HOW MUCH EMERGENCY RELIEF WILL IT TAKE TO REVIVE THE U.S. ECONOMY?

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DECEMBER 8, 2020
INTRODUCTION

As 2020 draws to a close, the U.S. economy stands at a daunting crossroads. The COVID-19 pandemic, which plunged the economy into the sharpest decline in generations, is resurging just as emergency economic support measures are expiring. Though economic activity partially rebounded from the lows seen last Spring, accelerating infection rates and expiring emergency federal support programs are straining health care infrastructure and threatening the economic ground thus far reclaimed. Millions of families and small businesses across the country already face precarious financial situations and, despite promising news of a vaccine on the horizon, it will still be some time before the economy can operate without social distancing. To contain both the public health crisis and the long-term damage to our economy, Congress must quickly renew and expand emergency measures to fill-in the economic hole left by the pandemic. This policy brief presents a range of estimates for which legislation should aim.

The federal government has two policy channels to support the economy: monetary policy conducted by an independent Federal Reserve, and fiscal policy at the discretion of Congress. The Fed’s monetary policy response has been robust and essential. While there is still some room for the Fed to provide additional support, Fed Chairperson Jerome Powell has been clear that substantially more fiscal stimulus from Congress is needed. Congress took action in the pandemic’s early stages to expand unemployment insurance coverage and provide $600 in weekly supplemental benefits to affected workers, to help businesses keep workers on their payrolls, and to relieve state and local governments of some pandemic-related expenses, among other support. That money has already been exhausted. While these measures helped fend off a depression, the economy nevertheless plunged into a deep hole, with low-income workers, small businesses and contact-intensive industries, and local governments bearing the brunt of the downturn. Without significantly more Congressional action American families and businesses will struggle to recover from the damages done by today’s crisis and to overcome the structural economic problems that left us so vulnerable to shocks like COVID-19.

Each cycle of economic expansion and contraction is driven by unique factors, but the downturn caused by COVID-19’s “Great Lockdown” and the Trump administration’s failure to contain the public health crisis stands apart both for its severity and scope. In July, the Congressional Budget Office forecast that U.S. gross domestic product, or GDP, would not recover to pre-pandemic levels until mid-2022—though still leaving unemployment excessively high. These projections were based on rather optimistic assumptions, including that the virus would by now be brought under control; however merely recovering to the pre-pandemic economic trajectory would not repair the fault lines of economic inequality along which COVID-19’s shock reverberated.

We estimate that Congress needs to provide economic relief of between $3-4.5 trillion in the short-term in order to get American families and businesses working at their full potential. Additionally, Congress should enact automatic triggers to renew support in the event of a prolonged recovery. This range of estimates accounts for a more realistic assessment of disguised unemployment not captured in official measures, and reflects uncertainty around the extent to which a temporary shock will mutate into permanent economic scarring, as well as the size of the multiplier effect from increased federal outlays.

The growing consensus among economists is that more risk lies in going too small than in going too big. The longer Congress waits to act, the more permanent damage will be done to
American families, and the harder it will be for the overall U.S. economy to regain prosperity. Whereas our estimate for needed economic relief would bring the economy in line with true full employment, falling short of this target will only widen the current health and economic crises, worsen America’s longer-term problems of caustic economic polarization and a carbon-dependent economy, undermining the country’s long-term economic potential. By committing to adequate support now and making support more targeted, with automatic triggers, Congress can create confidence that will ultimately hasten recovery and bring the economy to true full employment. These actions will help mitigate inequality, benefiting groups long marginalized from economic prosperity.
NOT YOUR AVERAGE ECONOMIC DOWNTURN

The uniqueness of the COVID-19 economic shock requires policymakers to look beyond traditional approaches to macroeconomic policy management and recognize past policy failings that reinforced structural economic problems. Unlike typical business cycles, the pandemic has caused shocks to aggregate demand associated with sharp losses to income and employment, along with supply-side shocks as workers, business, and governments—in the United States and around the world—took precautionary measures against spreading infection. Additionally, consumers and investors fundamentally changed their behavior as they realigned expectations of risk and uncertainty. Now, armed with a better understanding of the pandemic economy’s dynamics than in March, Congress can take a more tactical approach to delivering support where it is most needed and impactful, while avoiding policy actions which could have adverse consequences. Half-measures now will lengthen the pandemic and turn temporary financial pain into permanent scarring that constrains America’s economic potential, increases systemic financial fragility and inequality, and doubles-down on a carbon-intensive economy when we should be rapidly transitioning to a greener future.

Unsurprisingly, these shocks most impacted contact-intensive industries, as seen in Figure 1, but quickly spilled over to other sectors of the economy through Keynesian multiplier effects. Leisure and hospitality sector employment fell a staggering 49 percent from February through August, while passenger transportation industries continue to decline—though at a slower pace—and is down 33 percent in November relative to February. Paradoxically, even in an essential industry like health care, employment is down nearly 5 percent as people forewent routine medical procedures and health care employers were saddled with increasing costs for personal protective equipment.

FIGURE 1: PANDEMIC CHANGE IN EMPLOYMENT BY SECTOR

Source: Authors’ analysis of BLS data.
Not all workers and businesses have been affected the same. Job and income losses have fallen hardest on those least able to weather the shock: people whose jobs were largely unable to adapt to remote work were also disproportionately likely to be low-income, with low household savings resources, and members of historically marginalized groups. These groups were also disproportionately more likely to face risks of COVID-19 infection working in essential services. Even with support from the CARES Act and related legislation in March, an estimated 6-8 million Americans have fallen into poverty this year. Job losses have also taken a distinctly gendered tone, both as industries suffering the largest job losses had larger shares of women workers and as women disproportionately withdrew from the labor force under pressures to provide unpaid, but essential, family care work at home. Past experience indicates that even temporary absences from the labor force can take a lifelong toll on job prospects and income, widening gender and racial inequalities, helping transmit those inequalities to future generations.

The pandemic shock presented a potential extinction-level event for America’s small and medium enterprises, also disproportionately represented in the most impacted industries. Since well before COVID-19, the financial squeeze facing America’s middle-class families has been constraining the growth of new businesses as would-be entrepreneurs find it harder to accumulate the assets needed to start a business and assess the risks of failing as too high. Early evidence suggests the pandemic is compounding the long-term trend toward slowing new business starts by accelerating small business exits, or “deaths,” by as much as 50 percent in some industries. Rocky implementation of the CARES Act’s Paycheck Protection Program and the Federal Reserve’s Main Street Lending Program blunted their efficacy in supporting small and medium enterprises through the economic shock. Almost certainly, small business starts and job creations will suffer long-term setbacks, even post-pandemic, as lenders and investors reassess risks, raising the bar for potential entrepreneurs to access financing.

Overall, some lost jobs have bounced back as stay-at-home orders relaxed, consumers and businesses learned to adapt their activities to life in the pandemic, as emergency support policies kicked-in. Not all of this recovery may be desirable in the short-term, providing incentives for businesses and people to engage in behaviors that increase viral transmission, ultimately prolonging the crisis at hand. But even with such unprecedented policy support to replace lost incomes, in November the economy employed 10 million fewer people than in February. Already, the most recent data showed new job openings plateauing while new hiring is slowing. Growing at November’s pace of 245,000 new jobs, it will take 40 months to regain jobs lost since the start of the pandemic and would still leave jobless new entrants to the labor force and those in disguised unemployment. With resurgent infections in every region of the country, $600 supplemental unemployment benefits expired, and other emergency economic measures such as Pandemic Unemployment Assistance and Pandemic Emergency Unemployment Compensation are set to expire in December, the rebound is bound to disappear without further action. With infections surging, the withdrawal of economic support is likely to put the economy even deeper in the hole.
The spillover from directly affected workers and businesses to other sectors of the economy can be seen most clearly in plunging state, local, and tribal government employment (Figure 2). As tax revenues fell and demands for outlays increased with measures to meet public health needs and adapt the operation of schools and other public services to pandemic conditions, state and local governments have moved to cut jobs. Overall, state, local, and tribal public employment fell nearly seven percent, or 1.3 million lost jobs, from February to November, accounting for seasonal factors. These job cuts were concentrated in education, the largest component of most state and local budgets, which lost more than one million jobs, or nearly ten percent. Largely prevented from running budget deficits, aid to state and local governments typically features as a critical component of economic stabilization during downturns. Over the same duration during the Great Recession, which lasted from December 2007 to June 2009, state and local governments increased employment by nearly 1 percent. Every ten public sector jobs created or saved at that time supported an additional eight jobs elsewhere in the economy.\textsuperscript{12} Even with states dipping into their rainy day funds, alongside modest federal fiscal transfers provided by the CARES Act in late March and Federal Reserve actions to backstop municipal bond markets, the impact on state and local finances is nonetheless severe. Without substantial federal aid, contractionary measures taken by state and local governments will impede efforts to contain the pandemic, deepen the economic downturn in the near term, and undercut the economy’s long-term supply-side potential.\textsuperscript{13}
GOING BEYOND THE OLD NORMAL

COVID-19’s economic shock is unprecedented in modern history. In seeking to repair the damage, Congress must set a target beyond returning to the old normal—because the pre-pandemic economy was already not working for too many Americans. The official unemployment rate, also known as U-3, reached an astounding 14.7 percent in April, before falling to 6.7 percent in November—roughly double its rate in January. However, headline unemployment figures can paint a misleading picture of the health of the overall economy and help explain why, in the year leading up to the pandemic, wages for regular workers grew at just 0.6 percent despite official unemployment falling consistently below what economists used to consider “full employment”—an unemployment rate in the 5-6 percent range.14 The official unemployment rate excludes millions of people who have given up participating in the labor force due to underwhelming job prospects—the so-called disguised unemployed—whose ranks have been mounting through successive incomplete recoveries from business cycle downturns. And millions more have suffered reduced work hours and wages, or have been forced to accept work that does not fully utilize the skills and experience workers bring.15

For years, macroeconomic policymakers have been running the economy too “cold,” preventing millions of American families from sharing in the gains from economic growth. This is true of the Federal Reserve, which controls monetary policy, as well as of Congress, which controls fiscal policy—the two policy levers that can counteract the effects of economic downturns. The Fed is mandated to pursue dual objectives of stable prices and maximum employment, but economists and Fed governors have chronically underestimated how low unemployment can safely get, instead favoring to focus on stable prices at the expense of higher employment. In fact, there is considerable room to run with monetary policy that can boost the economy, without adverse consequences.16 While the Fed is intended to pursue its mandate independently from political influence, Congressional fiscal policy has been explicitly constrained by politics in recent years. Political concerns famously led President Obama’s advisors to pull their punches in 2009 when considering the appropriate size of the fiscal response to the Great Recession, contributing to a prolonged jobless recovery, and served as a prelude to the budget austerity that has dominated Congressional policymaking ever since.17

“The combined effect of the two served to lock-in income and wealth losses suffered by workers during downturns, to restrain economic expansions from generating enough employment to yield widespread wage gains, and to inflate the wealth of the small minority of Americans who own the lion’s share of financial assets. The impact has fallen most heavily on communities of color, where failure to deliver sufficient macroeconomic policy support compounds structural discrimination to result in unemployment rates that can be more than double the official national figure—even after accounting for differences in educational attainment.18 That means that even if the Federal Reserve hit its employment target, African-American workers, for example, would still experience unemployment in excess of nine percent—a level only experienced by white workers during the worst economic downturns. But even among white workers, chronically weak labor markets have led to untold disguised unemployment and “deaths of despair.”19
Underperforming macroeconomic policies have not only left behind many distinct worker groups, but also entire regional economies where benefits from growth have not trickled-down, saddling some states with depression-level economies. For example, Michigan did not return to its pre-Great Recession level of output until 2015. Arizona did not surpass its pre-recession level of output until 2016. Connecticut's economy never recovered: by the time the pandemic began, Connecticut's gross state product stood 4.2 percent below its 2007 level, after adjusting for inflation. As a nation, relative to pre-Great Recession trends, an estimated seven million potential workers have gone missing from the labor force in the face of poor job prospects resulting from running the economy “too cold.” If participation in the labor force today were the same as in 2007 before the Great Recession, the unemployment rate would be above 13 percent, rather than 6.9 percent as measured by “U-3.”

**HOW BIG A HOLE DO POLICYMAKERS NEED TO FILL?**

A more realistic assessment of the true level of unemployment suggests that policymakers have a much bigger hole to fill than is often acknowledged in order to return the economy to full employment and to reach our long-term potential output. Economists turn to “Okun’s Law”—one of the most well-established empirical relationships in the field, which relates the difference between actual unemployment and the minimum level of unemployment consistent with stable prices to the difference between actual GDP and the economy’s potential GDP when its labor and capital resources are fully utilized, the so-called “output gap.” The output gap should be filled by increased spending from Congress, while the Federal Reserve accommodates such spending by keeping interest rates low. With interest rates set by the Fed already pushed down near zero, the Fed has created a great deal of space for Congress to pursue fiscal policy measures—but Congress must choose to take action.

Okun’s Law provides a straightforward way to calculate the size of this hole, but requires employing a number of assumptions to do so. The first assumption is the true level of unemployment. As we argue above, the official U-3 unemployment rate, as defined, vastly underestimates the true level by not accounting for discouraged and disguised unemployed workers as millions have given up participating in the labor force due to underwhelming prospects for the quantity and quality of jobs available. Assuming that labor force participation remained at pre-Great Recession levels suggests a true unemployment rate today above 13 percent.

The second assumption is the minimum level of unemployment consistent with price stability. For decades, many economists believed this number to be around 5-6 percent for the United States. However, the unemployment rate has remained consistently below four percent since mid-2018 with no signs of inflation to be seen. Unemployment decreased to just 3.5 percent before the start of the pandemic, though inflation had not exceeded two percent, at an annualized rate, for more than a year, suggesting economists must re-evaluate their long-held beliefs about how full employment and inflation are related. Taking 3.5 percent as the full employment level of unemployment and 13 percent as a better estimate of actual unemployment gives an unemployment gap of 9.5 percentage points. Taking this gap together with an estimate of current GDP in November of nearly $21.3 trillion, implies a potential GDP of more than $25.7 trillion, or an output gap of $4.5 trillion that fiscal policy needs to fill.
For members of Congress, the question then becomes what is the fiscal multiplier? Or, in other words, how much economic activity does an additional dollar of net federal spending generate? The answer depends largely on how that dollar gets spent. In a sizable body of research since the Great Recession, economists have largely converged on the idea that fiscal multipliers are fairly large (1.2-2) during times of economic crisis, but as the economy approaches full capacity, the benefit of additional spending diminishes.\textsuperscript{24} Generally speaking, aid that flows to those most in need packs the biggest punch, as most of the aid flows back into the economy rather than being held in savings. Congressional Budget Office (CBO) analyses find that each dollar of net spending given to corporations and high-income individuals generates just $0.40 and $0.60, respectively, in additional economic activity. In contrast, one dollar in direct transfer payments to individuals generates $2.10 in additional activity. The impact of direct transfers is higher where recipients are more financially stressed, with less discretionary disposable income.\textsuperscript{25} Similarly, stimulus dollars are more impactful in regional economies that are hit harder by economic downturns.\textsuperscript{26}

In recent projections, CBO employed a fiscal multiplier of $0.58 on the dollar, noting that current stimulus measures will be “tempered by social distancing.”\textsuperscript{27} Certainly there is some truth to this observation, but only time will tell how accurate their assumed multiplier is. But it is safe for policymakers to assume that economic impact payments received by well-off individuals are more likely destined for savings (or debt reduction), or spending on consumption of imported goods that may exacerbate the output gap. In contrast, recipients of expanded and supplemental unemployment insurance benefits and economic impact payments to households in financial precarity are likely to spend all of their support back into the economy to meet basic family needs like housing, food, and health care. New stimulus well-targeted to those most in need could yield a substantially higher multiplier effect than assumed by CBO, but our interpretation of the evidence suggests even a broader stimulus aimed at supporting low- and middle-income households and the unemployed suggests that an average multiplier for new net federal spending going forward would fall in the range of 1-1.5.

Given the size of the current output gap, Congress should aim to provide a COVID-19 relief package of $3-4.5 trillion. This is based on our assumptions regarding the multiplier; however, using the lower multiplier favored by CBO suggests would imply the need for a $7.7 trillion stimulus to fill our current economic hole. Additional fiscal stimulus on this scale is essential to support the economy while individuals, businesses, and governments take life-saving measures to prevent transmitting infections that slow the economy, and begin to repair the U.S. economy that for too long has left out so many from America’s economic gains.
CONCLUSION

Sizable fiscal stimulus is essential if the country is to get the public health crisis under control while stabilizing, and then rebuilding, an economy that has long marginalized too many people from sharing in America’s economic prosperity. Previous crises have demonstrated that Congress and the Federal Reserve have aimed too low on stimulus measures and withdrawn support too early, resulting in slow, jobless recoveries that exacerbated a national trend toward widening inequality. In order to address the multiple concurrent crises currently facing our country—a global pandemic and a deep economic recession, compounded by economic and racial inequality and a climate crisis that promises similar economic disruptions to come—large, sustained, and well-targeted stimulus measures are needed now.

Congress should learn from past mistakes and amplify the impact of stimulative measures by targeting aid at critical areas and setting an expectation that it will continue supporting the economy as long as is needed to return to true full employment. This would include continuing to expand eligibility for unemployment insurance benefits, renewing the $600 weekly supplemental benefits, providing fiscal aid to offset budgetary pressures on state, local, and tribal governments, renewal and better management of the Paycheck Protection Program for small businesses, and resources to expand COVID testing and tracing and health insurance subsidies, among other measures.

While we recommend $3-4.5 trillion in immediate, near term relief, we also recognize that more support may be needed if relief measures move too slowly or aim too low, causing both the public health and the economic situation to deteriorate further. Thus, we also recommend that Congress should include measures to automatically reauthorize some stimulus spending until public health is normalized and the economy returns to full employment across all demographic groups. Furthermore, Congress and the Federal Reserve should target their actions to expand investment and job opportunities that help decarbonize the economy so that we take actions now to mitigate the likelihood and severity of similar future shocks. Such actions will not only fend off a prolonged recession and provide critical support for the millions of Americans forced into hardship by the crisis, but will also help reverse the problems of inequality and climate change that has left the United States so economically vulnerable.

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20 Authors’ analysis of Bureau of Economic Analysis data, available at https://apps.bea.gov/Table/index_regional.cfm.

21 Authors’ analysis of Bureau of Labor Statistics data. A similar pattern of falling labor force participation in so-called “prime age” workers, 25-54 years, shows that this trend is distinct from aging demographics that have slowed U.S. labor force growth.


23 We estimate November GDP as the monthly growth from third quarter 2020 GDP implied by the New York Federal Reserve’s “Nowcast” of fourth quarter GDP. See https://www.newyorkfed.org/research/policy/nowcast.


