Evaluating the US Policy Response to COVID-19

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A few introductory remarks

- There is a **high level of uncertainty** about the course of the disease *and* its economic implications
  - **Flexibility, adaptability** are essential
  - **“Indexed programs”—**expenditures linked to outcomes, the evolution of the economy—are better than repeatedly going to the trough
- Current programs were designed on the assumption of a short (ten-week) downturn, with a quick V-shaped recovery *if only we provide enough assistance*
  - That assumption is clearly wrong
  - There will need to be much more assistance—imperative that money be as well-**targeted** as possible
  - Form of assistance matters more if the crisis lasts a long time
    - Debt overhang can have perverse incentive effects

Key role of implementability

- That depends on the institutional infrastructure already in place
  - Argentina could get funds out to children in 3 days
  - US does not have that capacity
- Limitations in ability to expand unemployment insurance program rapidly, to get checks out to poor individuals rapidly, to expand Medicaid rapidly should have been paramount in the design of policy—but were not, or at least not sufficiently so
  - Relying on banks as implementing agencies was fundamentally flawed—conflicts of interest, limited capacities
  - Data processing firms may have had greater capacities and few biases

Covid-19 revealed weaknesses in markets, government, and society

- **Crisis revealed multiple market failures** (lack of resilience, short-sightedness, inability to respond quickly), but also **government failures**
  - Government failures linked to long-standing attempt to denigrate the role of collective action, science
  - Restoring confidence in government, trust, will require transparency
- **Crisis also revealed weaknesses in society**—massive inequalities, in income, wealth, health
  - Covid-19 is not an equal opportunity disease
  - Many of frontline workers, most essential, were both lowest paid, most exposed
    - OSHA didn't protect them
    - Employers were too short-sighted, greedy to protect them

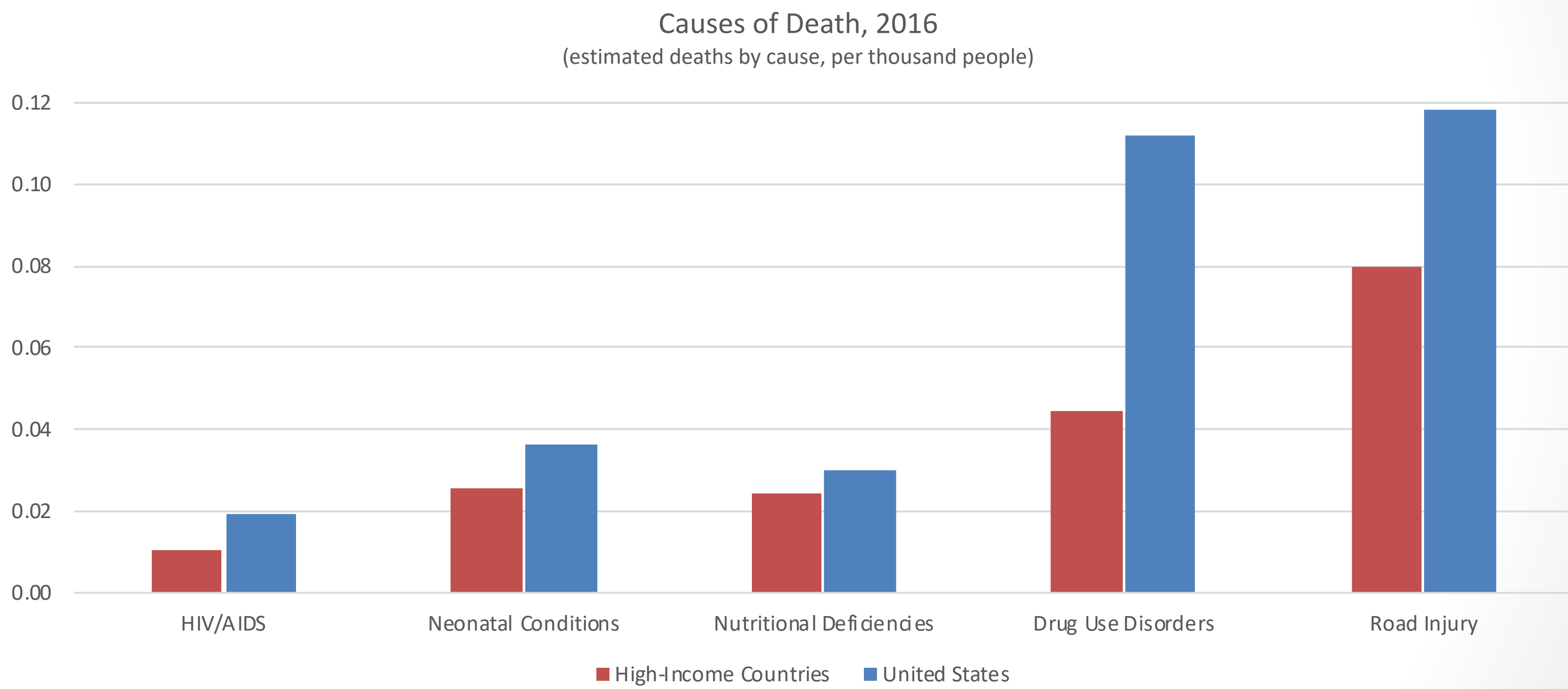
Introductory remarks

- **The decisions about who gets money and on what terms may shape—and distort—the economy for years to come**.
  - In many cases, they are life-and-death decisions for enterprises
  - We didn't have a vision of what kind of economy, society we want to see emerge from the crisis
- Crises and their aftermath tend to be moments of **intense distributive conflict**—we should expect nothing less; and how they are resolved will have profound effects on our society
  - How COVID-19 has played out reflects societal inequalities and the weakening of the role of government over the past 40 years
  - How the COVID-19 programs have been shaped reflects on-going battles
    - Banks, large businesses among the winners
    - Low-income individuals, states, higher-educational institutions among the losers

Background: US was ill-prepared for crisis

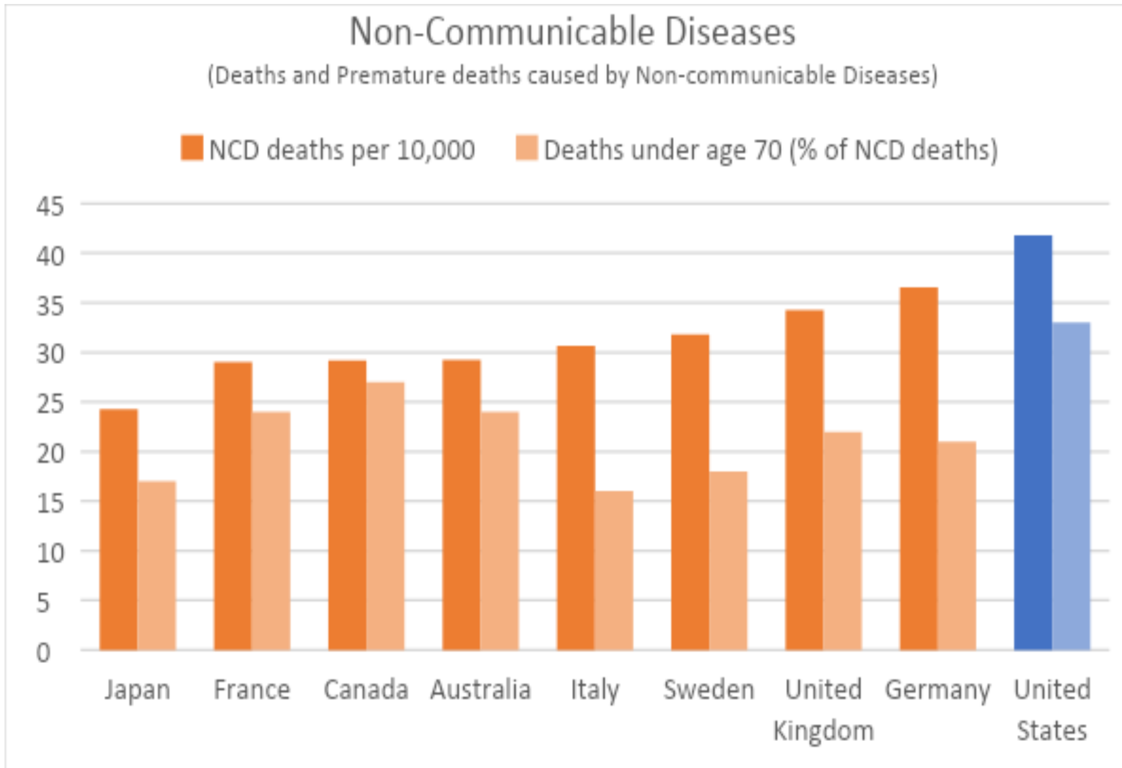
- **Weak health status and weak system of social protection**
  - Low life expectancy
  - High incidence of health problems
  - Low level of health insurance coverage
  - Few hospital beds (relative to population)
- **Related to high level of inequality, absence of public provision of health care**
  - Case and Deaton, *Deaths of Despair*
  - Likely may exacerbate pre-existing inequalities
    - 65% of those in frontline industries (most exposed) are women, 41% people of color
    - Large fractions live paycheck to paycheck, with few reserves
- **Particularly relevant because COVID-19's worst effects are among those suffering from other health conditions**
  - COVID-19 is not an equal opportunity killer
- **Trump administration had cut funding to CDC, not replenished national stockpiles of needed medical supplies, not maintained ventilators, abolished White House NSC Office on Pandemics**

Death Rates by Cause in the US Compared to Other High-Income Countries



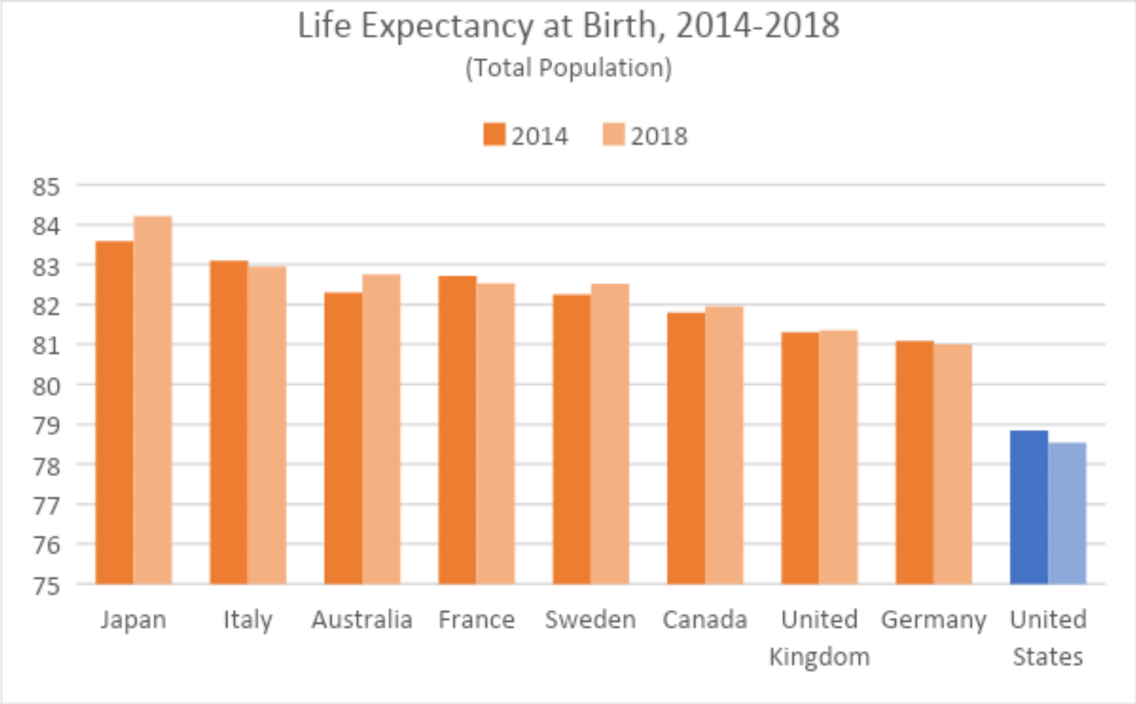
(WHO)

Death Rates from Noncommunicable Diseases in the US Compared to Other Advanced Countries



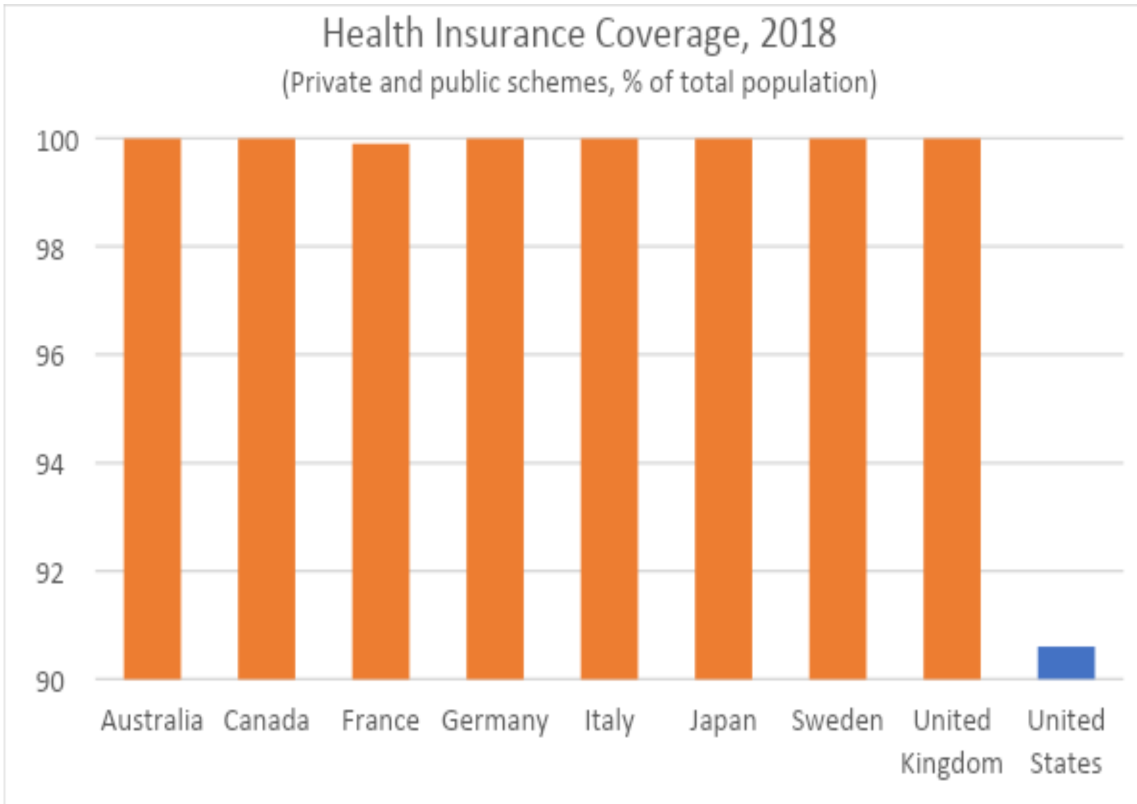
(OECD)

Life Expectancy in the US Is Markedly Lower Than in Other Advanced Countries and Declining



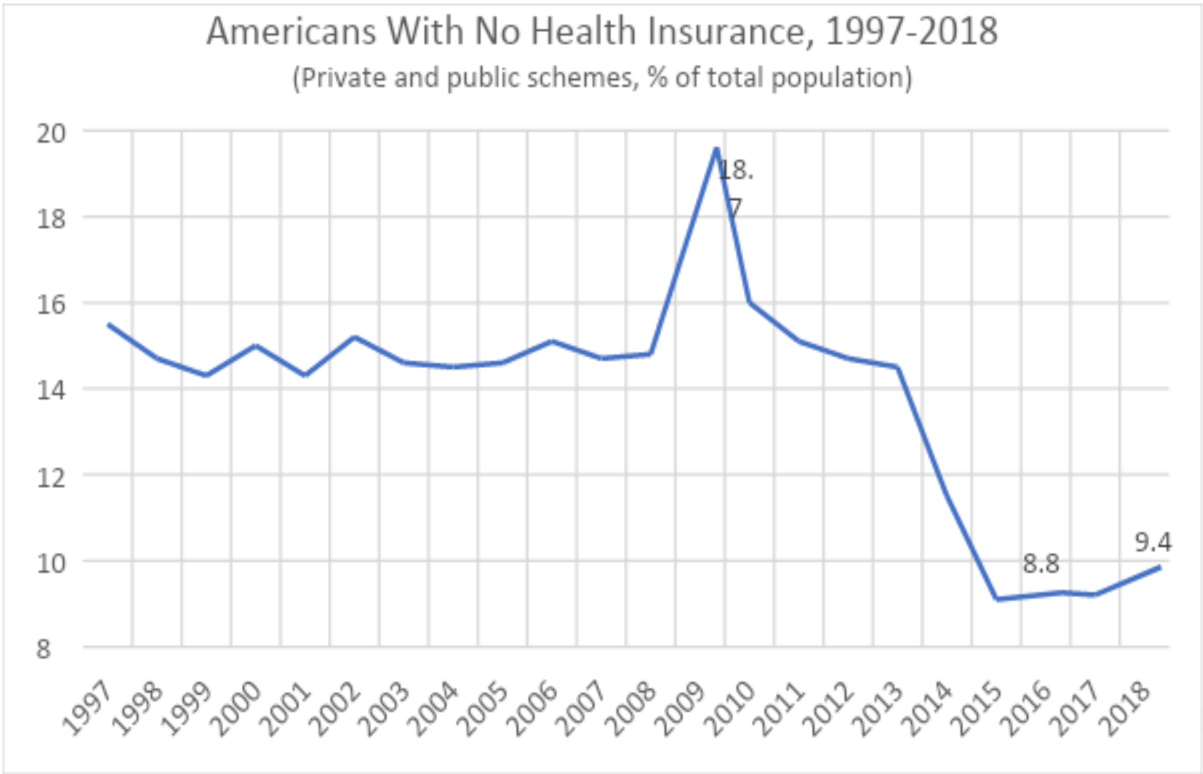
(World Bank)

Health Insurance Coverage in the US Is Lower Than in Other Advanced Countries and Declining



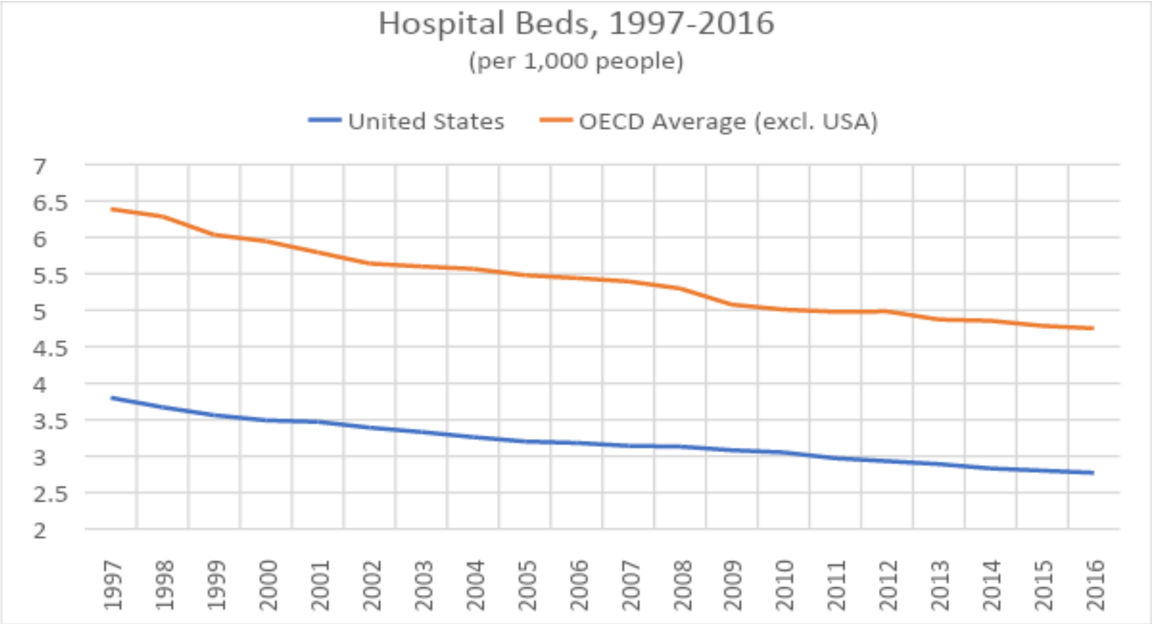
(OECD)

Americans with no health insurance has been increasing



(OECD)

US Has Markedly Fewer Hospital Beds per 1,000 People Than the Average of Advanced Countries



(OECD)

Objective of government programs

1. To maintain health/combat disease
2. To protect the vulnerable
3. To ensure preconditions of a robust recovery
   - No longer thinking about a V-shaped recovery—more a U or W
   - Preventing bankruptcy cascades
   - Protecting balance sheets for recovery

In spite of magnitude of expenditures, it looks like the programs fail on all three counts

Next stage, once pandemic is under control: ensuring robust recovery

- **Unlikely to happen on its own: Will need large fiscal stimulus**

1. Maintaining health

- Don't want those who are sick to go to work
  - US has poorest provision of paid sick leave
  - And especially poor among low-paid workers—only 30% in lowest decile
  - Congress recognized importance—**but then exempted 80%**
- Don't want undocumented workers going to work
  - Administration recognized—but **no commitment not to use information of those seeking health care assistance for later deportation**
- Don't want anyone not seeking treatment out of concern for health care costs
  - **Actions taken inadequate—**waiving of fees if one has disease, but not otherwise
- Don't want frontline workers to be exposed or to expose others
  - **OSHA refuses to impose health standards**
  - **In many areas, unions are strong enough to demand protections**

Underlying Economics

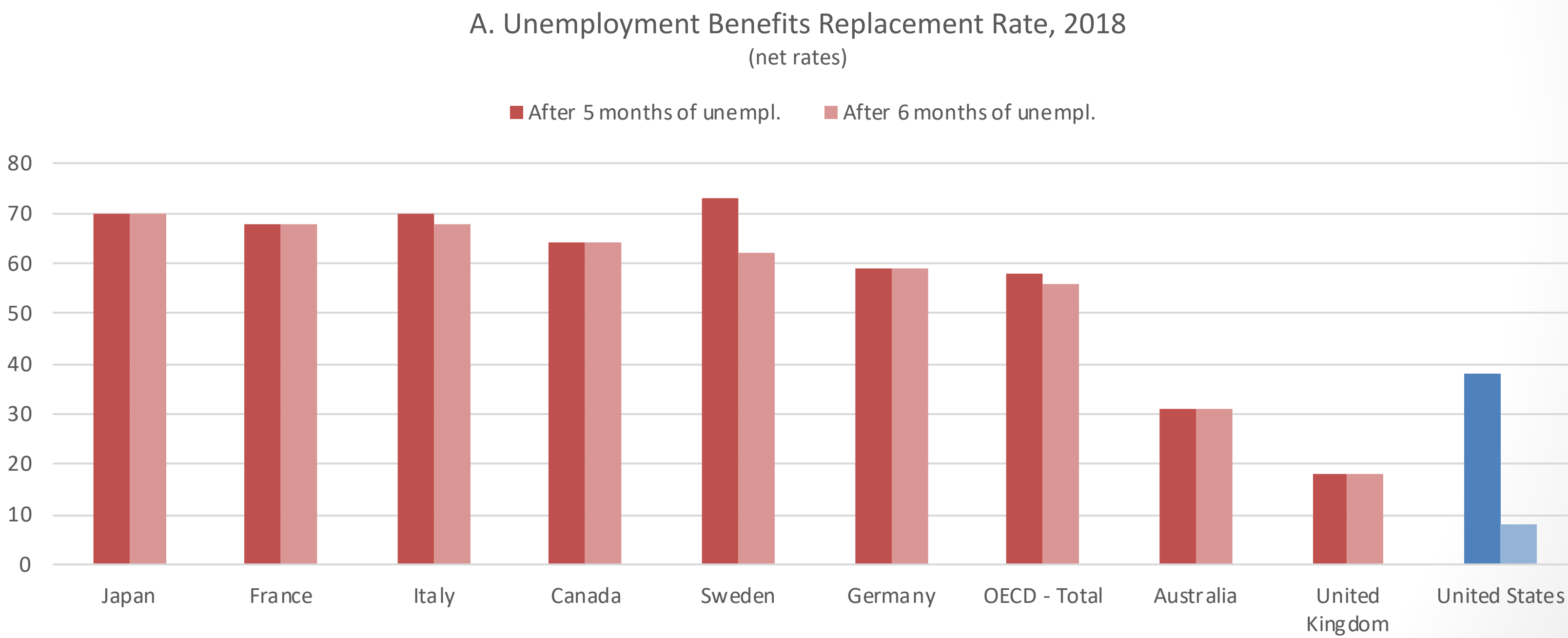
- **Large externalities: individuals' and employers' incentives not aligned with those of society**
  - **Need government intervention**
- **Workers don't have bargaining power**
  - Employers treat them as if they were disposable commodities
- **IPR regime doesn't promote access to medicines, vaccines, other products**
  - IPR regime an impediment to production of critical health care products
    - N-95 masks covered by numerous patents
    - **Administration unwilling to use compulsory licenses**

Stiglitz, Jayadev, and Prabhala "Patents vs. the Pandemic," *Project Syndicate*, April 23, 2020

2. Protecting the vulnerable and maintaining workers' link with workplace

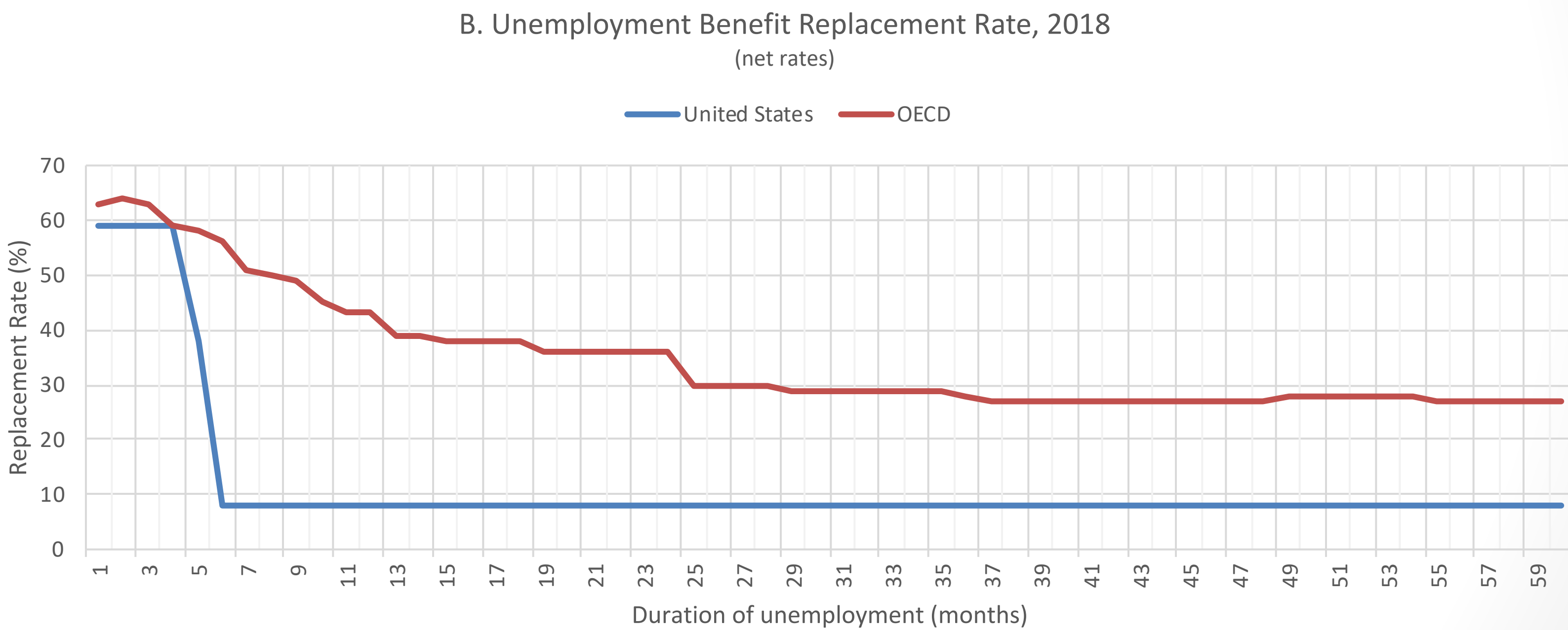
- Again: **US preconditions worst**
  - Poor system of unemployment insurance, both in coverage and replacement rate
- **Most cost-effective way of providing assistance is to maintain link with employer**
  - Avoids costs of rehiring, retraining: facilitates quick restarting of economy
  - Displacements associated with hysteresis effects, lower wages (productivity)
  - Especially important in US where majority depends on employer-provided health care
- **US performance dismal**
  - 33.5 million newly unemployed, unemployment rate, properly measured, somewhere between 20% and 25% +
  - Even before most recent data, highest increase in unemployment rate

US Provides Low Levels of Unemployment Insurance



OECD, Note: Rates refer to a single worker without children earning 67 percent of the average wage. For higher re-unemployment earnings, benefits are lower (for all family types).

Unemployment Benefit Replacement Rate, 2018



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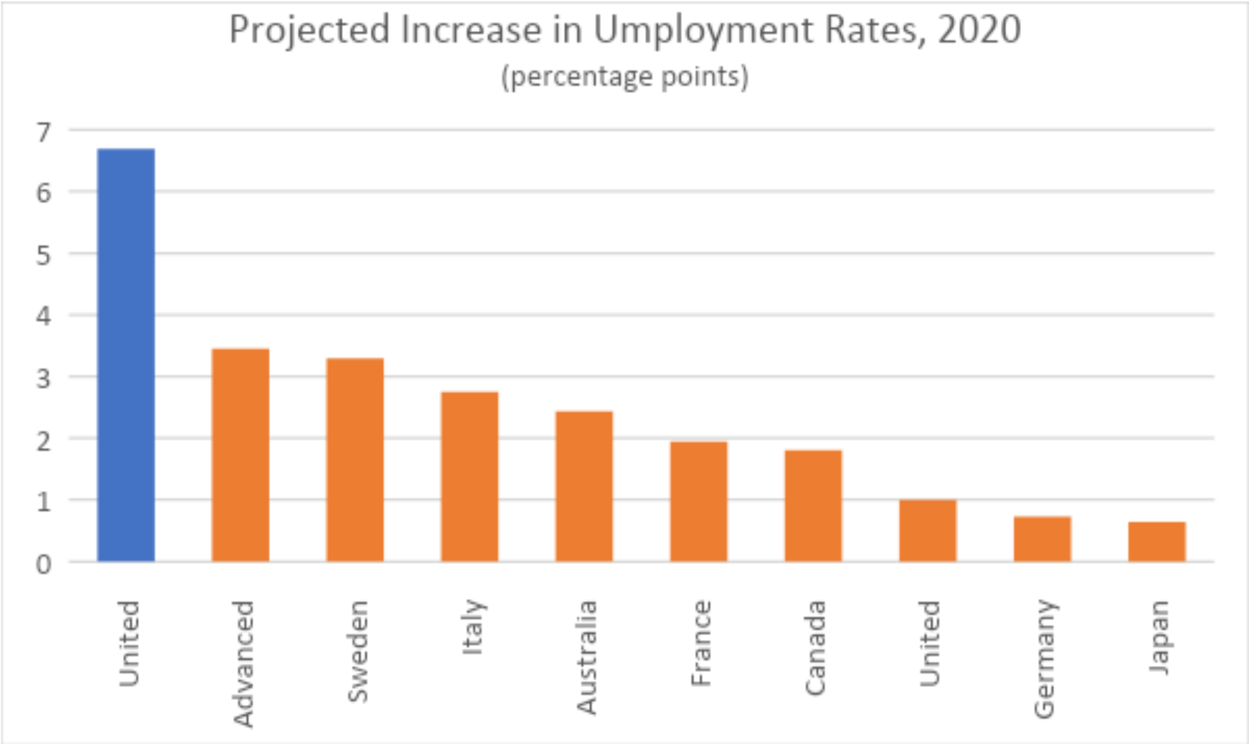

IMF, World Economic Outlook Database

Explaining the failure

- **Programs were not comprehensive, not well-targeted, shaped more by lobbying than economic analysis**
  - Largely left out important sectors of the economy (state and local governments, research institutions, higher education, large NGO's)
- PPP program (for small businesses) was particularly poorly designed
- **High administrative cost**
- With **banks as intermediaries**, money went to the good customers of banks—construction firms, large firms—not the most vulnerable
  - 4% of loans accounted for 43% of dollars; 75% of loans under $150,000 account for only 17% of the funds, .25% of the 1.66 million applicants received more than $5 million each

Further problems with PPP

- **Lack of trust**: provision on loan forgiveness if employer retained workers not credible
  - Many felt that they couldn't retain workers fully
  - Many used money just to build up capital buffers
- Lack of transparency
- **Lack of prioritization**
  - With scarce money, didn't identify where money would be most effective
  - In interdependent economy—firms/sectors most central, taking into account "net" budgetary costs
  - Analogous to question of identifying banks to bail out in partial bail-out—recent models have identified "centrality" metrics

Capponi, Corell, and Stiglitz, "Optimal Bailouts and the Doom Loop with a Financial Network," NBER, April, 2000

Benjamin, Capponi, and Stiglitz, "Bail-ins and Bail-outs: Incentives, Connectivity, and Systemic Stability", NBER Working Paper No. 23747, August 2017, revised September 2018

There were alternatives

- Other countries (Denmark, New Zealand) took alternative tack: giving money directly to employers who maintained employment
  - Similar proposals in US (Rep. Jayapal; Senators Warren, Sanders, Warner, Jones, Blumenthal)
  - **Costs are a fraction**: different variants between $115 B. to $150 B. per month, to cover most costs associated with workers with wages/salaries under $85,000
    - Net costs lower
  - Program comprehensive—doesn't entail banks or SBA picking "winners"
  - Worth doing now: pandemic is going to last longer than June 1.

Though $2.7 trillion or so has been committed, it won't be enough—because it was so badly designed and targeted

- Largely designed on assumption of a short "lock up"—now, length may be much longer than anticipated
  - But already debt/GDP ratio estimated to be 101% by September (CBO), deficit of $3.7 trillion around 18% of GDP.
    - Doesn't include expected default costs on risky loans being made by Fed

3. Establishing pre-conditions for strong and quick recovery: Providing liquidity

Big lacuna: households

- Did some things: stay on government-insured mortgages, student loans
- Not on other mortgages, student loans, credit card debt, car loans, etc.
- Rest of country put on hold: banks continue collecting interest
  - Especially problematic with usurious interest rates, fees, etc
  - Balance sheet effects can be disastrous
- **Already symptoms of problem: failure to pay rent up from 18% a year ago to 31% of tenants**

Three critical risks for the recovery

1. Standard **macro multipliers** could act with a vengeance
2. Avoiding **Debt Spirals**
3. Managing **Supply Chain Problems**

1. Macro multipliers

- What began as a “disease shock” affecting both demand and supply will morph into a more conventional economic downturn
- **Balance sheets** of firms, households, and banks hurt badly
- **Increase in uncertainty**—clearly we’re off equilibrium path, and there is little certainty about the future course of the economy—inducing **precautionary behavior**
  - Both will contribute to significant reductions in aggregate demand, making quick recovery difficult
  - Multipliers in deep downturns are large, and restoration of balance sheets may be slow, in the absence of appropriate government actions

Guzman and Stiglitz, “Towards a Dynamic Disequilibrium Theory with Randomness,” *Oxford Review of Economic Policy,* 2020.

2. Debt Spirals

- Resulting in **financial gridlock, bankruptcy cascades**
- As A doesn't pay B, so B can't pay C, and C can't repay A
- **Systemic bankruptcy** arose in East Asia crisis (70% of Indonesian firms were in bankruptcy or severe arrears; more than 50% of Korean firms, almost 50% of Thai firms)
- Hard to resolve; bankruptcy paralysis and strategic behavior worsens downturn (complex mathematical problem associated with interdependence of bankruptcies when there are bankruptcy costs; in general indeterminacy of solution)
- What is required is a ***super-Chapter 11***
- ***Even more important: providing money in a way which doesn't require bankruptcy***
  - Easy to do for publicly listed companies, harder for privately held firms

Roukny, Tarik, Stefano Battiston, and Joseph E. Stiglitz. "Interconnectedness as a Source of Uncertainty in Systemic Risk." *Journal of Financial Stability* 35 (2018): 93-106

Miller, Marcus, and Joseph E. Stiglitz. "Leverage and Asset Bubbles: Averting Armageddon with Chapter 11?" *Economic Journal,* 120, no. 544 (May 2010): 500-51

3. Supply Chain Problems

- Not just a demand problem—for now, “stimulus” is a misnomer
  - But lack of supply (shutdown of production) will create its own lack of demand
- Could eventually see **shortages** in important products, including medicine and food supply
  - especially with the interruption of global supply chains
  - especially so if some countries, worried about shortages, impose export restraints
- **Large changes in the structure of demand**, at least in the short run
  - **Markets often don’t manage such changes well** (question is, how to explain: absence of AD securities? Behavioral economic/institutional rigidities? Capital market imperfections impede reallocation of resources?)

Worries about inflation?

- Should consider government **interventions in the production and distribution of essential goods**—actions that, had they been taken earlier, in the case of masks, protective gear, and tests, might have saved a multitude of lives
- Fear of imbalance of supply and demand/future inflation should not impede current efforts
  - **Most likely outcome** is still **deficiency of aggregate demand** in aftermath of crisis
  - **Requires careful monitoring**, ready to raise taxes (progressive taxes, environmental taxes) and possibly tighten monetary policy

(Some theoretical insights on why markets may not shift resources: D. Delli Gatti, M. Gallegati, B. Greenwald, A. Russo and J. E. Stiglitz, "Mobility Constraints, Productivity Trends, and Extended Crises," *Journal of Economic Behavior & Organization*, 83(3) (2012a) 375– 393.)

Key elements of next package

- **Passage of key health provisions (support for hospitals, Medicaid, sick leave, testing, tracing, etc.)**
- **Extending unemployment insurance, with triggers**
  - Emergency loan fund for those not able to get state insurance because of administrative incapacities
  - Support for increasing administrative capacities
  - New entrants to labor market won't be covered: need comprehensive program
    - Every young person should be in a job, in school, or in a training program
- **Paycheck guarantee program**
- **Comprehensive support, including:**
  - **Aid to states and localities**
  - **Aid to higher education**
- **All programs need to be accompanied by conditions and priorities corresponding to our vision of the post pandemic economy**
  - **Green economy, with more transparency, better governance, better treatment of worker, fewer abuses of corporate governance**

Essential role for support of state and local government

- In 2008 crisis, tax revenue declines were twice that of GDP
  - Because they have balanced budget framework, expenditures decline in tandem
  - % Employment decreases greater than for country
    - By 2019 employment still not back to pre-crisis level
  - **Automatic “austerity”—impedes recovery**
  - Fed lending facility doesn’t solve problem
  - Nor would bankruptcy—if Congress were to pass a bankruptcy law
- Key to education, welfare, social protection