THE BROOKINGS PODCAST ON ECONOMIC ACTIVITY

"How did pandemic payments affect the US economy?"

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Episode Summary:

The COVID-19 Economic Impact Payments were not the first time the federal government has provided fiscal support to Americans during a crisis, but they did have a different purpose. The goal wasn't to stimulate the economy but rather to offer "pandemic insurance"—money to pay bills and buy food for people who may have lost income due to the pandemic. In the latest episode of the Brookings Podcast on Economic Activity, Hamilton Project Director Wendy Edelberg and MIT finance professor Jonathan A. Parker discuss Parker's recent BPEA study on how those payments were spent (or not spent) and the on-going impact on the economy.

[music]

EBERLY: I'm Jan Eberly, James R and Helen Russell Professor of Finance at Northwestern University.

STOCK: And I'm Jim Stock, Harold Hitchings Burbank Professor of Political Economy at Harvard.

EBERLY: We are the coeditors of the *Brookings Papers on Economic Activity*, a semiannual academic conference and journal that pairs rigorous research with real time policy analysis to address the most urgent economic challenges of the day. This is the Brookings Podcast on Economic Activity. In this episode, we're presenting a conversation between Wendy Edelberg, director of The Hamilton Project at Brookings, and Jonathan Parker, a professor of finance at the MIT Sloan School of Management. Jonathan is one of the authors of a new paper on the economic impact payments and household spending during the pandemic.

STOCK: During past recessions, the U.S. government has dispersed money directly to individuals to various support plans. This happened three times during the COVID recession. From a macroeconomic perspective, a key question is how much of those checks was actually spent because that spending would provide stimulus to the rest of the economy.

EBERLY: But the COVID recession was very different than previous recessions because so much of the economy was closed and people were not able to consume as they had previously. So, what do you think, Jim? How much of the economic impact payments were spent this time?

STOCK: Well, rather than speculate, let's find out from the folks who actually looked at the data. Here's Wendy's conversation with Jonathan Parker.

EDELBERG: Well, thank you, Jan and Jim. I am Wendy Edelberg, director of The Hamilton Project at Brookings, and I am speaking today with Jonathan Parker, who is a professor of finance at MIT Sloan School of Management. And I'm talking to him about his recent BPEA paper, which I learned a lot from and really enjoyed. It's titled "Economic Impact Payments and Household Spending During the Pandemic." And thank you for joining the podcast today, Jonathan.

PARKER: Thank you. It's very nice to be here, Wendy.

EDELBERG: So, I have a bunch of questions for you. Let's start with the highest level question. So, I'm guessing almost all Americans are likely aware that there were economic impact payments, sometimes called rebate checks. Far more unfortunately, sometimes called "stimmies." So they were provided by the government in 2020 and in 2021. But people may have lost track of the particulars because there was a lot of fiscal support and it came in different waves. So can you recap the three rounds of payments, how big they were, who received them? All that high level good stuff.

PARKER [00:02:51] Sure. So, let's start with the first wave of economic impact payments. So, if we remember what happened at the end of March 2020, the federal government declared a national emergency and shut down a lot of business in the United States. That was already of course, people were already reluctant to go to work. I know my university had already set students home early for spring break. But the government acted and then the government wanted to provide people with relief payments so that if they weren't working, if they weren't getting paid, that they would be able to continue for a potentially a shutdown or dramatic reduction in economic activity that was of an uncertain length and duration.

So, the first round of stimulus payments went out in April of 2020, very rapidly after the onset of the pandemic and the declaration of a national emergency. And these were quite broadly distributed to all but the top income households based on previously reported income and previous tax returns to the federal government. So, the IRS was in charge of making sure people got their money and in figuring out how much. And the amounts were a thousand two hundred per person or twenty-four hundred dollars per taxpayer, tax filer, excuse me. So, a $2,400 for a couple filing jointly and then an additional $500 per child eligible for the child tax credit. So, a family of four, traditional family of four with a married couple and two kids, would receive $3,400 as a payment. And those went out primarily in April of 2020.

And then with the pandemic lingering right around the end of 2020, a second round of payments were disbursed that were slightly smaller in scope and similarly targeted, which was all excluding high income households, but otherwise going out quite universally. And those were about, for a family of four, $2,400, so slightly smaller, about $1,000 less. And then in March of 2021, a final round of payments went out. The income cutoffs were a little lower, so they didn't go quite as high up the income distribution, but they were much larger payments. So, a family of four was receiving $5,600 check from the government.

The thing I just want to emphasize here is that none of this was additional ... there was no additional goods or output. In fact, we were in a period where people weren't working. They weren't supposed to work. Ideally, they would stay at home. So, people had replacement money to spend, some people had more money to spend. But we also didn't have a lot of of work or people producing stuff to buy.

EDELBERG: Yeah. So, this wasn't the first time that the government had, you know, used this form of fiscal support. But it did differ in some ways in its purpose in that in previous rounds, in previous recessions, when the government sent out these economic impact payments or whatever they were called in previous rounds, they were largely meant to stimulate the economy. So, we were very keen in previous recessions to think about what we call the marginal propensity to consume out of these payments were, and see if they were getting actually to people who were who were prone to spend very large fractions.

And so this time around they really had a different purpose. But nonetheless it is quite instructive, I think, to look at how the payments were used by households and you guys provide some really fascinating evidence about that. So, can you describe how those spending responses were different this time around than the times such payments were used in earlier recessions?

PARKER: That's great question. Let's give a quick recap of what was done before. So in 2001 and in 2008, at the time of each of these programs, the economy was entering what appeared to be, at those times, reasonably mild recessions. And in 2001, the government set out either 300 or 600 dollars to taxpayers who were married, filing jointly, $300 to individuals. And they were called stimulus rebates. They were explicitly tax rebates, and they were actually prepayments of a longer-term tax cut that the government had passed.

In ‘08, this was done before the financial crisis really hit, before Lehman went under and the economy really tanked. And they helped support spending through the summer of 2008.

And so in both of those instances, the government was sending out money saying, look, demand is too low. We have a potential recession. We have people getting laid off. We’re hoping to stimulate the demand side of the economy, not have resources become idle, not have unemployment go up and potentially minimize or even head off a recession.

There was a mild recession and it was viewed as a reasonably successful policy to send out these checks. And so it was re-implemented in ‘08. And it seemed sort of to be working, kind of, except then we had the really the run on the financial sector and the large financial crisis that followed.

So, the technology and the legal infrastructure in some sense was in place to implement something exactly like this, but for, as you say, a different purpose in the pandemic. So, in the pandemic, we have a set of automatic stabilizers that get people money during times of crisis. Say, if they’re laid off, there’s an unemployment insurance system. But the pandemic was unprecedented not only in the way people use the word unprecedented, but just in a phenomenal sudden collapse in employment and people going to work and incomes.

And really the systems like the unemployment insurance system was overwhelmed. It’s a state run program, not a federal program, the states have varying qualities of under-investment in these systems. And they were not running very well.

And so the government said, look, we have this rebate system that we’ve done before pretty effectively and pretty quickly. If anything, the technology should be better now because there’s more direct deposit and less mailing of these artificial ancient things called checks. And, and so let’s implement this. Let’s get money out quickly through these systems that we understand and can do.

And so the idea was not to stimulate the economy. In fact, if anything, the government wanted people staying at home, not working, not spreading the disease, at least if outside of the critical workers and the people providing the necessities that we would need. But they also wanted people not to be starving.

And so, given the cracks in the social safety nets that had emerged, the unexpected and severe nature of the pandemic, they said, let’s just roll out this program. It’s fast. It gets money out there quickly. And so the goal was a pandemic insurance to make sure that people who were falling through the otherwise the cracks would not be able to eat or pay their bills, etc., could. So, that was the purpose.

EDELBERG: So, Jonathan, before you get too to what you actually saw in terms of the spending response, let’s pause on this question about speed, because the speed was stunning.

PARKER: The speed was very stunning. So, in the first week, so the national emergency declared, I think March 28th. The middle of April, in one week in the middle of April, more than half the checks—excuse me, payments, they were not checks, most of them were direct deposited into people’s accounts—so, within three or four weeks, the majority of the recipients, bare majority of the recipients, had their payments. And by the end of April, something like two thirds did, and by the end of May, maybe 80 or 90%.

And then, of course, there's a few eligible folks whose records aren't complete or who haven't given the IRS the necessary information or have to file their taxes for 2020 before they'll receive their payments. And some people, they didn't even do it until—so, they got their payments, part of their refunds. But that's a very small minority of the payments. Really, a hundred million payments went out within a month or two of, within six weeks of the legislation.

EDELBERG: All right. So, now let's talk about the spending response in the three rounds.

PARKER: Sure. So, our question really was, let's see as a first indicator whether households, when they receive their checks, are turning around and just using them to pay off bills, to spend money, to keep themselves afloat. So, if we're really stressed, when you get this payment, if financially stressed, when you get this payment, they're going to turn around and spend it rapidly. That would suggest that it's filled what we call an urgent pandemic economic need. And so, we look and see on average, how much did people, when they got these payments are like, thank goodness it's arrived. And we've look at the three rounds, although our evidence, I think, is most clean and clear for the first round.

And what we find is not a very large spending response on average. So, I want to emphasize the "on average" and I'll loop back to that. So, for the typical person, within a couple of months or a month and a half of receipt, they may have spent 10 or 12% of the money that the government sent them, which does not suggest it's filling an urgent pandemic need for the average person.

Now, let's just let's just stop for a minute. Why potentially is that? Well, possibly it's because the government wasn't trying to target people who are unemployed. The unemployment system, insurance system is there but was overwhelmed. They were actually trying to find people who would be otherwise hard to help through other programs. And so they distributed it deliberately widely. And so that meant, for example, that they sent a whole lot of checks to retired folks or people who are not working or had other sources of income or and therefore didn't even lose income, but received this bonus check in the mail.

Now, retired people obviously were under enormous amount of duress during the pandemic. So, I don't want to belittle the pandemic, the health effects of the pandemic and the dangers of the pandemic. From an economic purpose, they were not people who necessarily would turn around and spend. If anything, their incomes were the same and their ability to spend money was much reduced. And so this was not a time when they were short on funds. So, a lot of people got the check who didn't really need the check. That's the conclusion of the first part.

However, in the second part of the paper we zero in and try and look for households who in particular would have needed that pandemic insurance. And when we narrow the sample that we look at of households to those types of people, we find much higher rates of spending on arrival. So, for example, if we look at people who were previously earning income, they had labor income coming in from their work effort, and that income is rated based on its occupation as unlikely to be done from home—so, these are people who are probably unable to work from home—if you look at those people when they got their checks, they spent them much more rapidly on arrival, suggesting that they were financially stressed in early stages of the pandemic and really valued these economic impact payments coming around in the first round.

EDELBERG: So, you talked about how your evidence for the first round is better than your evidence for the for the following two rounds and you find, you know, notably smaller responses in the following two rounds. How do you want us to interpret those?

PARKER: So, let me … one sentence on why we're a little bit less confident in those estimates, which I think might be important for the listener, which is that we're using survey evidence from a nationally representative survey on consumption spending that's actually collected by the Bureau of Labor Statistics as part of their building the Consumer Price Index, because they need to know the baskets of goods that typically people consume. On that survey, they collect some income information and they added questions. We worked with them on adding questions about "Did you receive an economic impact payment?"

The first round those questions seem to work wonderfully. By the second and third round, we have a lower response rate of people saying, "Yes, I got an economic impact payment" than the federal government data on the disbursement suggests should be. So, we're missing some recipients. And that means that when we look and see what happens when someone gets a check relative to someone—or payment, excuse me—relative to someone who doesn't get a payment, there's a possibility that that person who doesn't get a payment is actually getting a payment. So, the difference is mitigated.

Now, we've done a couple of different attempts to try and get around that. I won't go into that. Particularly we're imputing economic impact payments in the latest version of the paper that will be published. And still find lower spending responses in round two and three. And so one might think a little bit about why that might be, even though our evidence is not airtight. But it would be consistent with the idea that, for example, in December of 2020, in January of 2021, people have been holding back on spending. A lot of people have been holding back on spending for months and months, whereas some people have had real economic losses, but others have been unemployed, received unemployment insurance that in many states was more generous than the salary they were starting with. Other people would not have been unemployed. Retirees would have just cut back on spending without travel and so on and so forth without necessarily having any decline in pension income.

And so, you're sending people money at a time when there is no real urgent spending lead for the majority of them. Again, there would be some who would really need it. And so by the second and then the third rounds in March of 2021, you kind of think the average person again is even less in need of the payment than they were at the onset of the pandemic a few weeks into it.

They were also much, much bigger in the third round than they were in the first and second. And when you get a larger payment, nearly all models of economic behavior, as well as lots of older evidence, suggests that you just you take longer to spend it.

EDELBERG: So, let's come to that, taking longer to spend it. So, do you have a view on whether or not these economic impact payments—and "checks" is fine as long as we don't call them "stimmies," checks is fine—do you think that the economic impact payments are still affecting consumer spending?

PARKER: So, what seems certain is that the large and healthy balance sheets of the typical American household is still affecting spending. And one of the contributing factors to that, of course, is the stimulus payments. But in our research, we pose no tight direct link there. There's lots of factors that affect household spending. And one of them is going to be the amount of liquid wealth that people have in their accounts and short-term savings to support consumption. So, that is certainly a factor affecting the balance at the aggregate level between supply and demand factors.

EDELBERG: But you don't think people still have mental accounts going where this money is burning a hole in their pocket, but, you know, the other money in their checking account feels like savings?

PARKER: For people it can be quite the right thing to do to occasionally step back and optimize their long-term retirement savings and divide the money they have into the stuff that's available for short-term spending and stuff that should be put away and contributed to retirement plans and mortgages and so on and so forth. Or saved for a house, whatever the purposes, longer-term purposes are. And so to that extent, yes, it's quite possible that that money has dropped into the short-term spending account.

But the longer you go, the more people occasionally sit down and, you know, spend that painful weekend day or that annoying evening trying to make a longer-term financial plan. And at that point, the boundaries are temporarily erased and people do re-optimize and decide whether to maybe send some of that checking account money into a longer-term saving vehicle or moving it to a savings account or a mutual fund.

There is some argument that some of this stimulus payment money ended up contributing to some of the meme stock craziness that that occurred during the pandemic where lots of retail investors piled into a somewhat, from a finance professor perspective, crazy, I'll use the technical term crazy, investments that didn't seem to at any point be likely to pay out dividends in proportion to the value that they were being assessed at. But at the same time, casinos were closed.

EDELBERG: I think you're disparaging my purchase of an NFT of like a little dog hopping, you know.

PARKER: Oh dear, oh dear. Yeah.

EDELBERG: So, let's talk about what they were spending the money on. So it was really different this time around. And reading your paper, it created a challenge in comparing the spending response this time to what we saw in 2001 and 2008. Talk about the composition of spending. It was really quite extraordinary.

PARKER: Well, it was tilted. So, in the first round, it appears to be tilted a fair bit more towards durable goods and obviously not very much on services, which it is—our survey is not great at measuring in some ways, but the durables part was quite noticeable. So, there was a durables component which people were spending on. Of course, in the aggregate data we saw durable goods spending grow dramatically and services spending collapse dramatically during the pandemic. And some of the stories of this were people are buying running machines and replacing services that used to be done for them or they would go places to get like going to a gym with home exercise equipment or the like, and so more cooking at home, et cetera.

EDELBERG: And computer equipment, right? So that we could work ...

PARKER: ... computer equipment, for example. And that's actually—the computer equipment is actually a little bit fuzzy because we're going to call that in places consumption spending. But it might be better thought of as not very durable business fixed investment. So, I did buy the actually the desk chair and desk I'm sitting at right now in my basement with a big green screen behind me for remote teaching during the pandemic. And I was reimbursed by work. So, it wasn't consumption ... actually, not for the chair. They wouldn't reimburse the desk chair. So, that's consumption, I guess. But it really was about my work, you know, being able to work from home, not really about my standard of living.

EDELBERG: So, let's pivot towards the future and talk about what lessons your results have for future policy. And I should say I'm partly asking this question because of a recent book that The Hamilton Project, which I direct, and the Hutchins Center also here at Brookings, put out describing what kind of lessons we should draw from the many policies that were put in place over 2020 and 2021. So, just a shout out to that book. It's called *Recession Remedies*. I'm super proud of it.

So, there's so much here to think about just with the economic impact payments, to think about what lessons there are for future policymakers. There's the speed with which the government was able to get payments out relative to other kinds of help. And I think we got better at that even over time with the with the turnarounds. There's the relationship between the economic impact payments and other kinds of fiscal support that are in place. So, the fact that people were getting these economic impact payments, even when they were getting maybe extraordinary UI and other kinds of help. There's the role of targeting to those hurt by a recession. I am depressed how little we really understand about whether or not, you know, the degree to which these economic impact payments really made it to people who were otherwise not reached by other types of support.

And then what the role of targeting households is, who are likely to spend the most out of payments and stimulate the economy? Because in the next recession, if inflation is still high, we may not want to stimulate the economy. So, there's a tons of different places that you could go with that. Choose any or all.

PARKER: I guess let's start with some skepticism about the idea that we're going to take lessons from any pandemic lessons into any future recession. So, hopefully we don't have another massive pandemic. If we do, then all of these lessons will apply to a first order. But there should be at least some caution with applying pandemic recession policy responses to those in a normal recession. So, in a normal recession, we wouldn't be sending out payments as pandemic insurance—please stay home, don't work, consume out of this. It's exactly that we would send out stimulus payments to say go work. Hopefully you'll get other people to go work to supply you those goods and everybody can get back to work. So, those are two quite different sort of versions of the policy.

And for the for the anti-recessionary one, the idea that we're going to target those most in need is not the only purpose of sending out payments. It's also to target those who will spend it efficiently and effectively and quickly so that demand gets back to where it was before so that we don't have idle resources. And it's sort of fine tuning and balancing the growth path of the economy.

Now, of course, the Fed typically manages that, and so fiscal policy hasn't been that involved. And in some sense, the '01 and '08 payments were a switch back to more active fiscal policy because fiscal policy started to be viewed as able to act more nimbly, whereas the Fed can act on the drop of a hat, at least in terms of varying interest rates, whereas fiscal policy is legislative and usually lengthy and argumentative and sometimes doesn't deliver what anyone is particularly happy with because it's a mélange of everybody's preferences.

So, the first point, I guess, is that the pandemic is different and we do want to think a little bit about that difference. So, for example, the unemployment insurance evidence is that there was very little disincentive effects from paying people unemployment insurance in the sense that those who were receiving more and less returned to work at a roughly the same pattern over time. And so that would suggest that that unemployment insurance does not have any disincentive effect on working. But in a normal recession, that might be much less true where people are not working because they can't find a job rather than they're not working because they're afraid of catching the disease. And those are two quite different, different instances.

The second thing is, I think we do learn quite a lot still. So, the book is great and I've read bits of it, so I look forward to looking into it more. So, it is true that we learn a lot about the way the failures in some sense of the systems that we have in place and places that we can do a lot of work to improve targeting, to decrease fraud, and designed programs that are more effective at getting out the money, which means we can send out less money and accomplish the same thing. And that is a really first-order concern because we are a quite indebted society and we are currently observing some of the impacts of very high federal or national debt rates in both the UK and in Japan. And people are getting a little more nervous with interest rates rising about the amount of money that we as a society has borrowed.

EDELBERG: All right. So, I'm going to I'm going to push you just a little further to think about the next recession if we enter it while inflation is still high. Is there a role for checks? Is there a role for economic impact payments?

PARKER: That would be something that would not be ideal because one of the contributors to the next recession is probably higher interest rates because we're trying to bring down the inflation rate. There is a concern that the checks, as we discussed, contributed, were one of the contributing factors to high rates of demand. The best way to get rid of the next recession would be to try and increase the amount of work available to people, somehow get frictions out of the way so that we can produce more. Everything from supply chain issues to the regulatory issues that the Biden administration is currently working on to increase competition among firms to so on and so forth. And so you have a lot of effort going into trying to make us able to produce more and more efficiently.

We do need, I think, to lower inflation, and I would hope we can get there somewhat quickly, because once it becomes entrenched in people's expectations and beliefs and in the economy, it's kind of hard to get rid of. And we've lived through a really a golden age of low inflation during much of my lifetime. And I would hate to go back to a 1970s period where we're stuck with high inflation and no higher growth. So, one of the worries I have is, yeah, if we enter the next recession with high inflation, the recession is kind of designed to slow that inflation and have a low demand level so that we slow inflation, and in fact, checks would go in the opposite direction.

EDELBERG: All right. So, we will leave it there. Thank you very much to Jonathan Parker. I encourage everybody to go to the Brookings website and take a look at his paper. It's got a bunch of great evidence in it. And thank you very much for this conversation. It was a lot of fun.

PARKER: Thank you very much, Wendy. It's a pleasure, as always.

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STOCK: I'm Jim Stock, Harold Hitchings Burbank Professor of Political Economy at Harvard University.

EBERLY: And I'm Jan Eberly, James R. and Helen D. Russell Professor of Finance at Northwestern University. We're the co-editors of the *Brookings Papers on Economic Activity*, and this has been the Brookings Podcast on Economic Activity. Thanks to our colleagues for this great conversation, and be sure to subscribe to hear more discussions with BPEA authors.

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