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Recession Remedies Podcast

"What should we learn from the economic policy response to COVID-19?"
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Episode Summary:

The COVID-19 pandemic posed an extraordinary threat to the economy. In the U.S., the COVID-19 downturn was sharp, but the ensuing economic recovery was faster and stronger than nearly any forecaster anticipated. What was the effect of the economic policy response? Did it come with trade-offs? On the first episode of the Recession Remedies podcast, Jason Furman, Aetna Professor of the Practice of Economic Policy at Harvard University, and Wendy Edelberg, senior fellow and director of The Hamilton Project at Brookings, join host David Wessel for an overview of the economic policy response and the lessons learned for future recessions.

WESSEL: Welcome to the Recession Remedies podcast, exploring lessons learned from the economic policy response to the COVID-19 pandemic. I'm David Wessel.

The pandemic posed an extraordinary threat to the economy. In the U.S., the COVID-19 downturn was sharp, but the ensuing economic recovery was faster and stronger than nearly any forecaster anticipated. In part, that is because of the swift, aggressive, and creative response of U.S. fiscal and monetary policy. But they also added substantially to the federal debt and contributed to an unwelcome increase in inflation.

To talk about all that today, I'm joined by Jason Furman—he's the Aetna professor of the Practice of Economic Policy at Harvard, and Wendy Edelberg, who's director of the Hamilton Project at Brookings and with me a coeditor of the *Recession Remedies* book, which you can read in its entirety at Brookings Dot Edu Forward Slash Recession Remedies.

So, Jason, let me start with you. Let's go back to the onset of the pandemic in early 2020. How big a threat did that pose to the economy at the time?

FURMAN: At the time, all of the headlines were that we might be on the verge of a second Great Depression. In fact, the downturn in economic activity was steeper, more widespread, and faster than anything that we had ever seen before. So, it was a terrifying moment in the economy.

WESSEL: And with the benefit of hindsight, you describe it in the chapter as being like a natural disaster, that is, something that hits big and then we bounce back from. But did we know that at the time?

FURMAN: At the time I was going around, I remember it, I think it was in March of 2020, saying there's two models here. One is the financial crisis. Financial crises have long, lingering, painful effects. The other is a natural disaster where when the disaster passes, we tend to spring right back. And it wasn't clear that the natural disaster model made sense, because first of all, this was like a hurricane hitting every single part of the United States simultaneously, as well as every part of the world. And you weren't sure how long the hurricane was going to last. And we'll get to this, I don't think if we had just done nothing, this would have gone away, and the economy would have recovered.

WESSEL: Hmm. Wendy, so, how big was the response from Congress and the Federal Reserve compared to, say, what we did during the Great Recession of 2008 and '09? And how did what we did in the United States compared to what other countries did?

EDELBERG: It was enormous, and it was much bigger than the response and much faster than the response at the onset of the Great Recession. I mean, part of that was because the shock was so easily identifiable as huge, and just an enormous hit to the economy. And so, policymakers came together on a bipartisan, bicameral basis and they passed really significant relief. And it is one of the, I think, most significant lessons to take from the fiscal policy response to the COVID-19 recession, which is that in the midst of a crisis, Congress can really act quite robustly in a way to pull an economy back from the brink.

WESSEL: Wendy, when you look at everything that was done, what were a couple of the policies that you think had the biggest oomph, that made the biggest difference?

EDELBERG: I think you have to start with what monetary policy did. It is now easily overlooked because a lot of the extraordinary actions that they took were under the hood. They did a lot to stabilize the financial system and keep treasury markets stable. And so, part of what's the good news here is that we didn't have a financial crisis and there really was a significant risk of that in March of 2020.

The other thing that fiscal policymakers did that was probably most helpful in March of 2020 was the very significant expansion that they undertook of the unemployment insurance system. Historically, the unemployment insurance system has actually only covered something like a third of workers, and they so significantly expanded the system that virtually anybody who had been attached to the labor market for some time before the COVID-19 recession had access to unemployment insurance benefits if they lost their job. And they also added a $600 a week plus up on top of unemployment insurance benefits. And both really basically shored up the finances of those who found themselves without jobs.

They also provided a lot of other fiscal support to households in the business sector. But I think that UI response is really quite notable.

WESSEL: So, Jason, as Wendy mentioned, Congress did a big expansion of UI. We sent checks to every household or electronically deposited in their bank accounts. We had substantial subsidies to business. We had substantial aid to state and local governments. All in all, over 2020 and 2021, the federal government spent about five trillion dollars and the Federal Reserve bought about five trillion dollars' worth of U.S. backed bonds. So, when you step back and look at all this, would you say that this was a success?

FURMAN: We still don't know the definitive answer to that question, because the exit from all of this is going to matter just as much as what was done. The 2020 response was almost an unqualified success, in part for what didn't happen. There was not a financial crisis. Also, there was not a big increase in poverty and economic suffering. In fact, the poverty rate actually fell in the year 2020. So that was a year of enormous amount of suffering from the pandemic, from the disruption to our lives. But to the degree that economic policy could protect people from one additional source of suffering, it did quite a good job. Some people were left out who should have gotten money, wasn't perfect, but quite a good job.

When it comes to 2021, that's where the grade has to be a little bit more incomplete. It sped the recovery, it also contributed to inflation. The ratio of how much it did of speeding the recovery versus how much it did to inflation is unclear. And then the question is if the inflation turns out to be temporary, that's a small price to have paid to get to where we wanted to go faster. If it's permanently higher inflation and you need a deeper recession to get it out of the system, then you got some extra growth in 2021 at the expense of some additional pain and suffering in some future year. And we just don't know which of those it is.

And that's why the 2021 grade is a little bit more of an incomplete. The 2020 grade is quite strong for both the Fed and fiscal policy.

WESSEL: You have some credibility when it comes to saying that the inflation is partly caused by the large American Rescue Plan of 2021. But of course, there are other things that are driving inflation. So if you were trying to figure out today, make a guess of today's inflation how much do you blame on too much fiscal policy, how much on not aggressive

enough monetary response, and how much on all of the supply shock things from semiconductors to Russia invading Ukraine, how do you apportion the blame?

FURMAN: If we're talking about 2021, on the policy side, to the degree that policy contributed, I think it was much more fiscal than monetary. Even if the Fed had dramatically raised rates starting in April and May, so much of what was in the system was in the system and monetary policy matters with a lag. I've estimated that the fiscal plans, both the December and the March, which I think you should really think of together because they both applied to the same year, to 2021, that they plausibly added between one and four percentage points to inflation in that year.

So if you're talking about inflation, it was about five and a half points higher than the target, roughly half of that was due to fiscal policy, roughly half of that was supply chains, bad luck, all of that sort of stuff.

If you look going forward, the Fed is going to bear an increasing share of the blame for inflation in 2022 and beyond because they're the ones with the main inflation tools and their tools matter with the lag.

WESSEL: Wendy, the federal debt amounted to something like 75 percent of GDP at the beginning of the pandemic, which was twice what it was before the Great Recession. And now we've driven it up to 100 percent of GDP and it's still growing. Yet interest rates, and not only because of the Fed, didn't rise very much. So how do we think about this run up and debt? Have we mortgaged the future? And why didn't interest rates rise if the federal government was doing all this borrowing?

EDELBERG: So, unfortunately, we don't know for certain why interest rates didn't rise, but there are certain things that we can surmise so. We have a bunch of empirical evidence that suggests that the actions that the Fed took in buying bonds, expanding their balance sheet as it's called, that those actions did indeed put downward pressure on interest rates. Exactly how much is hard to know? Perhaps as much as 70 basis points.

It also looks like interest rates were held down just by plain old risk aversion, that investors in response to the COVID-19 pandemic were very worried about what was going to happen to future economic growth, were very worried about how well the economy was going to recover from the pandemic. And as is typical when financial market participants become worried, they went to lower risk assets like Treasuries, and that drove down interest rates on Treasuries.

Now, on the flip side, it stands to reason that the increase in federal borrowing did put upward pressure on interest rates. And that was offset by these other factors and will probably be a reason why interest rates will settle at a higher rate than they would have otherwise. But this is not a reason in my mind for us not to have done what we did. I think that this was money well spent. I think it alleviated a great deal of suffering and this is exactly what the power of borrowing that the U.S. government has should be used for.

WESSEL: But should I worry that the debt is now 100 percent of GDP and on its way to 200 percent of GDP over the next couple of decades?

EDELBERG: So, let me say a couple of things. First, just in case anybody out there is thinking that there is something special about the fact that it's a hundred percent, there's nothing particularly magical about 98 percent versus 102 percent. So we only talk about debt as a share of GDP to sort of give us a benchmark of whether or not debt seems to be growing or shrinking over time as a share of the economy.

I think financial markets told us loud and clear that in the midst of a crisis, particularly when inflation, at least until what we saw in the latter part of 2021 and more recently, when inflationary pressures don't look too worrisome and with responsible policy, financial markets told us that they are not particularly worried about a one-time run up in federal borrowing. So we don't see strains in financial markets along those lines.

And the other thing I'll say is, let me say two other things. One, debt as a share of GDP is probably on track to fall modestly over the next several years as the economy grows and borrowing shrinks. Now, we do have a longer-term problem, I think, in terms of our fiscal trajectory. We have spending pressures that are going to continue to increase, and we seem unwilling to tax ourselves appropriately to pay for the spending that we value. But that is a longer-term problem, and it has been a problem on the horizon for a long time. And this is something that policymakers should be solving over the next years and not in the short term.

WESSEL: Jason, if someone called you before Congress on the eve of the next recession and said to you, okay, you had the benefit of being in the Obama White House during the last crisis, you have made a lot of observations about the recent crisis, what should we learn from this experience? What should we repeat? And what should we do differently?

FURMAN: So, I'd say, first of all, we've learned that economic policy can really help. It can really help families. We can create a disconnect between an economy that's going through a lot of pain but protect a lot of households from going through anything commensurate with that pain. We can speed up the economic recovery.

The second thing I would tell them is that I don't know what's about to happen in the economy, just like I didn't know last time, just like I didn't know the time before that. That, in part, you need to take your best guess. But in part, put some more formulas in place so that if the problem lasts for years, the assistance lasts for years. If the problem goes away quickly, the assistance goes away quickly. Because Congress is not like the Fed, it doesn't meet every six weeks to review the latest economic data and fine tune their response. So, formulas are imperfect, but they're better than counting on Congress.

The last thing is we saw a lot of job losses in the United States, both in the Great Recession and in the COVID crisis, a lot more than many other countries saw. And so to try to create a bit of a wedge between what's happening in the economy and its impact on the labor market, one way of doing that is with more pro-rated unemployment insurance, part-time unemployment insurance that compensates people who aren't fully laid off. I think that question, though, I don't fully know the answer to how to have a more European like labor recovery with less of the unemployment along the way. So, hopefully by the time I'm invited to that hearing, David, I'll have a better answer than I have right now.

WESSEL: I just want to back up on two things you said. One is when you said about formulas, what you mean is that Congress should write into law some things that automatically trigger benefits when the economy is bad and then they trigger off when the

economy gets better. We don't have to wait for them to have a meeting and a conference and an argument. That's basically what you're talking about there, right?

FURMAN: Yeah, exactly right. And the two biggest candidates for that are unemployment insurance—where it should be more generous when it's harder to find a job and it should be less generous when it's easier to find a job—and assistance for states, which I prefer to do through the Medicaid system, but there's a lot of other ways to do it because states balance their budgets, and you don't want them cutting back in a recession.

WESSEL: And then you referred to the European approach. So, this is a bit of an oversimplification. But basically some European countries essentially paid employers to keep their workers on the payroll, even if they weren't working, and we did the opposite. We said, you can get laid off and we'll replace your lost wages. And so is what you're saying is that we need to think about how to fine tune our benefits a little better, so we don't end up with so many people who get detached from the labor market as we see now and simply don't come back to work?

FURMAN: Exactly. And just to be clear, we should be thinking really hard about it. I wish I knew the exact answer. Some of this may be specific to European institutional structures. They have labor unions that bargain. Some of it may be this particular type of recession, which is very different from other types of recessions. But the issue is big and important enough that—I hate to have the conclusion be more research is needed—on a lot of the recovery, we know the right lesson already, we could go off tomorrow and implement it. This may be one of the areas where more research is indeed needed.

WESSEL: Thanks, Wendy, what would you add to Jason's list of things that we should bear in mind when the next recession comes, which may unfortunately become sooner than we thought when we started this project?

EDELBERG: So, one thing I'll say is that listeners might be thinking, but didn't the Paycheck Protection Program do exactly what you, David and Jason, have been talking about in that it paid firms to keep to keep their employees on payrolls? And the Paycheck Protection Program was something that was stood up very quickly in the fog of war, and it was not well targeted to firms that really needed the money. And it was rather short lived in terms of how long it kept workers on payrolls to the degree that it actually did have any effect on employment.

And I actually think one of the main lessons that I learned in doing this project is all the ways in which even so much as policymakers deserve a ton of credit for the extraordinary policy response in 2020, it could have been better. So if we had better policy infrastructure in place before the COVID-19 recession had hit, we wouldn't have had to stand up a completely unwieldy program like the Paycheck Protection Program. We wouldn't have had to try to fix the unemployment insurance system, which was widely understood to need fixing before the pandemic. We wouldn't have had to fix that and greatly expand it on the fly.

And also one of the reasons why policymakers had to keep coming back to sending out checks or felt like they needed to keep coming back to sending out checks, is because we actually had a very poor sense and in fact still have a poor sense of exactly which households were eligible for what kinds of benefits. Was eligibility wide enough? And for those who were eligible, was that fiscal support coming through things like unemployment insurance

systems or SNAP benefits, nutrition program assistance? Were those other benefits sufficiently large?

And so we sent out checks in a sense as insurance to make sure that households that weren't reached by other programs or that weren't sufficiently reached by other programs to make sure that those households had some level of fiscal support. Policymakers need better data, and they need to make those investments now to be able to better target programs so that we could be a lot more efficient in the next crisis.

WESSEL: Right. Wendy, this project was very ambitious. We have teams of economists working on each part of the response to the COVID-19 pandemic—unemployment insurance, business, state and local government, and so forth. I'm curious what things surprised you the most as we edited these papers and talked to the authors?

EDELBERG: Sure. So, at the risk of all of my insights now seeming utterly obvious as all basic insights to do after the fact, one thing that I did not appreciate before we undertook this work, David, was how interrelated the programs were and the effects of the programs were.

So one of the reasons why the housing market where mortgage holders and even renters did as well as they did—recognizing that some households have felt a lot of pain or still feeling a lot of pain, but in general, people were able to pay their mortgages and able to keep current on their rent in a way that was surprising given the economic downturn—was because of unemployment insurance and it was because of the checks that were sent out in 2020.

And similarly, the business sector did pretty well. This was the only time in a recession that we're looking at modern data where the number of bankruptcies actually fell, the number of business bankruptcies actually fell even in the midst of a contraction in the economy. And that was because we supported the economy in all of these other ways. So if you do enough support through the social insurance system, it means you don't have to do nearly as much to help businesses and to help state and local finances. So, I think one of the reasons why state local finance remained as healthy as they did is because the people who live in those states got help from the federal government.

WESSEL: Jason, you have made clear that you think we did too much in December 2020 and in March 2021. But are there some elements of the response to the pandemic that you think we should really not do again or if we do, then we should radically change them?

FURMAN: Certainly, PPP should not be repeated in anything resembling the form it was done, whether it should have been done in this form at the time we can debate. I don't think anyone, including its architects, think we should repeat it again. Unemployment insurance, I will be really sad if we continue to be limited in our policy to having to do the formula plus a certain fixed dollar amount. Policymakers, because of the computer systems in states, the only options they had was taking your regular benefit and adding a fixed number. They initially did $600, then they did $300. That meant some people got more money than they'd ever gotten working. Other people got a lot less. I really hope that next time we can just pick a percentage, make it 90 percent, make it 80 percent. You can argue, but you should hopefully have a computer system that would let you do that.

WESSEL: You mean 80 percent of their pre-pandemic wage? Yeah?

FURMAN: Yeah, exactly. Just pick a number and do the number.

And then finally, I was an early advocate of the checks. I continue to think that general fiscal support makes sense, and that's one of the cleanest and easiest ways to do it. We did something like it a little bit in 2001, in 2008. I'd have that as part of our arsenal. But to the degree we can get things like unemployment insurance working better, that is a better way to target assistance. And then we can rely a lot less on the checks in the future.

WESSEL: I worry a little bit about the tendency of Washington to overreact to the last crisis. So I think that one reason that we spent so much money this time was because the perception was that the federal government was too tight fisted in the years following the Great Recession. And so, I'm a bit concerned that since we can now say without any doubt that state and local governments got more money from the federal government than they lost due to the pandemic, that next time we'll say, 'Oh, they don't need money.' Or similarly, because business bankruptcies didn't go up this time, we'll say that we don't have to worry about business next time. Do you have any concern, Jason, about that Washington habit of remembering the lesson of the last time, but not having much perspective?

FURMAN: Absolutely. I think it's much more likely that next time we do too little, not too much. And I'll be out there if I think that that's the case and it's happening saying, I think we did too little in the financial crisis. I think we did too much in the COVID crisis. And if I think it's the case, we're doing too little now. That's why it's also important to get this lesson right. If all the people remember is just this generalized sense that too much happened, they might be more nervous than if you can explain sort of here were the numbers, here's what was available at the time. Using that same way of measuring this time, it's not enough, even though last time it was too much. So I'm absolutely worried that next time we'll do too little. I don't think the right response to that is to say everything was perfect this time. I think it's to explain what was not perfect this time so that we can get that right next time.

WESSEL: Well, thank you both. I think that what we've done here is outlined some of the big themes in the *Recession Remedies* book, and in subsequent episodes of this podcast, we're going to examine each of the elements of the pandemic individually: unemployment insurance, aid to business, aid to state and local governments, and so forth. We hope you'll join us for those. And of course, you can read the entire book on the Brookings website, www Brookings Dot Edu Forward Slash Recession Remedies.

So with that, thank you, Wendy, thank you, Jason.

I'm David Wessel, director of the Hutchins Center at Brookings. Recession Remedies is a joint project of the Hutchins Center and the Hamilton Project at Brookings and is a production of the Brookings Podcast Network. Learn more about our other podcasts at Brookings Dot Edu Slash Podcasts and follow us on Twitter at PolicyPodcasts. You can send feedback to us at Podcasts at Brookings Dot Edu.

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