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The Pandemic and America's Economic Future

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Gen Ed 1092 – American Society and Public Policy

October 28, 2020

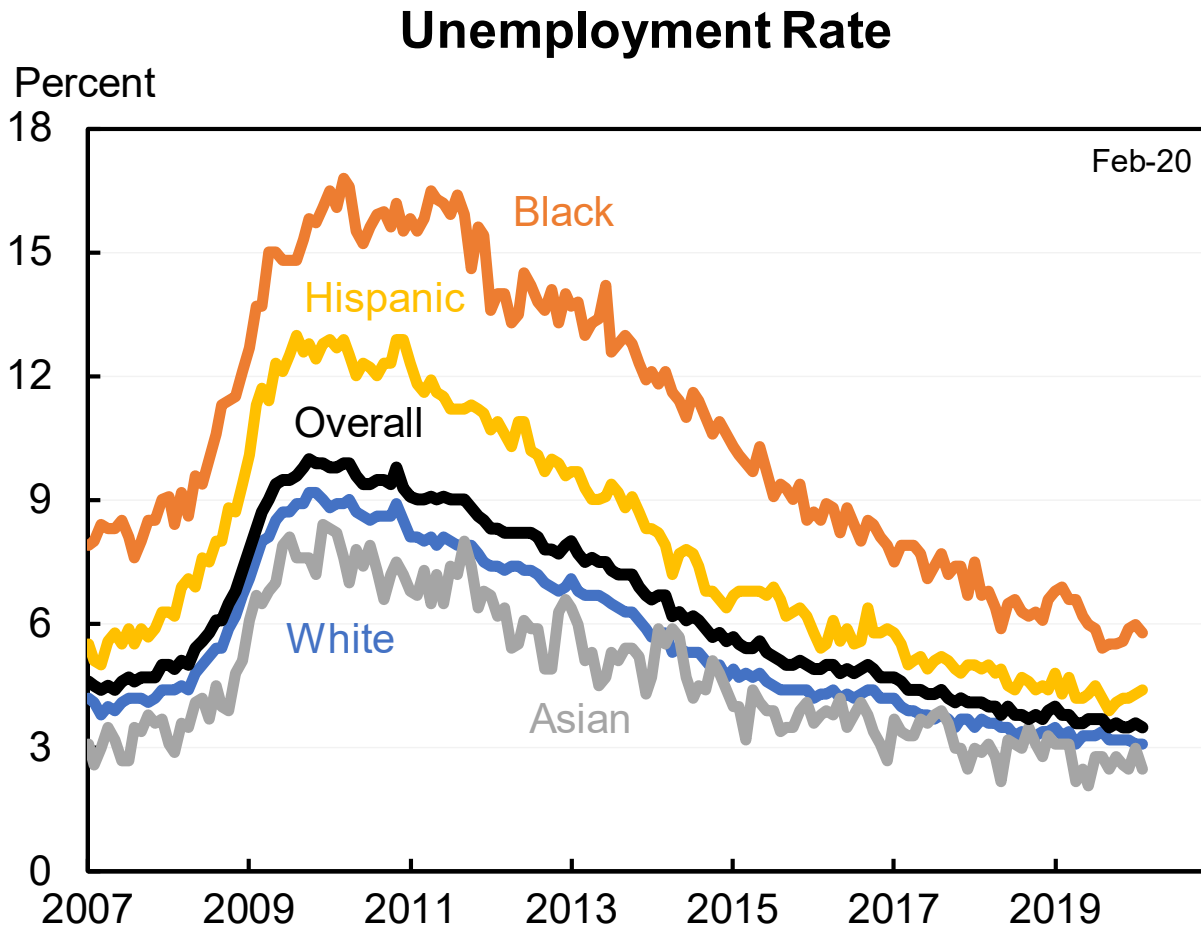
Outline

1. Macroeconomic Overview
2. Two Debates on the Policy Response
3. Fiscal Sustainability
4. What's Next? (If Biden)

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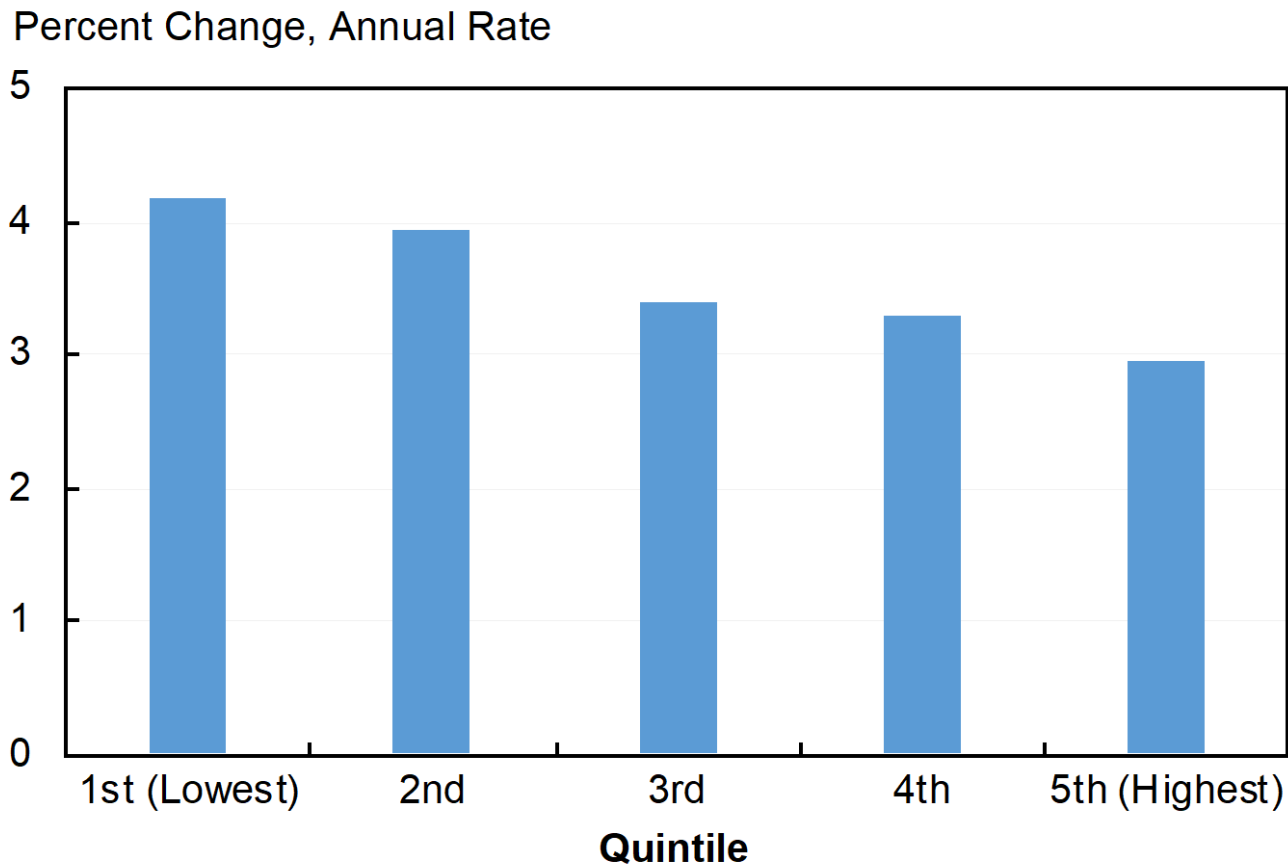
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The macroeconomy matters: the consequences of low unemployment pre-pandemic

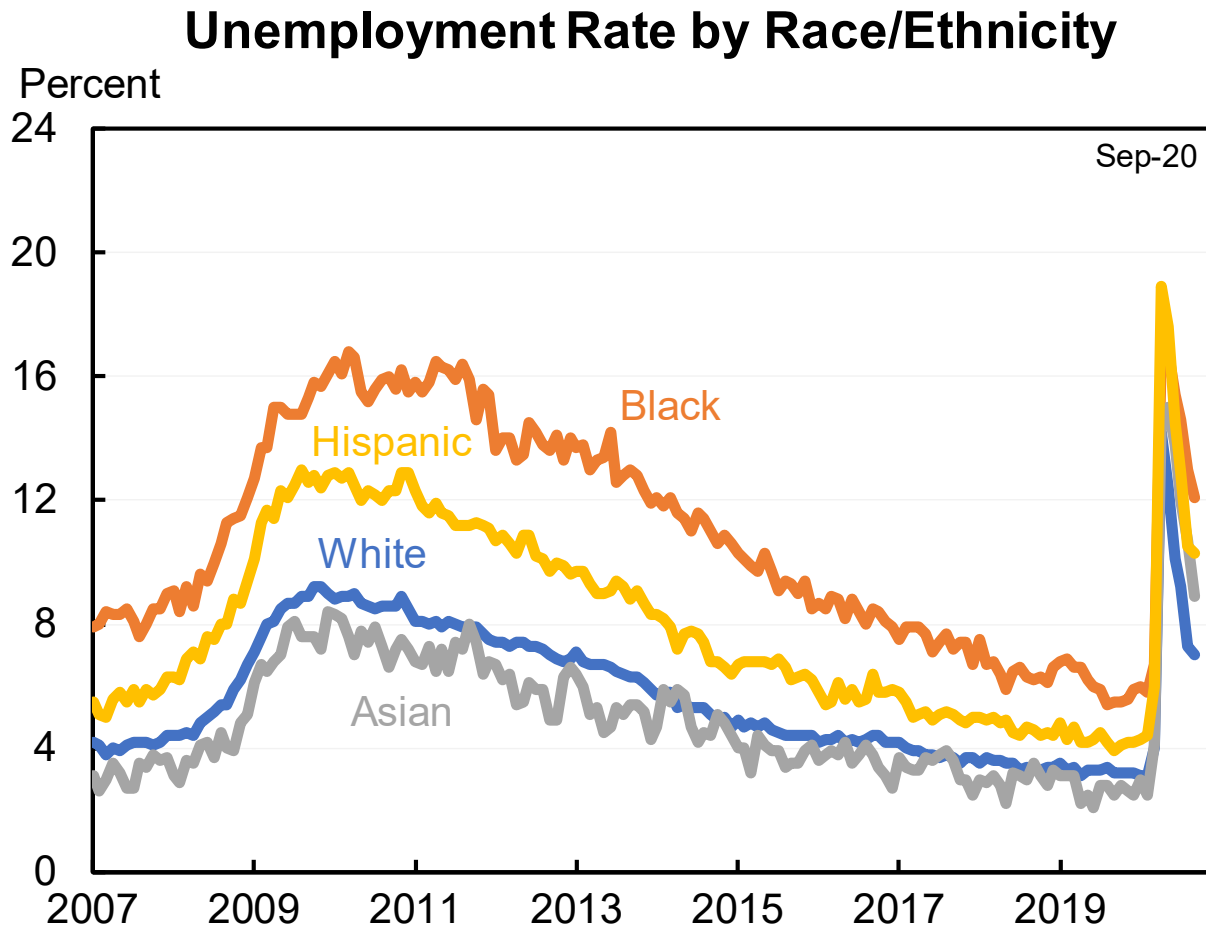


Pre-pandemic wage gains were stronger at lower end of wage distribution

Average Hourly Earnings Growth by Quintile, 2015:Q4–2019:Q4



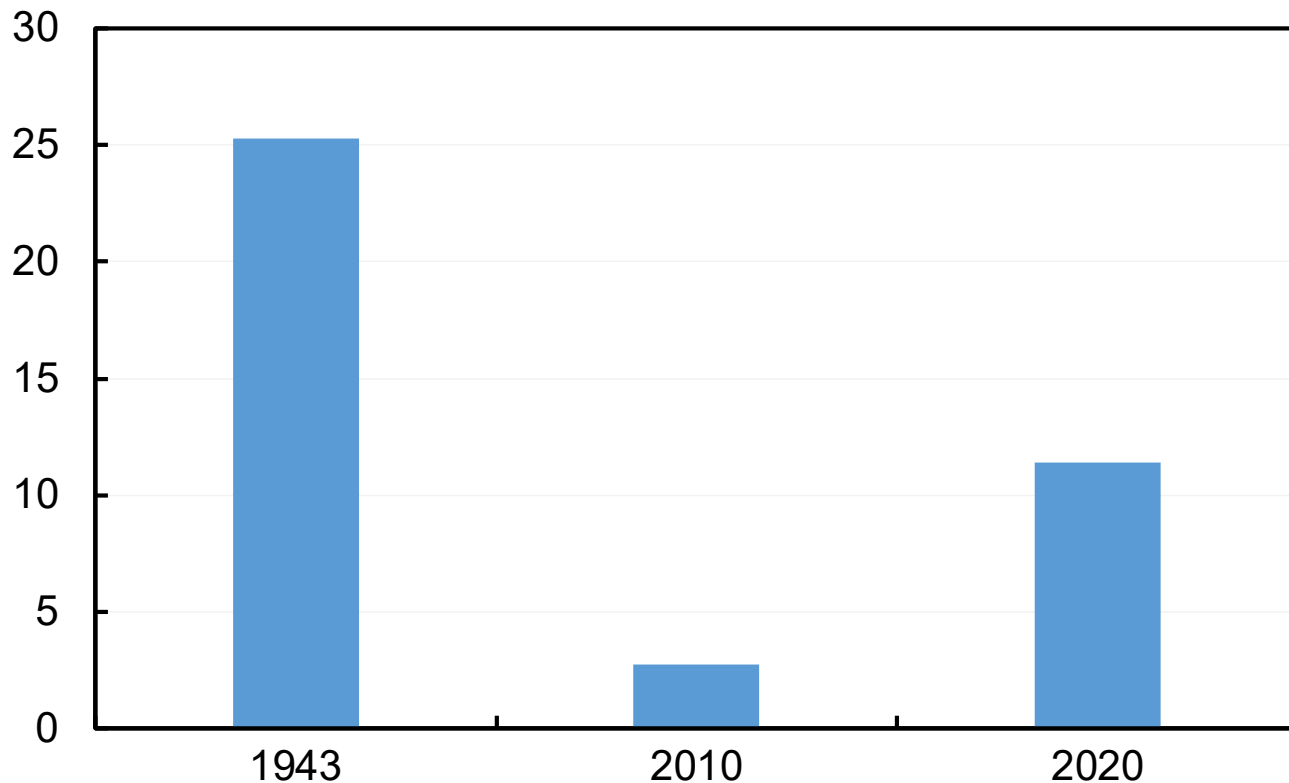
When the economy deteriorates, it deteriorates worst for Black and Hispanic workers



**Largest discretionary fiscal response to an economic crisis ever...
...More like the magnitude of World War II**

Discretionary Fiscal Stimulus as a Percent of GDP

Percent of GDP

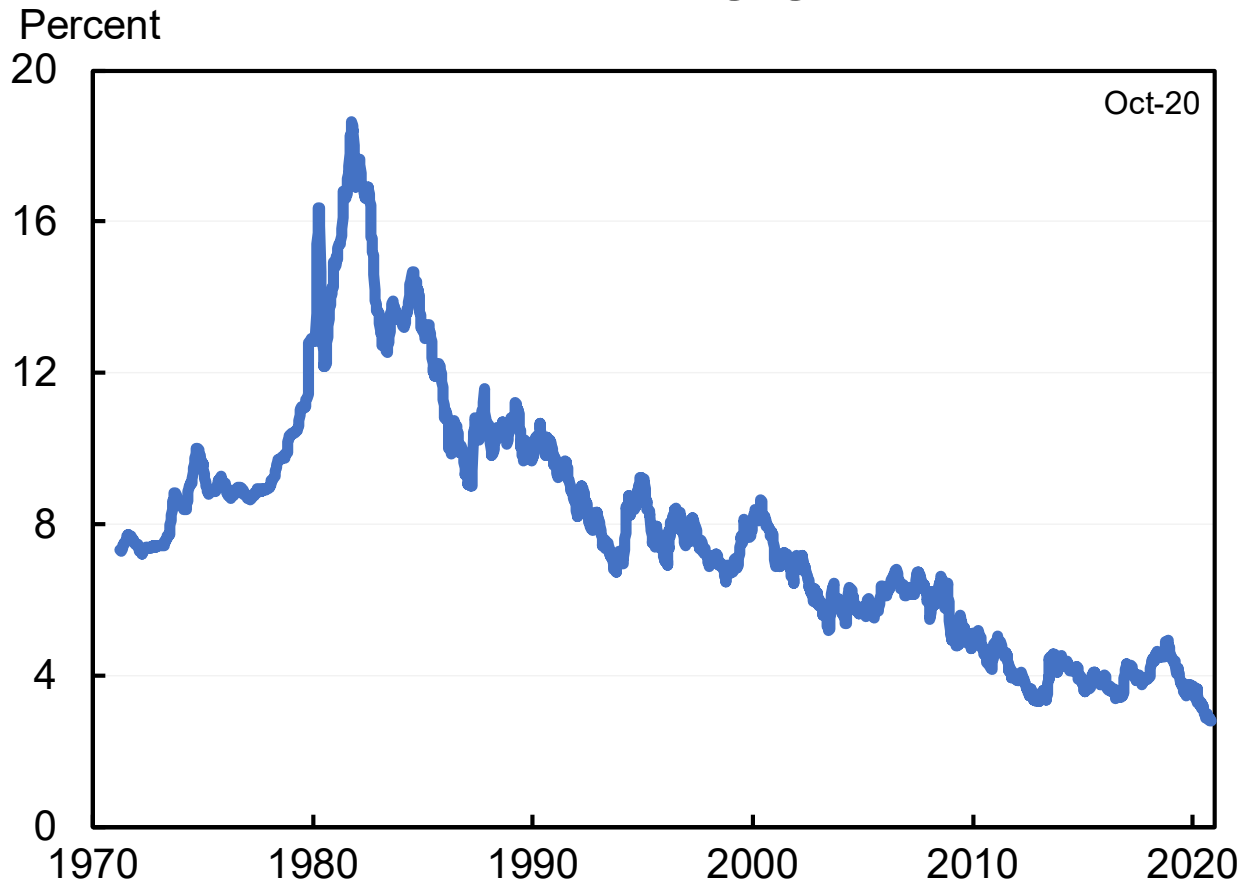


Note: Calendar year basis for 2010 and 2020.

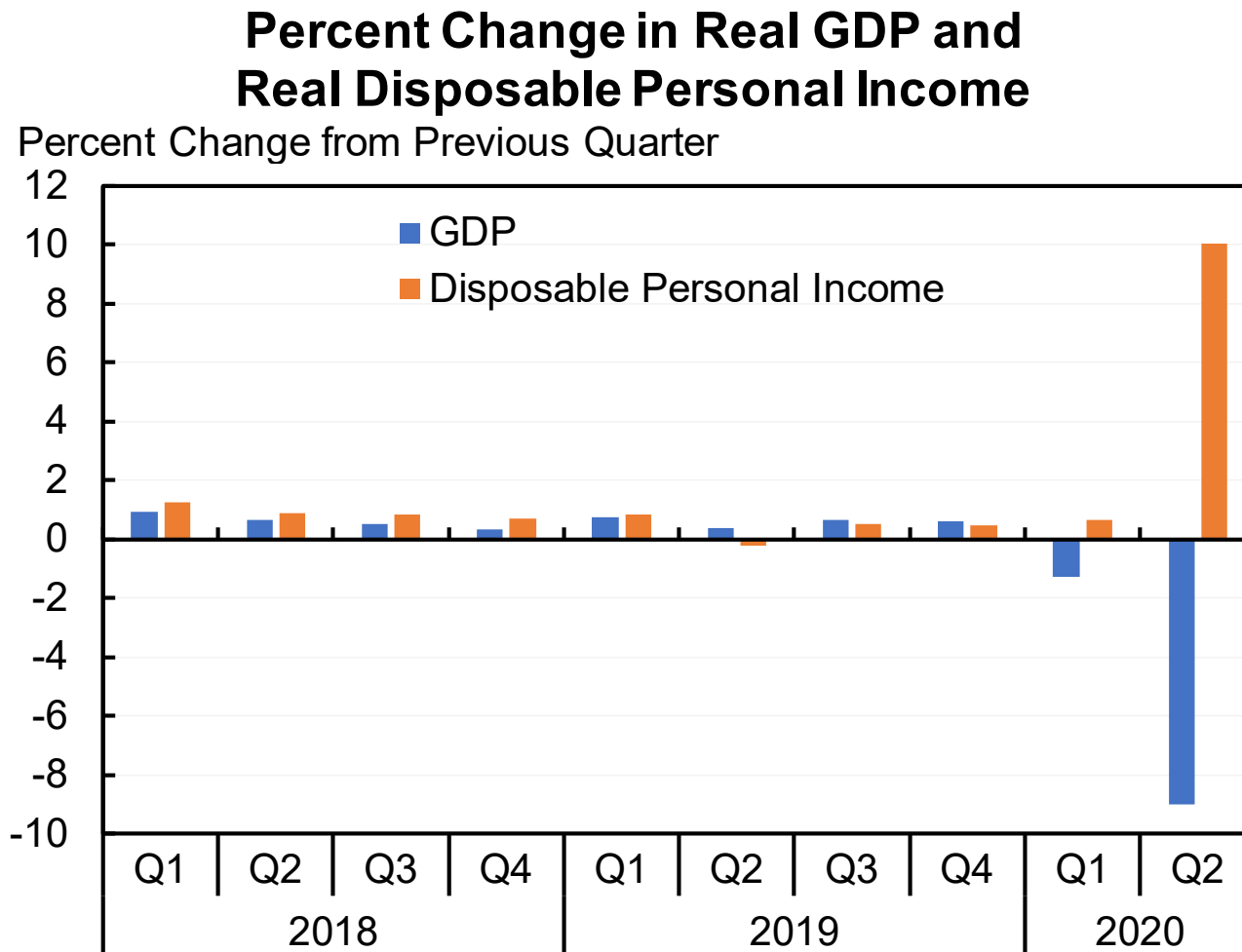
Source: Calculations based on Council of Economic Advisers (2014); Congressional Budget Office; Office of Management and Budget; Bureau of Economic Analysis.

The Federal Reserve has been very successful in lowering the interest rates that matter

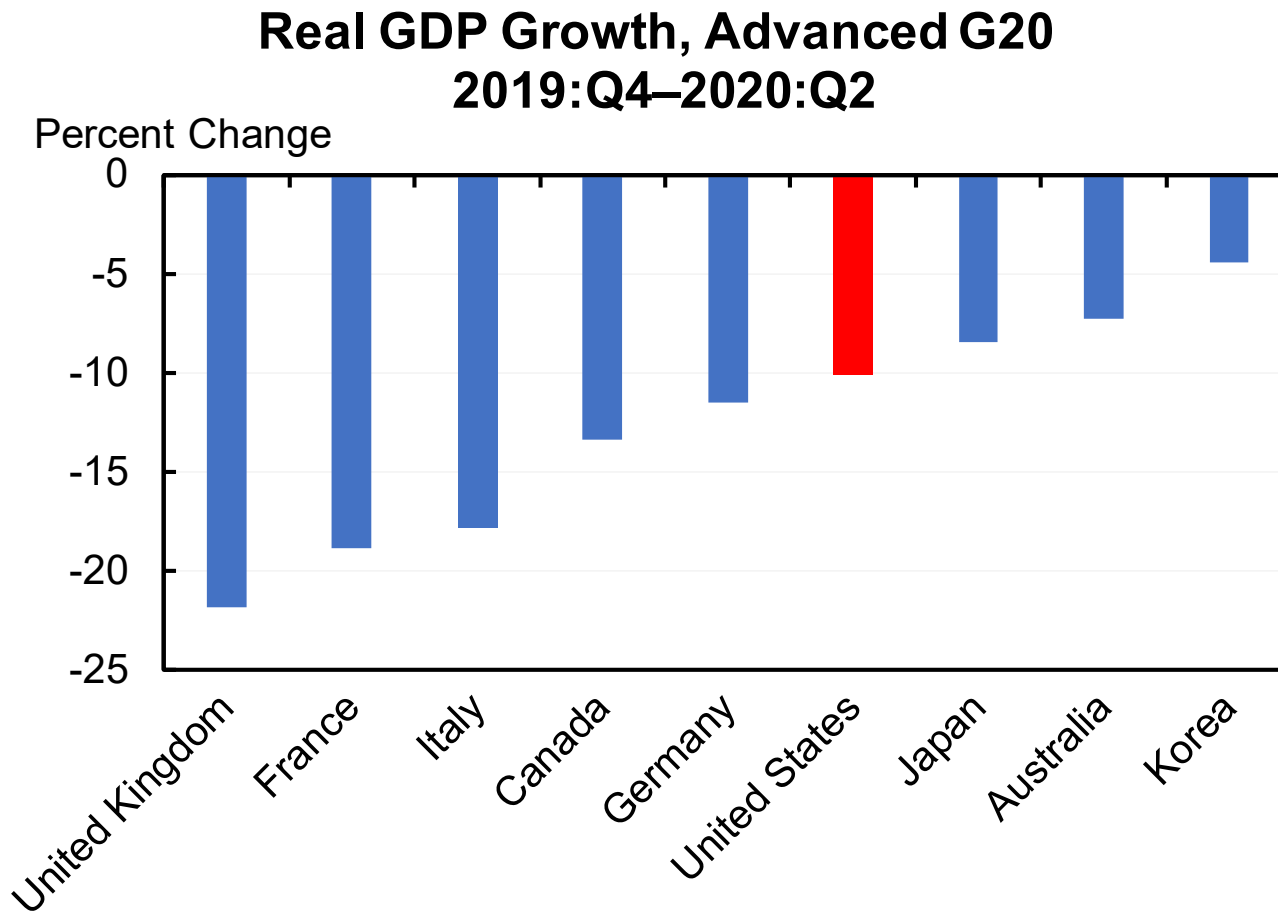
30-Year Fixed Rate Mortgage Interest Rate



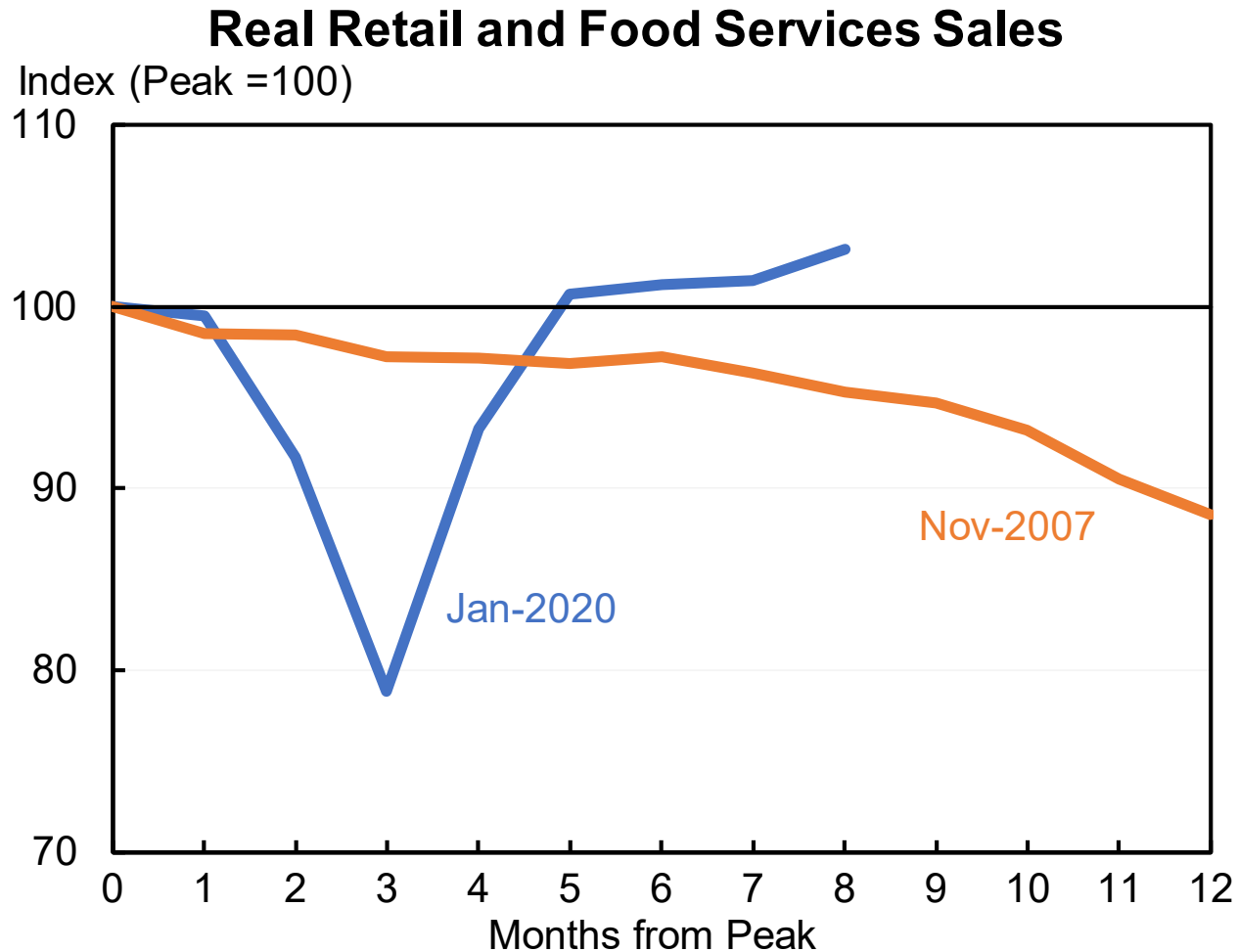
GDP down but disposable personal income up



The United States had a smaller economic contraction in the beginning of the year

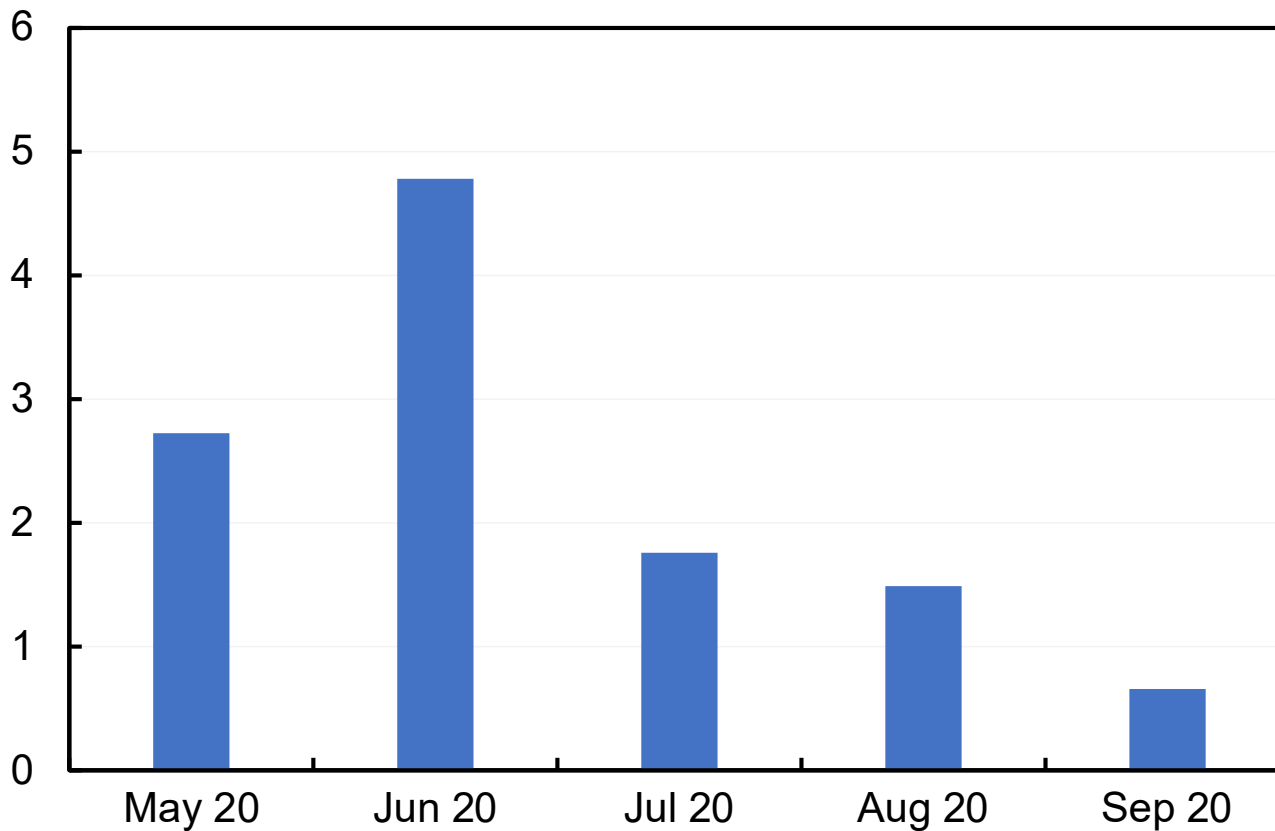


V-shaped recovery in retail sales, unlike 2007



The fiscal support ended at the end of July, contributing to a slowdown in the improvement

1-month Change in Nonfarm Payroll Employment
Millions of Jobs



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#1. Unemployment insurance vs. job protection

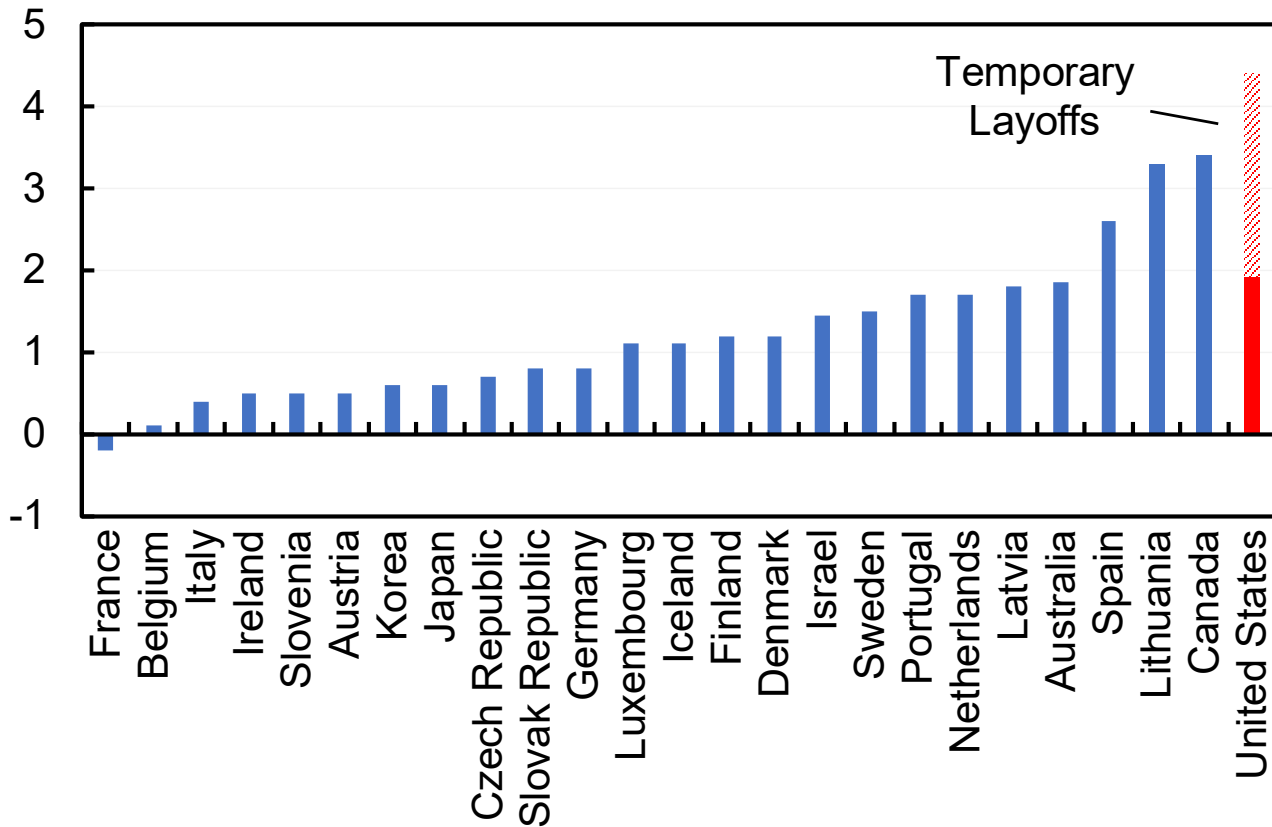
“U.S. Model”: Workers furloughed, receive public benefits—replacement rate > 100 percent for the majority of workers.

“European Model”: Workers paid by business (sometimes < 100 percent) and business partially reimbursed by government (usually < 100 percent).

Many arguments for the superiority of the European model in preventing mass unemployment.

The macro data does not settle the question: furloughs not treated comparably in the data

Change in Unemployment Rate in Advanced OECD Countries, February 2020–Most Recent
Percent of Labor Force



Commonalities and differences

Commonalities

- Non-working are compensated and employers have little/no cost.
- Employers that can return to economic viability will be able to reactivate their employees and employers that are not viable cannot reactive employees.

Advantages of U.S. Approach

Lower cost for employers

More leverage for employees to refuse to return to work

Handles reallocation better

Advantages of European Approach

Less disruptive for employees

More leverage for employers to force a return to work

Possibly higher job attachment

#2. \$600 per week unemployment insurance vs. less

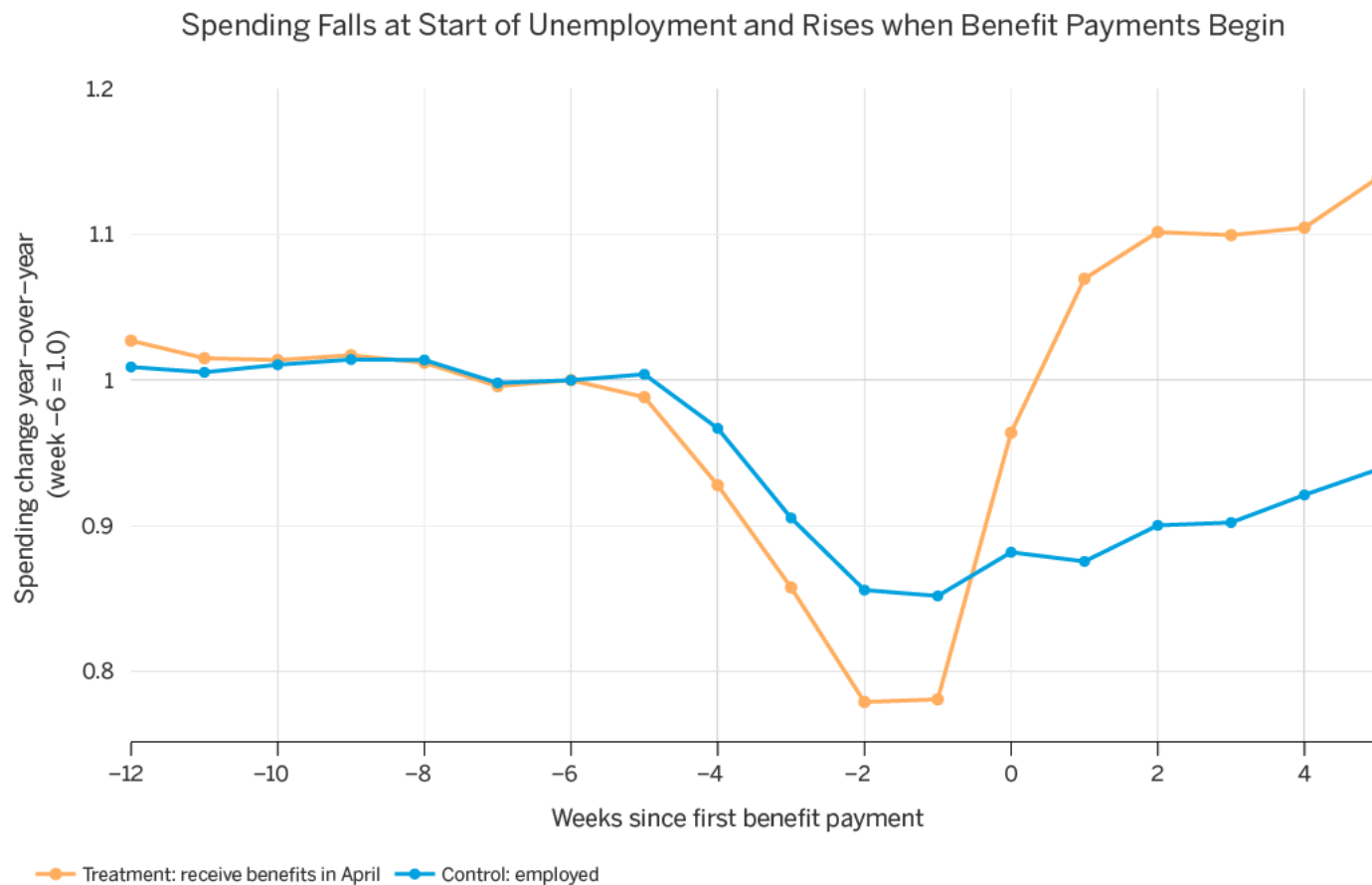
With \$600/week addition:

- Median replacement rate: ~150%
- More than 20 percent of workers get a replacement rate of 200%+

Two opposing effects (in theory):

- **Increase consumer spending** (good for the economy)
- **Reduce labor supply** (bad for the economy)

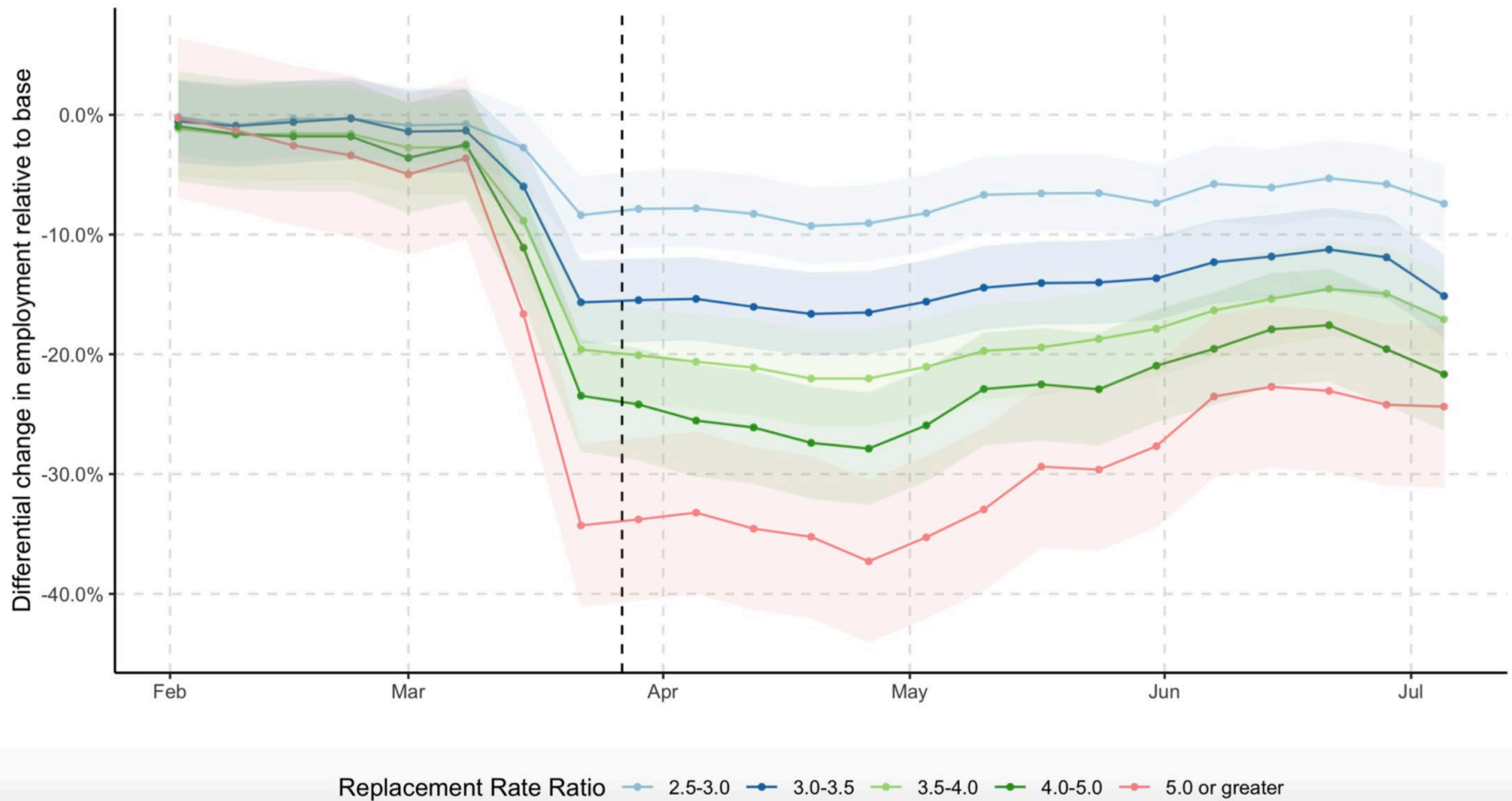
See clear evidence of more consumer spending due to benefits



Note: This figure shows the change in spending year-over-year around the start of unemployment benefits. The x-axis shows the number of weeks since the first benefit payment. The treatment group, shown in orange, receives benefits beginning in April. The control group, shown in blue, is employed workers. See "Data and analytical approach" section for details on how the control group is constructed. The y-axis is normalized to one at six weeks prior to the first benefit payment.

Do not see clear evidence of an employment disincentive of more generous benefits

(b) With controls for state business restrictions and new Covid-19 cases

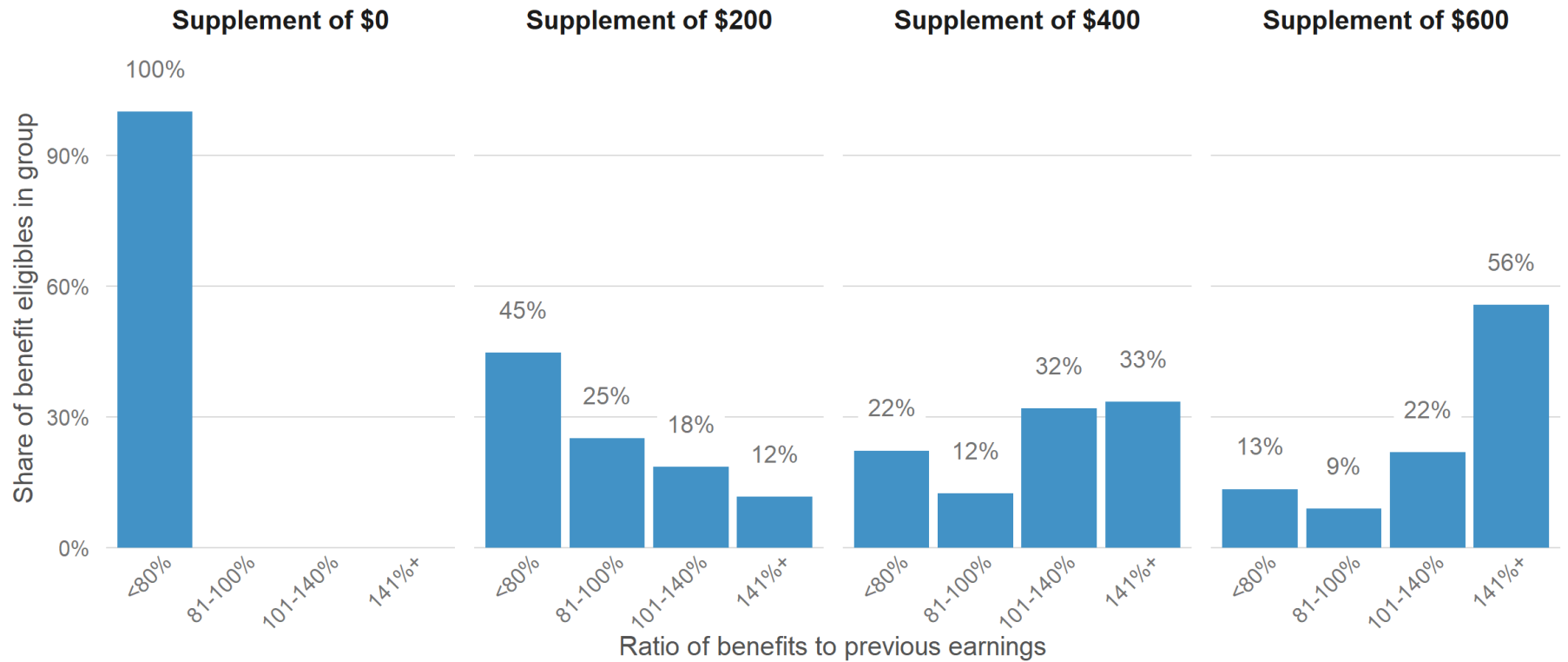


Does this mean we should continue the \$600 per week?

1. The evidence from April/May is not completely clear.
2. Part of the lack of an effect may have been the expectation that the \$600 would not be continued.
3. External validity: The labor market in December very different from the one in April.

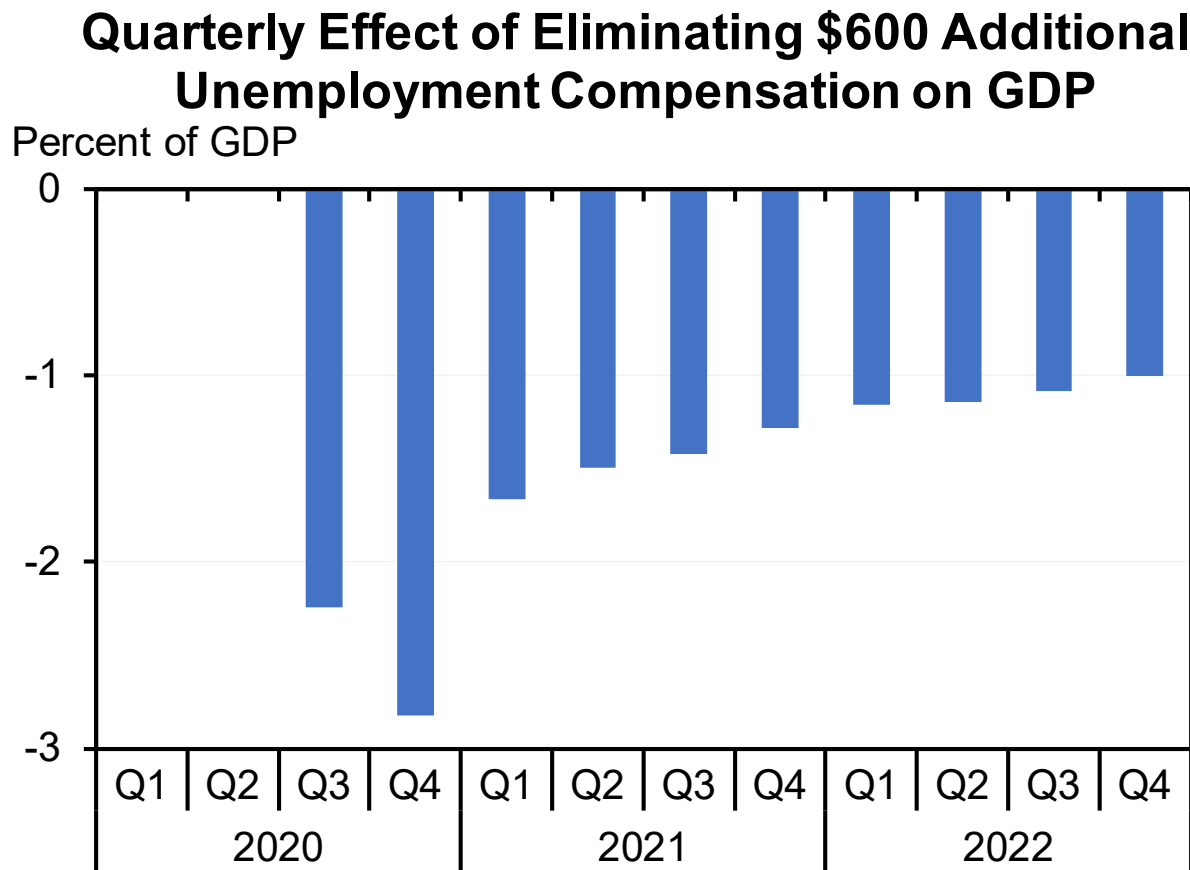
Impact of alternative UI policies on replacement rates

Distribution of Replacement Rates for Alternative Unemployment Benefit Supplements



Source: calculations based on Ganong, Noel and Vavra (2020)

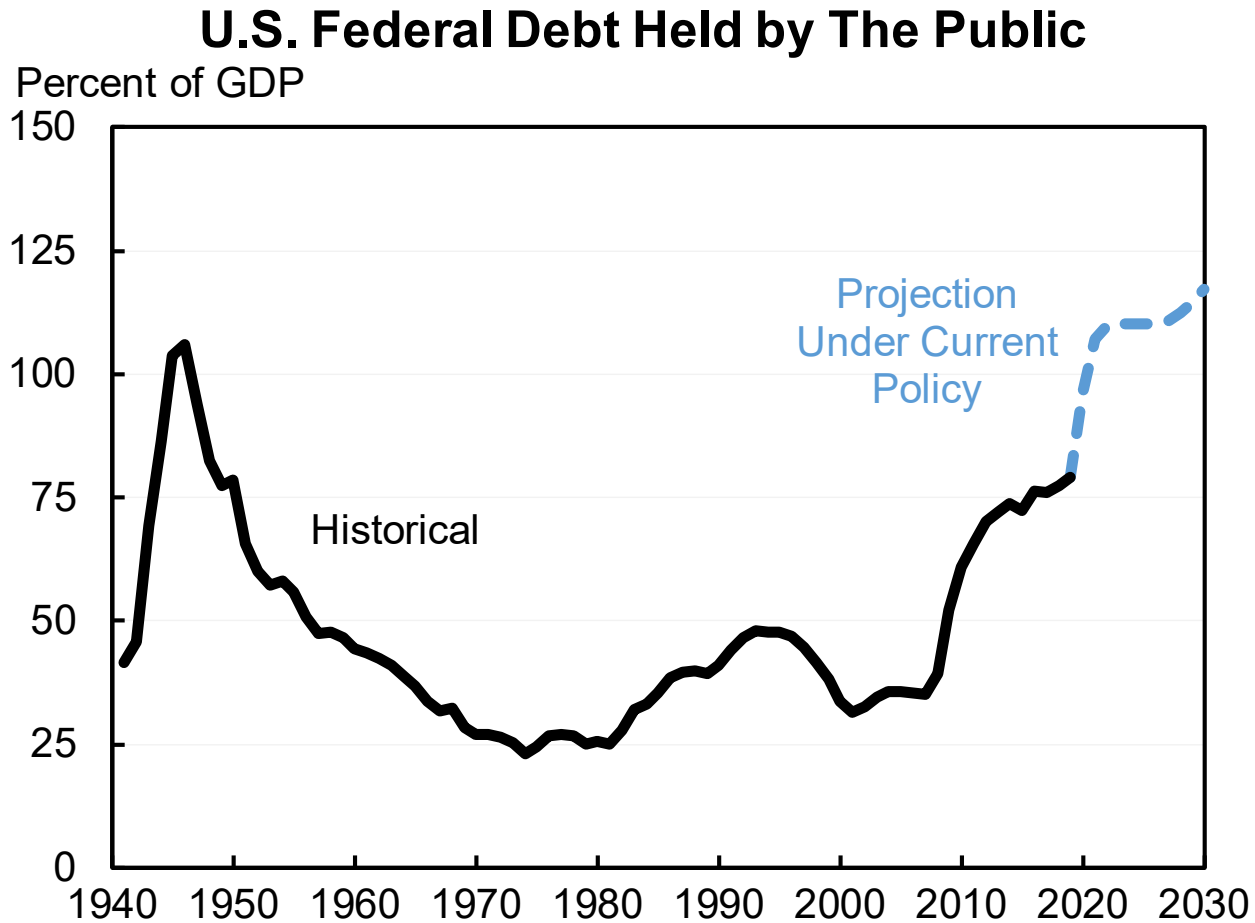
\$0 per week with no other compensating stimulus is a particularly bad policy



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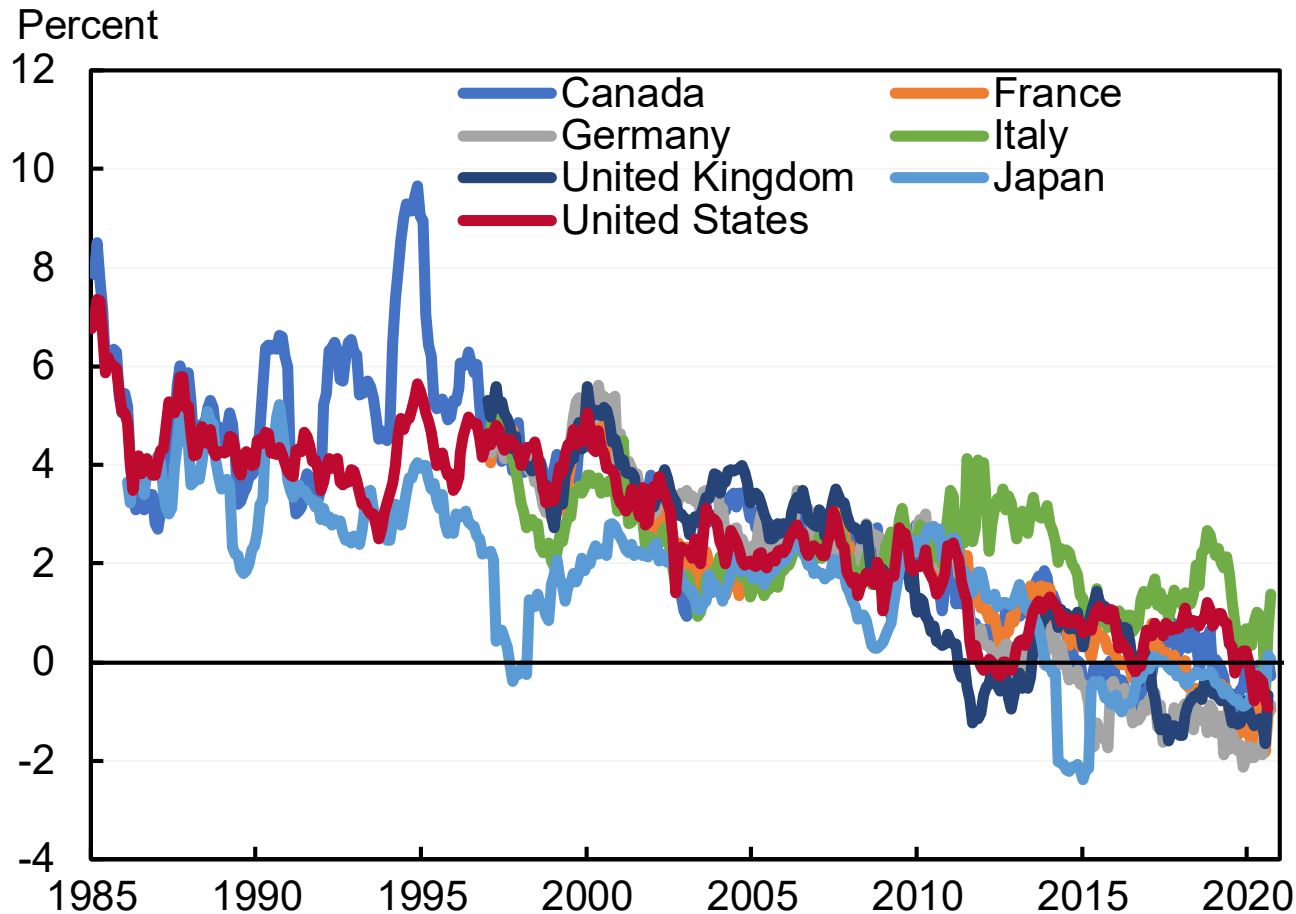
What can we afford?



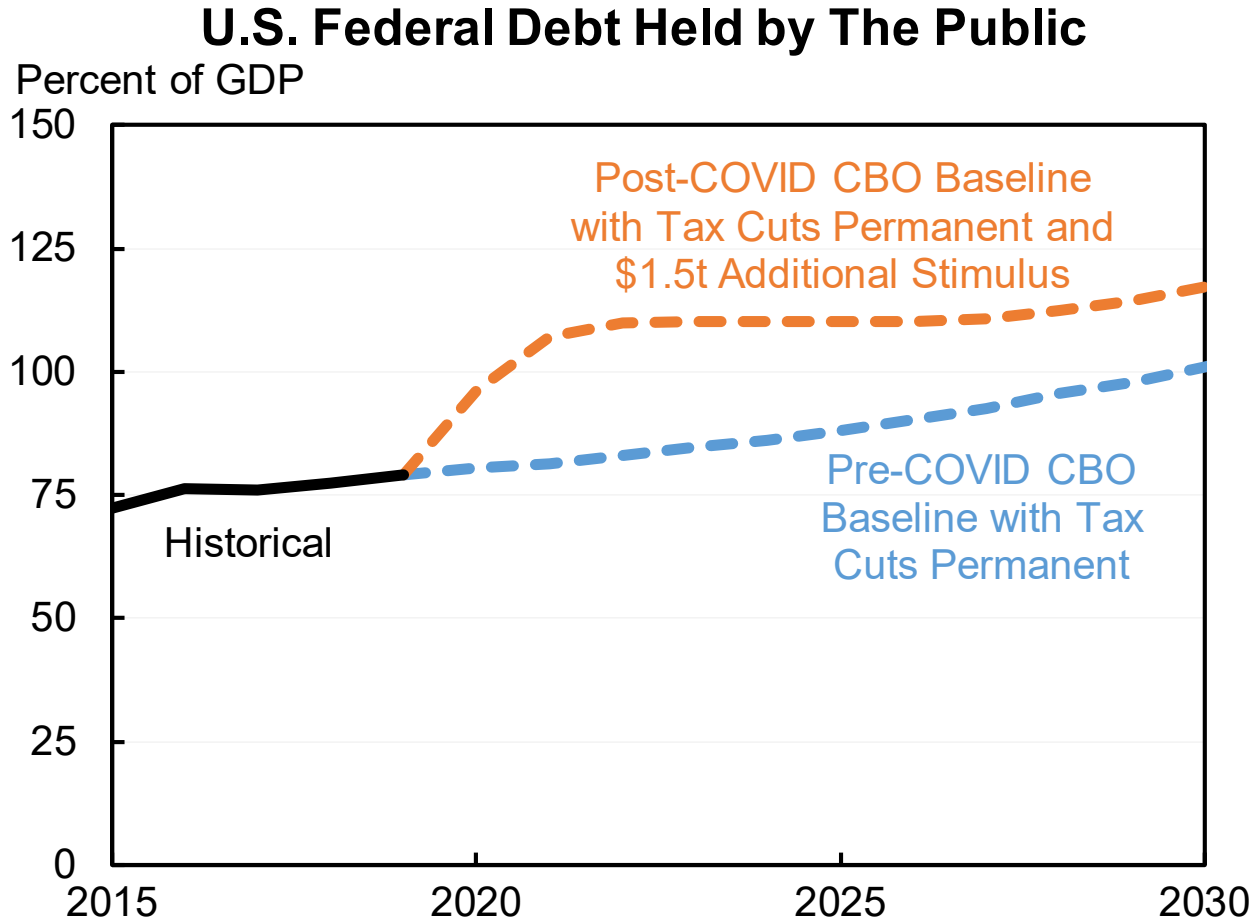
Note: Assumes \$1.5 trillion of additional COVID-related measures and extension of 2017 tax cuts.
Source: Author's calculations based on Congressional Budget Office; Office of Management and Budget; Macrobond.

Rates were falling before the Global Financial Crisis and low well after

Real Ten-Year Benchmark Rate

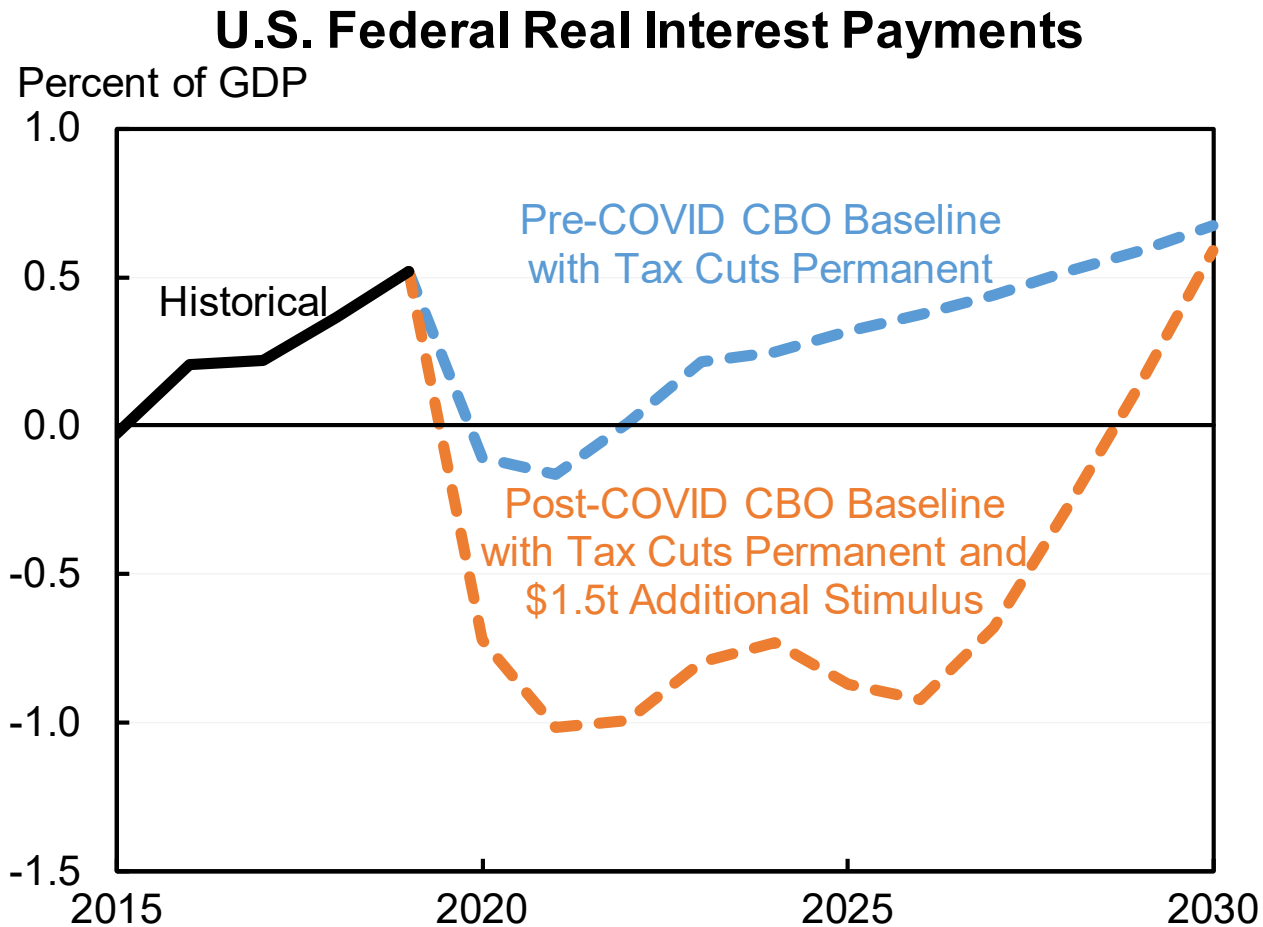


...Leading to higher debt



Source: Calculations based on Congressional Budget Office; Office of Management and Budget; Macrobond.

...But cost of servicing that debt projected to be much lower over next decade



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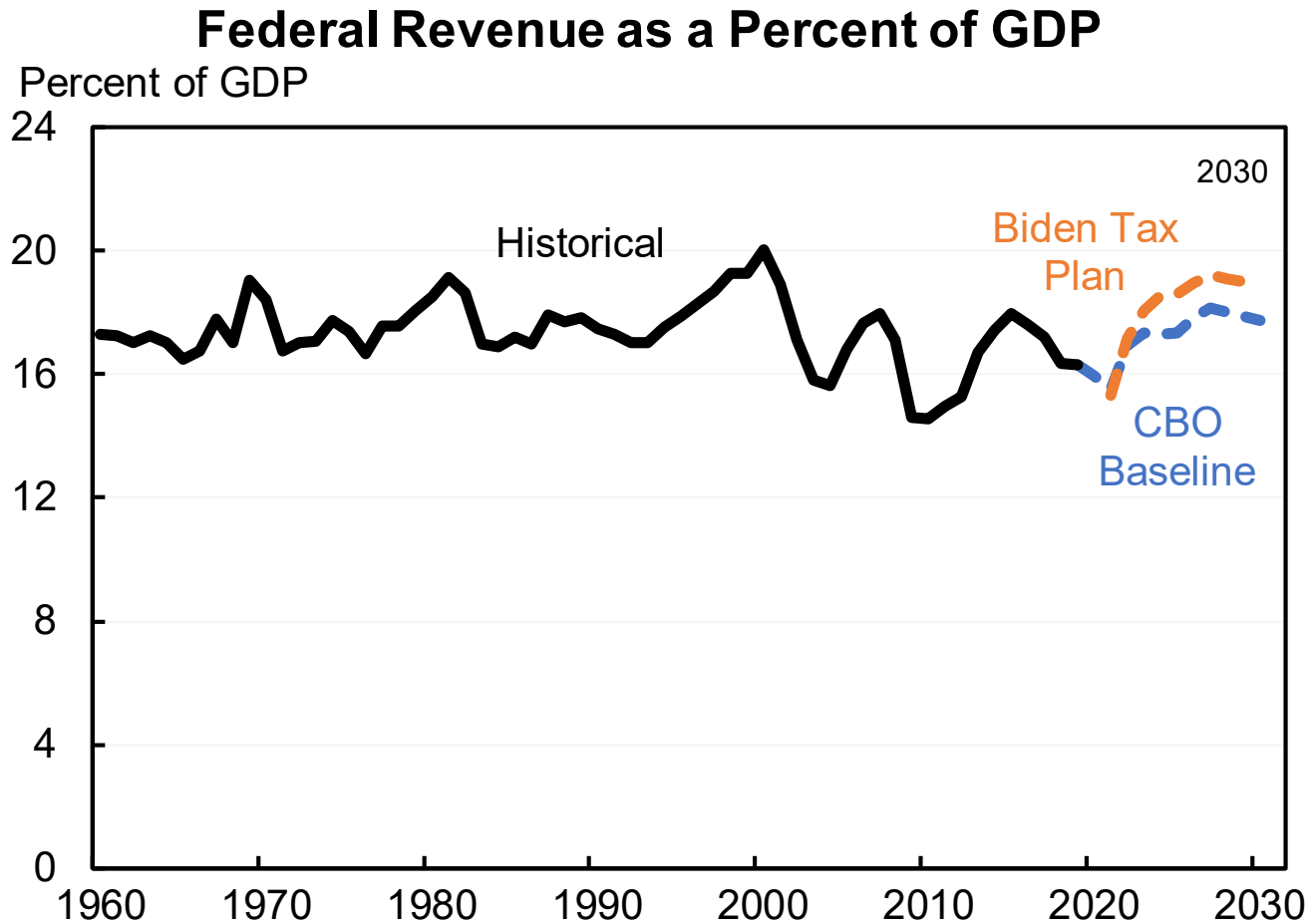
Tax increases focused on wealth and corporations

Biden Tax Plan – TPC estimates (billions of dollars, 2021-30 – not campaign estimates)	
<u>Individual</u>	
Restore pre-TCJA rates for \$400K+	110
Dividends/capital gains as ordinary income & end step up	370
Social Security 12.4% for \$400K+	740
Other	-250
<i>Subtotal</i>	980
<u>Corporate</u>	
Raise rate to 28%	730
International reforms	840
Other	-180
<i>Subtotal</i>	1,380
TOTAL	2,360

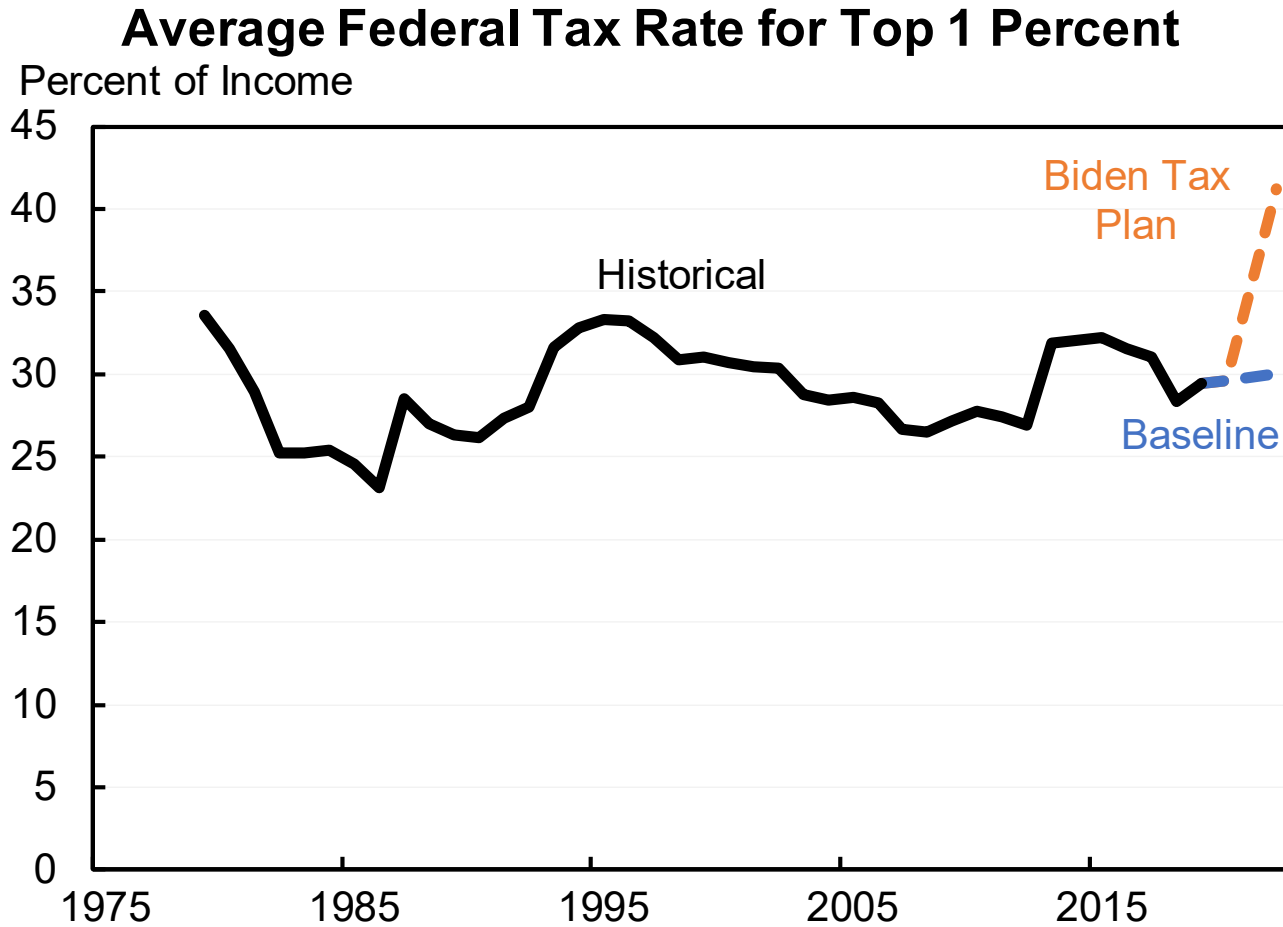
On larger end of recent tax increases

Magnitude of Tax Legislation/Proposals (revenue effect in the fourth year as a percent of GDP)	
<i>Biden Proposal (gross/net)</i>	<i>1.7 (1.2)</i>
<u>Tax Cuts</u>	
1981	-4.1
2001	-0.9
2017	-1.1
<u>Tax Increases</u>	
1982	1.2
1993	0.8
2010 & 2013 (ACA + fiscal cliff, gross)	0.8
Obama Campaign (gross/net)	1.2 (0.4)
Clinton Campaign (gross/net)	0.7 (0.5)

Biden's plan would increase revenue as a share of GDP, but still below Clinton's second term



Big increase in top tax rate under Biden plan



The top tax rate in New York City

Top Marginal Tax Rate for a Resident of New York City

Current	57%
Proposed, no S&L deduction	70%
Proposed, S&L restored	65%

Assumes: 37/39.6% federal income tax rate, 12.7% state and local rate, 3.8% Medicare tax (1.45% deductible, 0/12.4% Social Security tax (50% deductible), no Pease/Pease limitation adds 1.2%, and sales tax adds 4%.

Relative to the past, raising more tax rates at the top of the distribution

Federal Tax Rates			
	1998	2021	2022 - Biden
Bottom Quintile	6.9	3.2	-2.2
Second Quintile	13.4	8.0	5.2
Third Quintile	17.4	13.2	11.6
Fourth Quintile	20.6	16.9	15.9
Fifth Quintile	27.4	24.0	27.8
<i>Top 1 Percent</i>	32.4	29.7	41.2
<i>Top 0.1 Percent</i>	32.8	30.4	45.8
AVERAGE	22.7	18.9	20.0

Note: Tax rates for 1998 not fully comparable to 2021/2022 due to methodological differences.

The Biden spending agenda

Biden Spending Plan – PWBM estimates (trillions of dollars, 2021-30 – not campaign estimates)	
Education	1.9
Infrastructure and R&D	1,6
Housing	0.7
Social Security Benefits	0.3
Healthcare - Prescription Drugs	-1.3
Healthcare - Other New Spending	1,6
TOTAL	5.4

Note: Does not include any stimulus/emergency spending

Some questions facing a change in policy

- What tools to improve incomes/distribution before taxes/transfers?
 - Stronger macroeconomy
 - Minimum wage?
 - Unions?
 - Education?
- What tools to improve incomes/distribution after taxes/transfers?
 - Health
 - Child allowance
 - Others??
- Universality programs vs. targeted programs?
 - How to finance universal programs?
 - Achieve progressivity on tax side or on spending side?
- Much of the above costs money, whether/how to handle the deficit?



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