Using Fiscal Policy to Mitigate the Harms of the Pandemic

What Policies Should We Enact?

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Introduction

As it has already become clear, the pandemic is going to have a powerful impact on the economy and the government is going to have to step in to mitigate the damage. Fiscal policy is going to become a critical tool in that effort, and policy makers need to determine how best to craft new programs to minimize the damage as quickly and as reasonably as possible. Fiscal policy in a pandemic needs to solve three primary problems. First, in order to avoid a downward Keynesian spiral the government needs to step in and replace lost income as quickly and completely as possible. Second, in order to speed up the recovery, the government needs to make sure businesses are still solvent and able to reopen after the pandemic ends. Third, the government needs to offset any collateral damage to other organizations to make sure they can keep serving people effectively during and after the crisis.

Offsetting Lost Income

The first problem can be dealt with most effectively through expanded unemployment insurance. Clearly, the people who lost their jobs are the ones who are losing their income, so a government program designed to distribute money to people who lost their job is going to be the most effective and efficient at doing it. Fortunately, the bureaucracy already exists to process claims and send out checks, but unfortunately it was not designed to handle such an influx of cases that rose so dramatically and so quickly.(1)

This means that unemployment insurance is well suited in some ways to deal with the crisis. Since the aid is targeted only on those individuals who lost their job, you can make the program significantly more generous without becoming overwhelmingly expensive. The problem of course is that unemployment insurance only replaces some of the benefits and covers some of the workers, so it does make sense to expand benefits and extend coverage to make sure fewer people fall through the cracks and more of the lost income gets replaced.(2)

Unfortunately, there have been problems getting unemployment insurance checks to those who need them. Partly, this is a problem of an antiquated system being overwhelmed by new applications and new changes to the program. To help deal with this problem, direct payments to individuals do make sense because some people will be hurting from the loss of their job and income, and have little to no savings to fall back on and need to get some money coming in to pay the bills that cause money to go out. The problem with direct payments is that about 90% of households received a stimulus check but only 15% of people actually lost their jobs.(3) Direct payments have the advantage that they can go out quickly and few people fall through the cracks, but they are not as well targeted so you can only provide modest benefits without becoming unmanageably expensive.

Just to note, giving the payment out equally to each individual makes a lot more sense than cutting payroll taxes, because people who lost their jobs pay no payroll taxes and get no benefit from a payroll tax cut. If the goal is to replace income as quickly and completely as possible, you want to make sure as much of the money goes to people who lost income, and unemployment insurance is the best option in that regard (where 100% of beneficiaries lost their job), followed by equal direct payments to individuals (where less than 20% of beneficiaries lost their jobs), and leaving payroll tax cuts far behind (where 0% of the beneficiaries lost their job).(4)

Keeping Businesses Running

The second big problem that fiscal policy needs to solve is that it needs to keep businesses solvent long enough so they can reopen once the pandemic is over. If businesses temporarily cut back, unemployment goes up dramatically over the short term, but if they reopen quickly after, then all of those people can be hired back, and unemployment could potentially decline as dramatically as it went up. If, however, businesses close down or go bankrupt during the crisis, they will not be able to reopen after it is over, which means all of those employees will be permanently out of a job, and have to find a new source of employment. This will cause unemployment to remain high long after the pandemic is over, and it could take many years to return to previous levels of unemployment. Since we want unemployment to recover as quickly as possible, we want as many of those business to be able to reopen after it is all over too.

That means the government needs to fund large bailouts of both large and small businesses. True, some wealthy corporations did give out a bit too much money to shareholders through stock buybacks during the good times, but this mistake should not be met with the corporate equivalent of the death penalty for failing to prepare for an unexpected crisis over which they had no control. In the 2008 financial crisis, Obama supported big bailouts for the car companies that ended up saving over a million jobs, and similar bailouts might have to take place for airlines, hotels, big retailers, and other negatively impacted industries.(5) The government should make sure to get some equity in return, so they can get some or all of their money back later on, and deter companies who do not need bailouts from taking them.

Small businesses, however, are a different story. The government cannot reasonably take equity in millions of small business around the country in exchange for bailout funds, and simply handing out zero interest loans might not be enough to keep a lot of businesses with very small margins operating during this difficult time. That means grants to small business would likely be necessary, and it also seems reasonable to expect some regulations on those grants to make sure they are effectively distributed and spent. At the same time, however, any restrictions quickly developed will not be able to accommodate the full diversity of all the small businesses affected, so some flexibility will likely be required. (6)

Reducing Collateral Damage

Finally, fiscal policy also needs to deal with all the public and non-profit organizations who might be negatively affected by the crisis. Clearly, state and local governments will need a big bailout, since tax revenues will go down because of the declining economy, while spending on the pandemic and those affected by it will need to go up as well. Leaving state and local governments to fend for themselves, without any significant aid, will force them to cut services dramatically, which in turn will cause the economy to deteriorate even further as well. Remember we want the federal government to run deficits and replace lost income for governments as well as individuals, because states cannot run deficits themselves in order to pay for their services, and reducing state and local government spending can cause the same Keynesian downward spiral that reducing incomes for individuals does. (7)

Other organizations will also need to get funds from the government to help them through the crisis. Hospitals in many states experienced temporary bans on elective procedures that significantly impacted revenue, while also incurring some extra costs to deal with the virus as well. Colleges and universities are experiencing a lot of pressure to reduce tuition as long as instruction is being done remotely, and many incoming freshman are considering taking a gap year if on-campus instruction does not return. In addition, colleges and universities are losing a lot of international students due to the virus, which represents a significant loss in revenue since those students generally pay full price. Other non-profits will need help too, like arts organizations who can no longer bring in any revenue from holding events, and also for social service organizations who might see a greater need for their services. Making sure these organizations can continue to serve people both during and after the crisis is going to be key to maintaining our quality of life, since many of these organization cannot be easily replaced by the private sector.(8)

Conclusion

Fiscal policy then has to be expanded to help deal with all of these three major problems. Individuals who lost their jobs need to have their incomes replaced as quickly and completely as possible, either through expanded unemployment insurance or direct payments. Businesses will need bailouts and grants to make sure they can continue to operate after the crisis ends. State and local governments will need bailouts too, in order to make sure they do not cause economic harm by dramatically cutting back on their own services, while hospitals, colleges, and non-profits all will be facing difficult times during the crisis and will need help of their own.

End Notes

#1 – More than 40 million people filed new claims for unemployment insurance over the course of just 10 weeks, reaching a peak of 6.87 million claims for one week in late March. The previous one week record was 695,000 new claims for unemployment insurance in October of 1982.

#2 – The CARES Act increased benefits for unemployment insurance by $600 a week and extended benefits to independent contractors and the self-employed.

#3 – The Urban-Brookings Tax Policy Center estimates that approximately 9 in 10 households will get some sort of stimulus check. The official unemployment rate was 14.7% in April of 2020.

#4 – Since unemployment insurance only goes to people who lost their jobs, that means 100% of the benefits go to the unemployed. If approximately 90% of households got a stimulus check but only 15% were unemployed then that means at most 17% of the stimulus checks went to the unemployed (0.15/0.90), but is likely somewhat less than this since some people who were out of the labor force (like the elderly and disabled) also got a stimulus check. Since the unemployed pay no payroll taxes none of them will benefit from a payroll tax cut.

#5 – The Center for Automotive Research estimated that Obama's bailout of the auto companies saved 2.6 million jobs in 2009 but that number declined to 1.5 million in 2010. The CARES Act sets aside about $500 billion to bailout large businesses, of which $25 billion was set aside for airlines in particular.

#6 – The CARES act created the Paycheck Protection Program to provide $349 billion in loans to small business that was later expanded to $669 billion in subsequent legislation, and many of those loans are forgiven and turned into grants if the business uses 75% of the funds on payroll expenses.

#7 – The CARES act did provide $150 billion in direct aid to state and local governments to help with any cash flow problems due to a large number of infections.

#8 – The CARES act initially provided $100 billion to hospitals with another $75 billion in funding being added in subsequent legislation. The CARES act did provide $14 billion to help support students attending college and also made some changes to help those with student loans.

References

Sly, James. 2020. "Economic Policy During and After a Pandemic." Unpublished Working Paper, June.