping over into another depression was this type of "stimulus."

As states and localities shut down major parts of the economy to try and stem the spread of COVID-19, the existing social safety must be supplemented with robust emergency measures to support working people and families. Once the threat of the virus passes and social distancing protocols are lifted, all signs point to the need for a fiscal stimulus just to emerge from the current crisis, coupled with long-lasting expansionary fiscal policy to create a people-centered recovery and rebuild an inclusive economy in the years to come. The best fiscal stimulus and recovery measures put money in the pockets of the people who will spend it most urgently, provide critical protections like health care, support states and localities in ramping up needed services even as their revenues crater, or directly invest in the creation of high quality jobs. Additionally, we should be using this moment of low interest rates to make long-needed investments in workers and the inclusive economy of the future, tackle the looming climate crisis, and leave our workers and families more resilient and better prepared for future crises.

CONCLUSION

The first few bills Congress passed in response to the crisis sparked by COVID-19 provide some much needed relief to struggling families, but are wholly insufficient to address the magnitude of the current economic crisis. As of April 23, 2020, nearly 25 million people have filed for unemployment insurance since the economic crisis began in March. Congress must ensure that families and communities receive substantial, and ongoing aid throughout the duration of the economic crisis, while simultaneously addressing the structural flaws that decades of conservative policies have inflicted on our economy, making us more vulnerable to economic crises. The human toll of the economic crisis will be entirely dependent on the policy response - the economic devastation from this crisis is already enormous and will grow, but it doesn't have to if we make different policy choices. This will require substantial relief to struggling families while large swaths of the economy remain shuttered, followed by expansionary monetary and fiscal policies that boost aggregate demand by investing in people, families and communities.

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