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Recession Remedies Podcast

"How did COVID-19 Economic Impact Payments affect households and the economy?"
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Episode Summary:

The three rounds of Economic Impact Payments during COVID-19 were by far the largest direct stimulus payments made to American households. They were one of the main policy successes of the pandemic response in providing immediate support directly to households. What effect did these checks have on households and the economy? Should the program be replicated in future recessions—or better targeted? Melvin Stephens Jr., professor and chair of economics at the University of Michigan, and Michael Gelman, assistant professor of economics at Claremont McKenna College, join host David Wessel to discuss lessons learned about stimulus checks.

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 federal government provided three rounds of economic impact payments during COVID-19, sometimes called stimulus checks, more than $800 billion in all, by far the largest such attempt to help American households during a recession. Over roughly a year, a family of four with income below $150,000 received $11,400 in stimulus payments. The scope of these payments, the number of people who are [eligible], the speed with which the government delivered them, made this one of the main ways the government quickly got aid to households to protect them against the economic damage that the pandemic threatened to provide.

So, what effect did these checks have on the economy, on households? Who got money, who didn't? And how should we think about a program like this the next time we have a recession, as we surely will? To talk about these issues today, I'm joined by Mel Stephens of the University of Michigan. Mel?

STEPHENS: Nice to be here, David.

WESSEL: And Michael Gelman of Claremont McKenna College.

GELMAN: Thanks for having me.

WESSEL: Mel and Michael wrote a chapter on the economic impact payments and our new Recession Remedies book. You can read their chapter and the rest of the book online at www dot Brookings dot edu slash recession remedies. So let's get right in. Mel, the stimulus payments, a lot of money, what was the thinking of policymakers when they decided to add this to all the other things they did during the COVID pandemic?

STEPHENS: Thanks, David. So, when the stimulus payments, or economic impact payments, were made at the time, if you recall, there's a lot of uncertainty about what was going to happen in the economy. We had lots of businesses transitioning to remote work. We had a lot of government imposed shutdowns. And so, if you were reading the popular press at the time, what we saw is politicians arguing that, well, some people need some form of insurance because we just don't know what's going to happen, but it would be great to get stimulus to these families so they will be able to do something. And that differed a little bit from in the past where the usual thing that we're advocating is we want to go out and have people spend and sort of ramp up the economy in a recession. In this case, you know, a lot of the discussion initially was about insurance for households. So, it differed a little bit in terms of the initial rationale for distributing these EIPs.

WESSEL: I see. And Michael, one thing that struck me from your chapter was just how much technology has changed over the decades so that these payments came very quickly compared to past recessions when the governments did tax rebates or stuff. Talk about that.

GELMAN: Sure, yeah. So, in previous recessions, usually the government sent out checks, so that would take a while. So, it even took a while for them to send out the checks. And obviously then it took a while for the checks to get to households. Now that technology has improved, the first checks went out two weeks after the bill was signed. And then by the end of the pandemic EIP programs, the checks were sent out one day after. So this was a vast improvement in the speed in which the checks were sent out.

WESSEL: Right. And in fact, they weren't always checks. They were deposits made directly to people's bank accounts, right?

GELMAN: Yeah, that's exactly right. So because the IRS has direct deposit information for some individuals who filed their taxes and paid via direct deposit, they were able to utilize that information and get them to them right away.

WESSEL: So, Mel, let's divide this in two parts. As you mentioned, there are two reasons the government would do this. One is to help stimulate the macro economy, to keep the economy going when it has suffered this enormous shock. And the second is to help households so they don't get hurt by this. But let's take the first, first. When the government gives money to people in a recession, it hopes that a lot of them will spend the money and not tuck it away, because only if they spend it will it keep the economy moving. So on that measure, how did economic impact payments do?

STEPHENS: Well, when we think about economic impact payments and on that front, they measure very well what we've seen in the past literature. So, economists like to talk about something known as the marginal propensity to consume, and that is, say, the share of each dollar that a family receives, what fraction of that is being spent? And so, over the past, we've seen our estimates of the marginal propensity to consume be somewhere between 30% to 50%. That is, for every hundred dollars that a family receives, they spend somewhere between $30 and $50.

If you look at across a number of studies, as we did in our review of the literature, for the first round of the EIPs, we saw numbers that were pretty much in line with what we've seen in the past. One notable difference is in the past literature a lot of times we had only been able to look at monthly spending or even quarterly spending of households, whereas this time around we're actually able to look at daily information because a lot of transaction level data that's available. And so we're seeing that a lot of this response of the 30 to 50% is actually occurring not in the first month or first quarter, but actually within the first week. We're starting to see households building and ramping up their spending. And so in that regard, things look very similar to what we have seen in the past, although there certainly were some differences depending on which study that you drill down into the terms of what they were finding.

WESSEL: And what about by income level? How did lower income people respond to the getting this government money compared to upper income people?

STEPHENS: So, on that front, just very briefly, when you think about sort of standard economic theory, the puzzling thing actually is, is that if somebody just drops a lot of money on you, you think to yourself, oh, I get this money one time, I better not spend it all right now because I may not have it in the future. That may not seem like the rational wisdom to everybody, but it sure is to economists.

But consistent with that, the more well-off families tend to spend a lot less out of their payments that they're receiving relative to the lower income families. And indeed, that's part of the rationale is that since the government wants to induce spending, why we have these income thresholds or cutoffs, that the dollars are not necessarily going to the highest income families because they do have lower MPCs.

And so, in this recession we did see once again somewhat higher MPCs out of the lower income families relative to the higher income families. And some of that, of course, is they just have less savings to offer themselves in a shock. Right? And so they're unable to draw on the savings to help increase their spending, whereas higher income families tend to have more savings and therefore tend to have lower MPCs, to use the economists' lingo.

WESSEL: Right. So, Michael, we gave unemployed people a lot of money in unemployment insurance benefits. We gave state and local governments a lot of money to beef up their safety nets or whatever they wanted to do with it. We gave businesses money and told them don't lay off people. Why do we do economic impact payments on top of all that?

GELMAN: Sure. Yeah. So, there might be people who don't fit neatly into some of those categories. So, there could be people who were affected by the pandemic but didn't lose enough money to really maximize the unemployment insurance benefits. Furthermore, depending on what type of business you have that might affect your eligibility with the other programs. So, we found that the EIPs were kind of a nice catchall and they somehow sometimes plug the holes where people didn't receive benefits from these other programs.

Also, we found that, somewhat surprisingly, there was a lower amount of take up for certain programs than at least I had expected. So, for example, with unemployment insurance, it seemed like there are people who are eligible who didn't necessarily apply for them. So, that can be for a myriad of reasons. Maybe the hassle was just too much for the expected benefits. But in these cases, the administrative burden of the EIPs were much lower. And so, those people would still receive these EIPs if they were below the income threshold.

WESSEL: I see. So, it's almost as if we said, some people who need help may not get it through some other avenue, so we're going to do this across-the-board payments to everybody, making sure no one falls through the cracks, even though some people who get the checks, or the stimulus payments, may not actually have needed the money.

GELMAN: I think I think that's fair.

WESSEL: Mel, what do we know about who did fall through the cracks, who didn't get economic impact payments, who deserved them, or who were excluded by some of the ways they were distributed or the rules that surrounded them?

STEPHENS: So, when the payments were distributed, if you had reason to give the IRS your account information when you filed your taxes early in 2020, so then it turned out that this information [was] on hand, like if you were due a big refund or an earned income tax credit payment or for some other reason they had your account information, it was very easy for them to distribute money to you right away. Right? And so those individuals received money right away.

Also, other individuals who received money right away were people who were recipients of federal government benefits, such as Social Security, Supplemental Security Income, Railroad Retirement benefits, and VA pensions. So, they all, really all they had to do was just be there and suddenly the money would show up in their account.

But it turned out that many other people actually who did not have reason to give the IRS to know this information did not receive a benefit right away. Now, of course, you can apply for these benefits. And for them, benefits were distributed in a way such as by electronic benefit transfer cards that were subsequently mailed out to households. But it turned out that there was a GAO report even in September, saying that they were estimating that there were 9 million individuals who had still not yet received their EIP, although they were eligible. And of course, the benefits had been started being distributed in April. So that was five months later and they still had not received payments.

It turns out that among those households, studies have found that a large number of those individuals were not required to pay taxes or they didn't file federal taxes. And about three-quarters of them received either Medicaid or received SNAP—Supplemental Nutrition Assistance Plan. And so they were seen and known by the government, but they weren't getting the payments directly as sort of their brethren who were receiving things directly from the federal government, because the ways that these programs are run differently. So, a lot of those households that were, again, relatively low income and again getting assistance because of their low income status, but yet they were not going to the EIPs right away.

WESSEL: Mel, so, when the government gave these economic impact payments to households, did they have to pay income tax on them?

STEPHENS: No, they do not. They just received the full benefit amount and they were not subject to any sort of taxes.

WESSEL: I see. So, unfortunately, we're certain to have another recession, might come sooner than we thought when we began this project. If members of Congress or some economists at the White House called you up and said, Hey, guys, you did a lot of thinking about economic impact payments, should we do them again? And if so, how should we do it differently? I'm interested in what each of you would say to that. Why don't you start, Mel?

STEPHENS: I think it's an area we're still learning about, right? And it would be great to learn an awful lot about this. And I say that because I think on the one hand, thinking about the insurance role, as Michael had mentioned earlier, the payments were able to fill these holes. For example, when the UI benefits systems were crashing from state to state, the benefits were able to sustain families in the very short term. Right?

But in terms of exactly who fell through the cracks and who did not, right, that's still something that we don't know. I think we're quite hopeful that through the use of big data, various sources that are available, we can now start answering these questions. And with this round of EIPs, researchers have been able to start to answer and do a better job of getting at longstanding questions of how well did the EIPs actually affect households and how they interact with different benefits and different benefit programs.

One of the challenges, of course, is as part of this book, we're learning about so many different programs are out there and so many different expansions, it's hard to isolate just how the EIPs worked. But I think, again, if we're getting back to this question about at the very beginning, were households are able to benefit, we go back to the studies that were finding pretty substantial what, again, we called the MPCs, marginal propensity to consume, out of the benefits early on. So I think the short answer to me is yes, it's great to help fend off a recession, but exactly how it interacts with all the other benefit programs is something we don't quite know well yet.

WESSEL: And Michael, how would you advise?

GELMAN: I would agree with that. I would say the EIPs are a good program. There are sort of two main ways to look at it the EIPs—so either stimulus or insurance. If you're thinking about these things as insurance, then it would be ideal if we can target individuals who lost income. So, that's kind of a tricky subject because there's this idea of moral hazard where people might anticipate that and it would affect their behavior negatively. So they might go out and make risky bets. But ideally, if you can identify people who lost income, you would want to give those people the benefits versus people who didn't really have any income shocks.

Now, if the goal is to stimulate the economy, then you want to focus on people who have the highest MPCs. Those tend to be lower income individuals. So, once again, if you could then target people based off their liquidity levels, that would be ideal. But that also raises this issue of moral hazard, because then people would know when there's a recession, they should just spend money in their bank account.

WESSEL: Now, I know your chapter focuses, as we asked you to, on the economic impact payments themselves. But of course, the EIPs were a part of a very big fiscal package. And as you probably know, there is a lot of talk that maybe we did too much and that's why we have an inflation problem now. In particular, there are people who wonder whether sending out 1,400 dollars for every adult and another 1,400 dollars for every child in March of 2021 was really a good idea, especially with the benefit of hindsight. I'm curious whether either of you have a view on that?

STEPHENS: I don't have a strong opinion on that. One other thing I was going to follow up to the last question was, one of the things we did not do was to, it wasn't our charge, to think about well, what did it mean to have the multiple rounds of EIPs, one on top of the other? And how did that have both short-term and long-term impacts on the economy? We certainly have seen from data from JPMorgan Chase Institute that there were certainly substantial amount of savings, especially among the highest income households, but because of the EIP. And it appears as if, of course, that was sustaining a lot of income or savings at the household level. And so there's certainly a lot of potential to be concerned about what people might call pent up demand, right. People have a lot of income, et cetera, and they might start spending it. And what are the implications or consequences of that? So, we did not delve deep into that. So, maybe …

WESSEL: … okay …

STEPHENS: … strategically avoiding, but we don't I don't have a great answer for that. I do think that that is an important question certainly to address, though.

WESSEL: So, Michael, you pointed out that there are some upsides and downsides to having people expect to get a check. As you say, there's the insurance idea, which is we want to make sure people have money so they don't suffer if there's a calamity like a pandemic. And then there's the macroeconomic stimulus aspect, which is if we want to keep the economy going when private demand goes down, the government steps in and gives people money so they spend.

So, some people think that it's a mistake to count on Congress to react swiftly and wisely in every economic downturn. And they think that we ought to make this part of the economic stabilizer system. That is, when we have a downturn in the economy, some defined somehow as a big increase in unemployment or two negative quarters of GDP growth or whatever, that automatically the government would deposit money in the accounts of people below some income threshold. What do you think are the pros and cons of doing something like that, Michael?

GELMAN: Yeah, that's an interesting idea. I think the pros and cons would likely come down to targeting. So, I think in that type of program, I'm not sure how you would set the parameters of these important cutoffs. So, for example, when do the benefits start phasing out? I think that would be an important consideration because we did see that there are some people who received the benefits that didn't necessarily have much income loss and that also might not have a high MPC. So, it might not really be helpful in that context.

From what I've seen in most past recessions, there has been sort of broad political support to pass these packages quickly. So, I'm not sure if it's completely necessary, but it does seem like it might alleviate some concerns for people who are worried about a downturn. But yeah, that's a very interesting idea.

WESSEL: What do you think, Mel, would you make this part of the automatic response to a downturn?

STEPHENS: To me, one of the biggest questions here is on the on the firm side. Right? So, we focused on questions such as, with the MPC how much spending do we see in households? I think the other thing about automatic stabilizers, if we're really thinking about these as a way to stimulate the economy, in a way we want to ask how many businesses stayed open or how many jobs remain employed because of the fact that these EIPs were out there. And that's not something that we've really focused in on here. So, it's a little hard to understand that question.

But I do think it's a very interesting question, right, because part of it is, again, protecting families. Part of it is providing insurance. But then the other part of it is, you're injecting lots of cash in the economy and you're keeping demand from shifting way far in and having a vicious cycle of more unemployment. Right? And we didn't really look into that. So, asking the question of how bad would unemployment have been had it not been for the EIPs I think is a fascinating question, but not something we've addressed here, but certainly something I think we'd really want an answer to precisely for understanding and considering policies such as these.

WESSEL: Right. Well, I think it's pretty clear that unemployment would have been worse without the EIPs. What you're saying is how much worse we really don't know. And it's hard to separate out this from all the other things we did, which is certainly the case.

STEPHENS: That right. I certainly wasn't saying they did not have an impact on unemployment. Again, I think the question is always going to come down to what is the magnitude, right. And so I think an automatic stabilizer like what would the cost be if we waited a week or two weeks to implement the policy rather than, say, have it happen automatically. And a week or two with getting things on to a bill and through Congress, you know, that could take a little bit of time. And so that's where I understand people are quite worried about this, and that's why you may want to have it. But it's just understanding how big the impact is on unemployment or other measures of economic activity I think is something that would be a useful input for policymaking purposes.

WESSEL: Absolutely. Well, I think that the advantage of this whole project is that we've taken the available evidence and summed it all up in quite digestible chapters. But as you're suggesting, Mel, we know this is an early analysis of something that as we get more data and we see how the pandemic ends and what happens to inflation, we'll be able to draw much firmer conclusions. But the premise of the project is that the recession may arrive next time before we have those answers. So, I think you've helped provide a really good first cut that policymakers will find quite useful, because I'm sure that there will be consideration of another round of economic impact payments when the next recession arrives.

So, with that I want to thank Michael Gelman and Mel Stephens for their work on this chapter and participating in this podcast. And you can read their chapter and a one page summary of it and all of the findings of our book at www dot Brookings dot edu slash recession remedies.

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