



**PIIE** PETERSON INSTITUTE FOR  
INTERNATIONAL ECONOMICS

# Global Economic Prospects: COVID-19 and Labor Markets

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# Outline

1. The Initial Fiscal Response and Current Nonresponse
2. Two Labor Market Policy Debates
3. The Future of Fiscal Policy

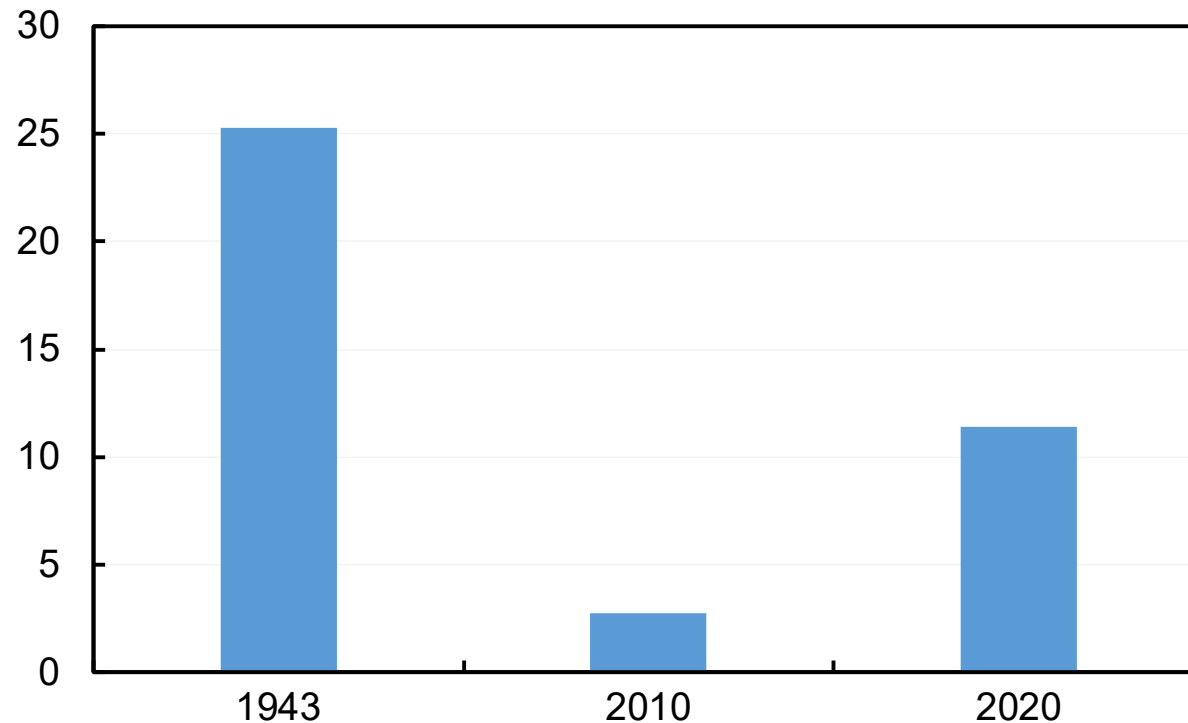
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# Largest discretionary fiscal response to an economic crisis, more like World War II

## Discretionary Fiscal Stimulus as a Percent of GDP

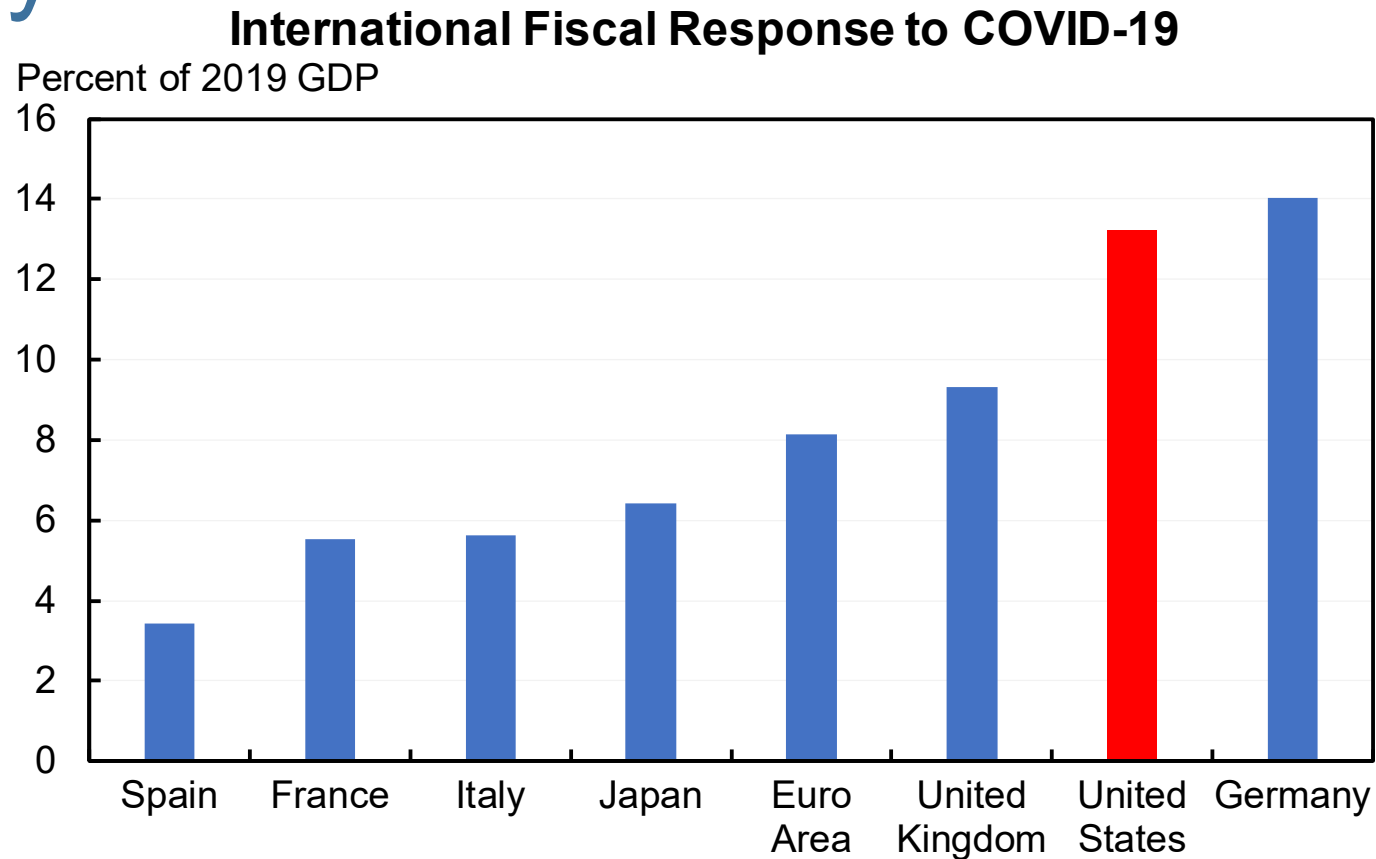
Percent of GDP



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.

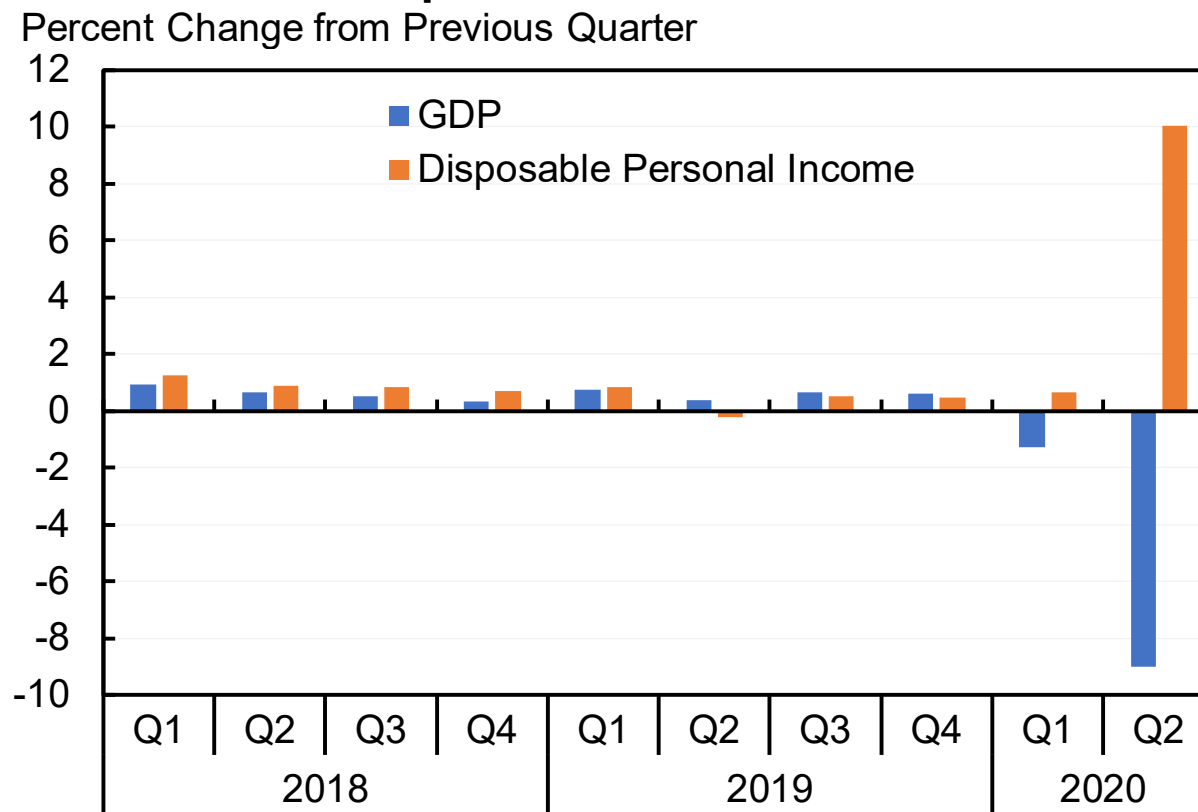
# Substantial fiscal response in advanced economies, especially United States and Germany



Note: As of August 25.  
Source: Evercore ISI.

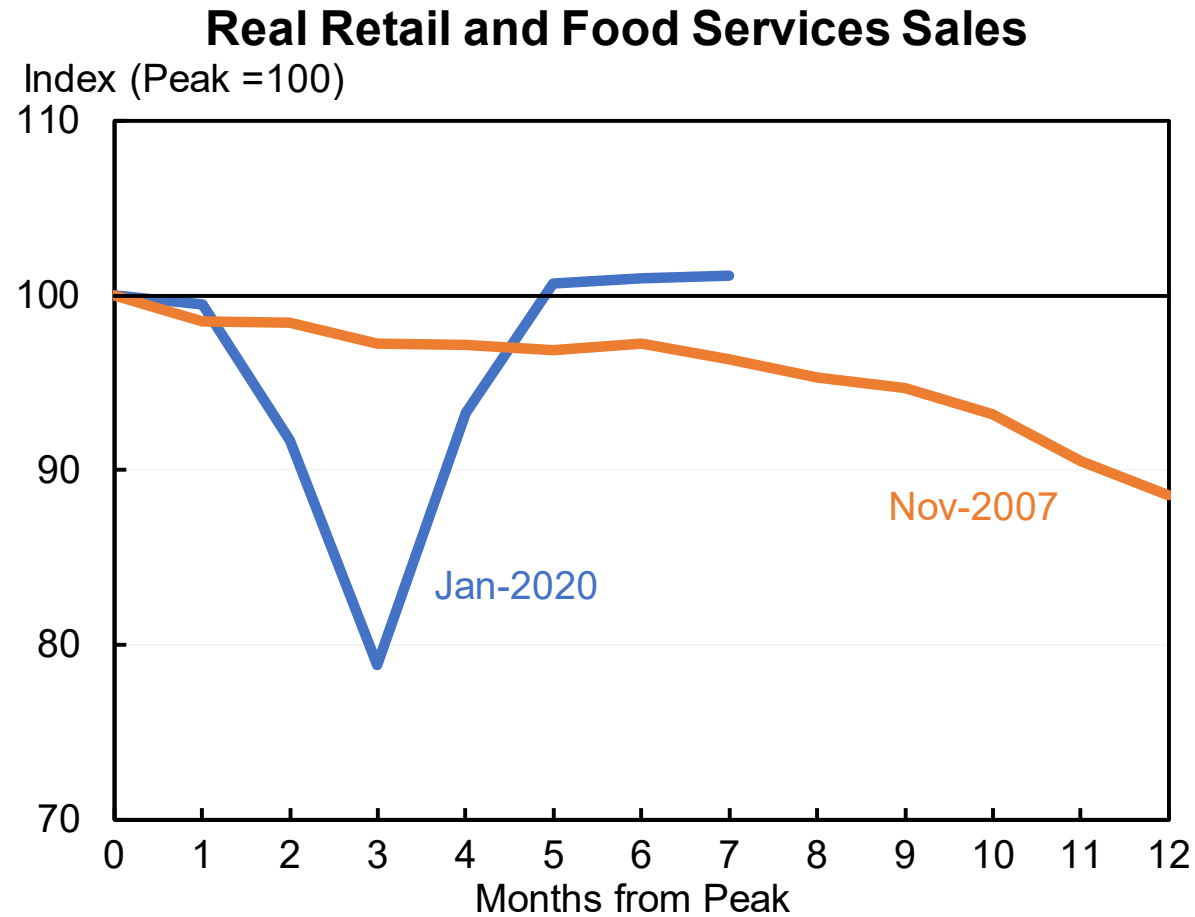
# Unprecedented policy response: GDP down while disposable income up

## Percent Change in Real GDP and Real Disposable Personal Income



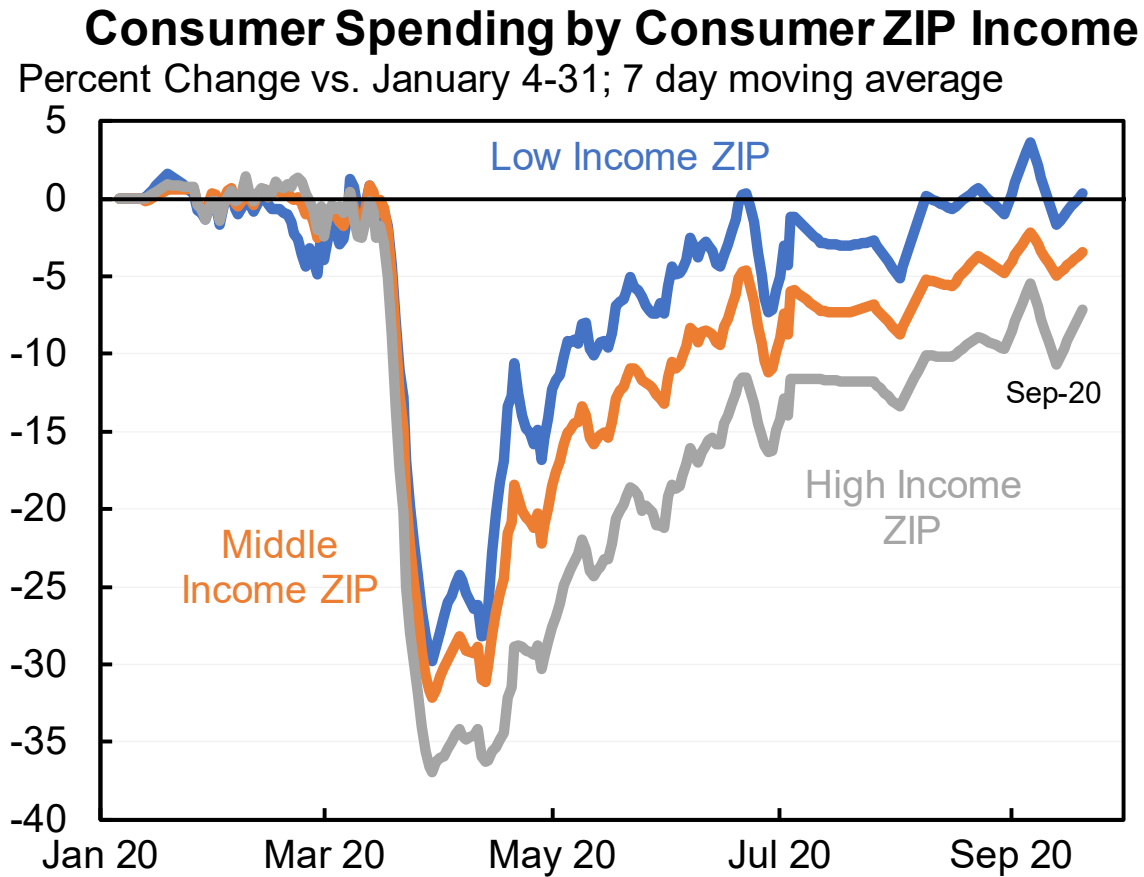
Source: Bureau of Economic Analysis; Macrobond; author's calculations.

# V-shaped recovery in retail sales



Source: Federal Reserve Bank of St. Louis; Macrobond; author's calculations.

# Consumption declines smallest for those in lower-income areas (Opportunity Insights)

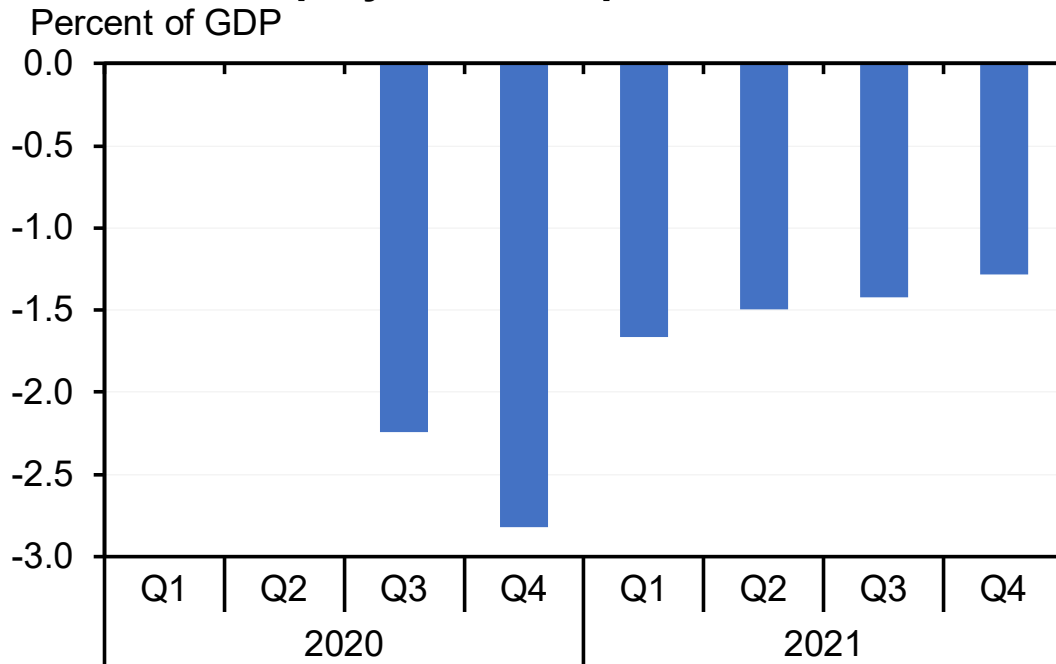


Source: Opportunity Insights.

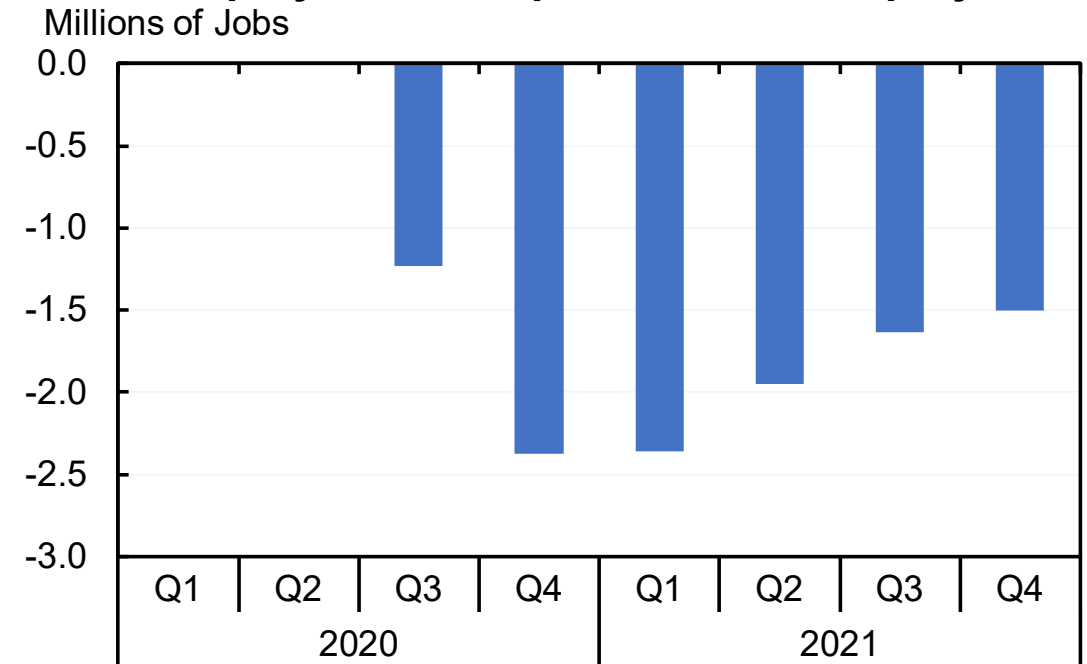


# The macroeconomic effect of the lapse in expanded unemployment insurance benefits

## Quarterly Effect of Eliminating \$600 Additional Unemployment Compensation on GDP



## Quarterly Effect of Eliminating \$600 Additional Unemployment Compensation on Employment



Source: Council of Economic Advisers; Congressional Budget Office; author's calculations

# Large revenue declines in states, without assistance to help in 2021 and 2022

<b>Effects of Pandemic on State and Local Fiscal Outlook, Excluding Higher Ed and Hospitals</b>			
	2020	2021	2022
<b>Projected Declines in Revenues</b>	<b>\$155b</b>	<b>\$167b</b>	<b>\$145b</b>
Personal Income Tax Revenues	22	37	40
Corporate Income Tax Revenues	2	29	14
Sales Tax Revenues	49	45	46
Other Taxes and Fees	82	55	45
<b>Additional Demands on Spending</b>	<b>?</b>	<b>?</b>	<b>?</b>
<b>State Aid</b>	<b>\$212b</b>	<b>\$19b</b>	<b>\$9b</b>
Coronavirus Relief Fund	150		
K-12 Aid	13		
Transit	25		
Medicaid (Excess over additional Spending)	24	19	9

Source: Auerbach, Gale and Sheiner (2020).

# What stimulus is needed now in the United States?

- 1. When?** Two months ago.
- 2. How long?** As long as it takes—ideally with triggers
- 3. How much per month?**
  - **Top-down models based on output gap: \$36 billion to \$270 billion**
  - **Bottom-up models to protect people/states/health: \$235 billion (roughly the largest magnitude you get with this approach)**

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# #1. Unemployment insurance vs. job protection

- **“U.S. Model”**: Workers furloughed, receive public benefits—replacement rate was  $> 100$  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.*

# 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

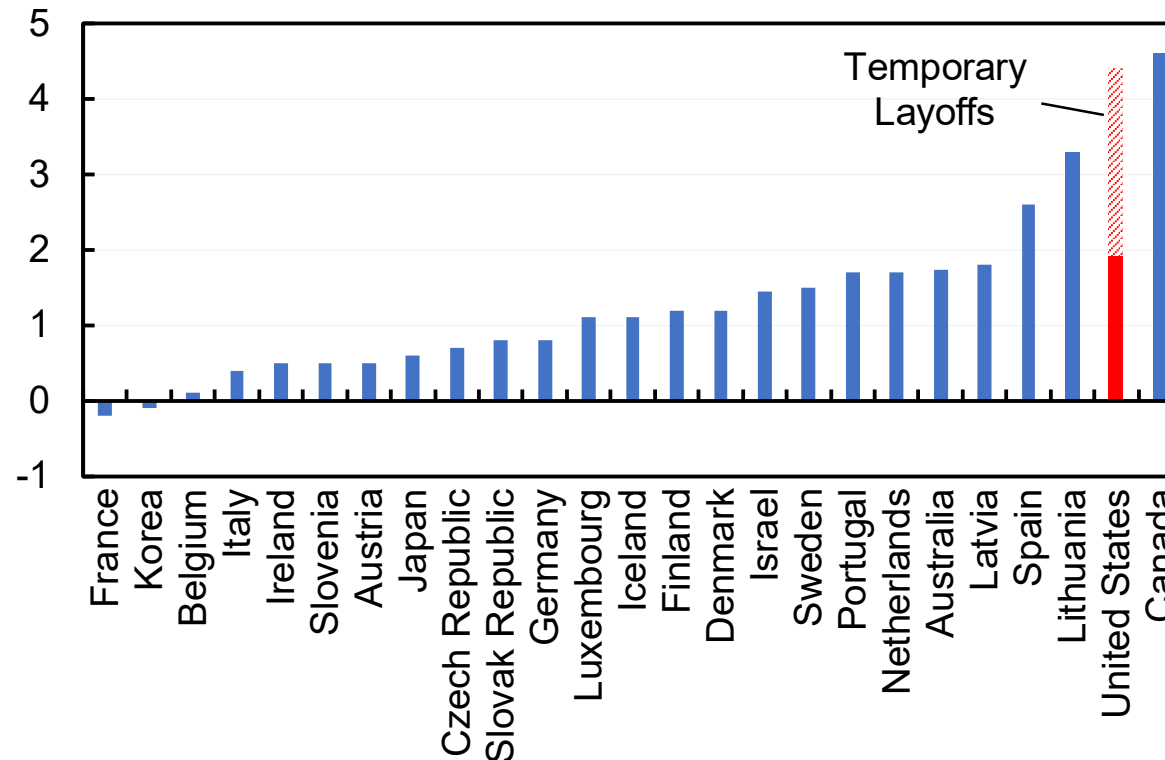
More leverage for employers to force a return to work

Possibly higher job attachment

# Unemployment rate changes have been similar when temporary layoffs excluded

**Change in Unemployment Rate in Advanced OECD Countries, February 2020–Most Recent**

Percent of Labor Force



Note: Most recent data from September for Ireland and United States; August for others.

Source: Organisation for Economic Co-operation and Development; Bureau of Labor Statistics; Macrobond; author's calculations.

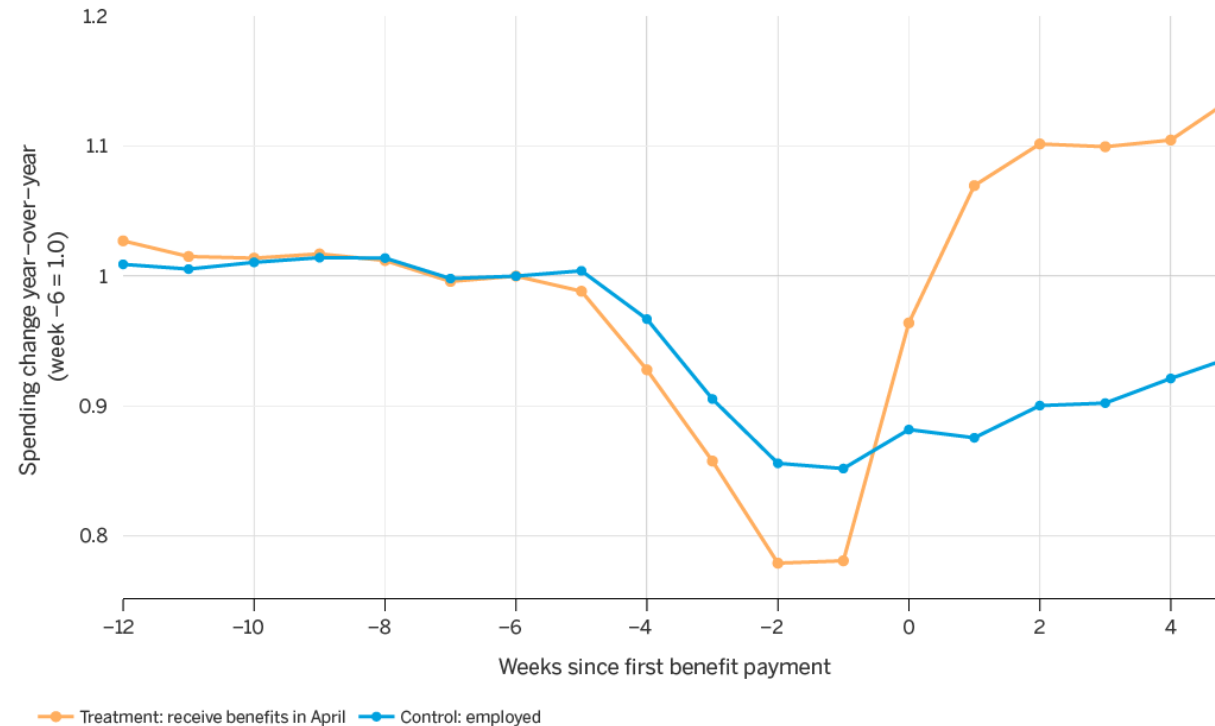
## #2. \$600 per week unemployment insurance vs. less

- **With \$600/week addition:**
  - Median replacement rate was ~150%
  - More than 20 percent of workers were getting 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

Spending Falls at Start of Unemployment and Rises when Benefit Payments Begin



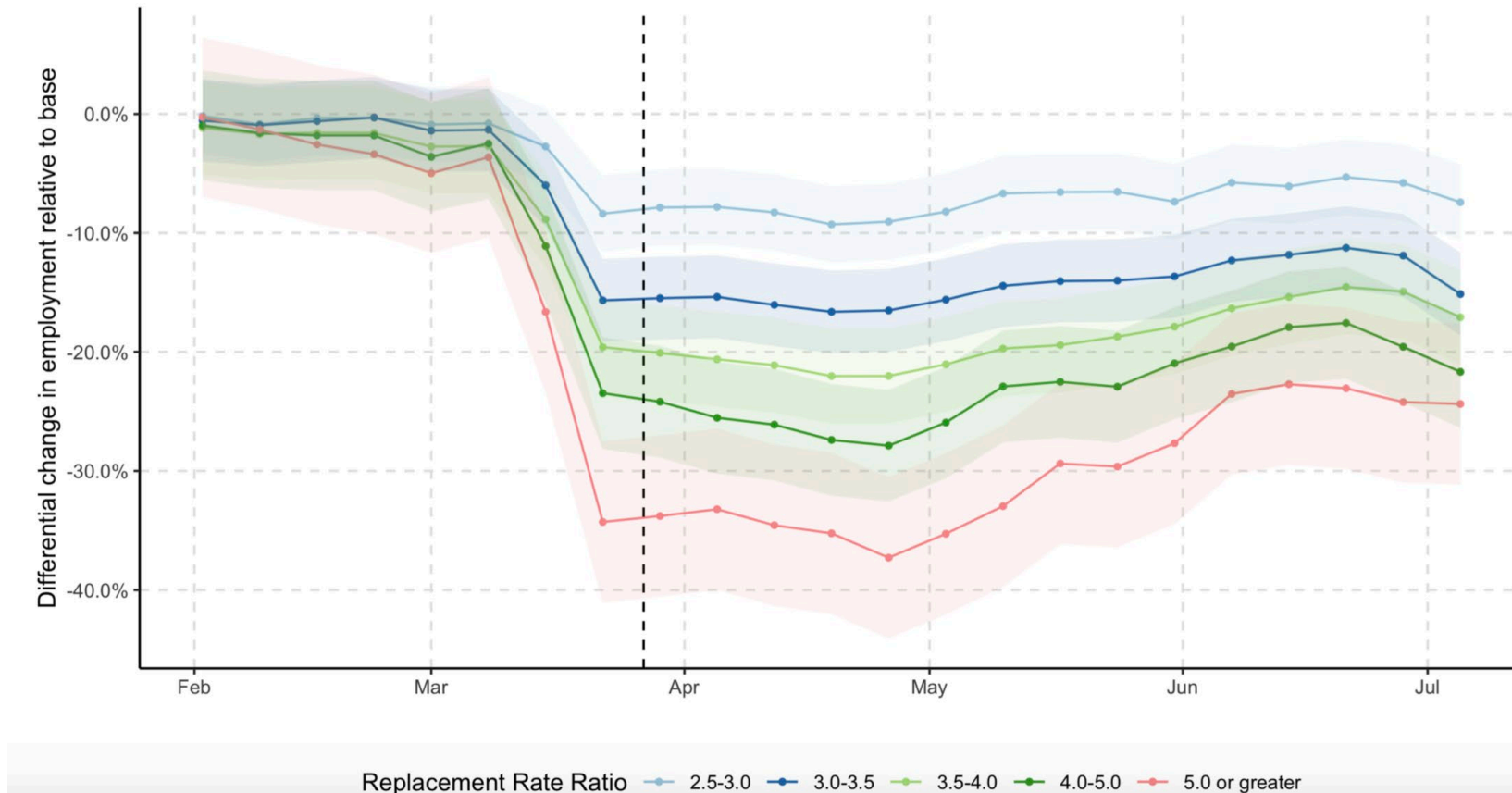
Note: This figure shows the change in spending year-over-year around the start of unemployment benefits. The x-axis shows the number of weeks since the first benefit payment. The treatment group, shown in orange, receives benefits beginning in April. The control group, shown in blue, is employed workers. 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.

Source: JPMorgan Chase Institute

Source: JP Morgan Chase Institute (2020).

# 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



Source: Altonji et al. (2020).

# Does this mean the United States should restore 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.

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# Debt increasing everywhere...

## IMF Projection of General Government Net Debt as a Percent of GDP, 2020

	<b>October 2019 Forecast</b>	<b>April 2020 Forecast</b>
Canada	26	41
France	90	107
Germany	38	49
Italy	122	143
Japan	154	169
United Kingdom	75	86
United States	84	107

Source: International Monetary Fund, Fiscal Monitor.

...But debt/GDP is a problematic metric

Debt

Stock

Backward looking

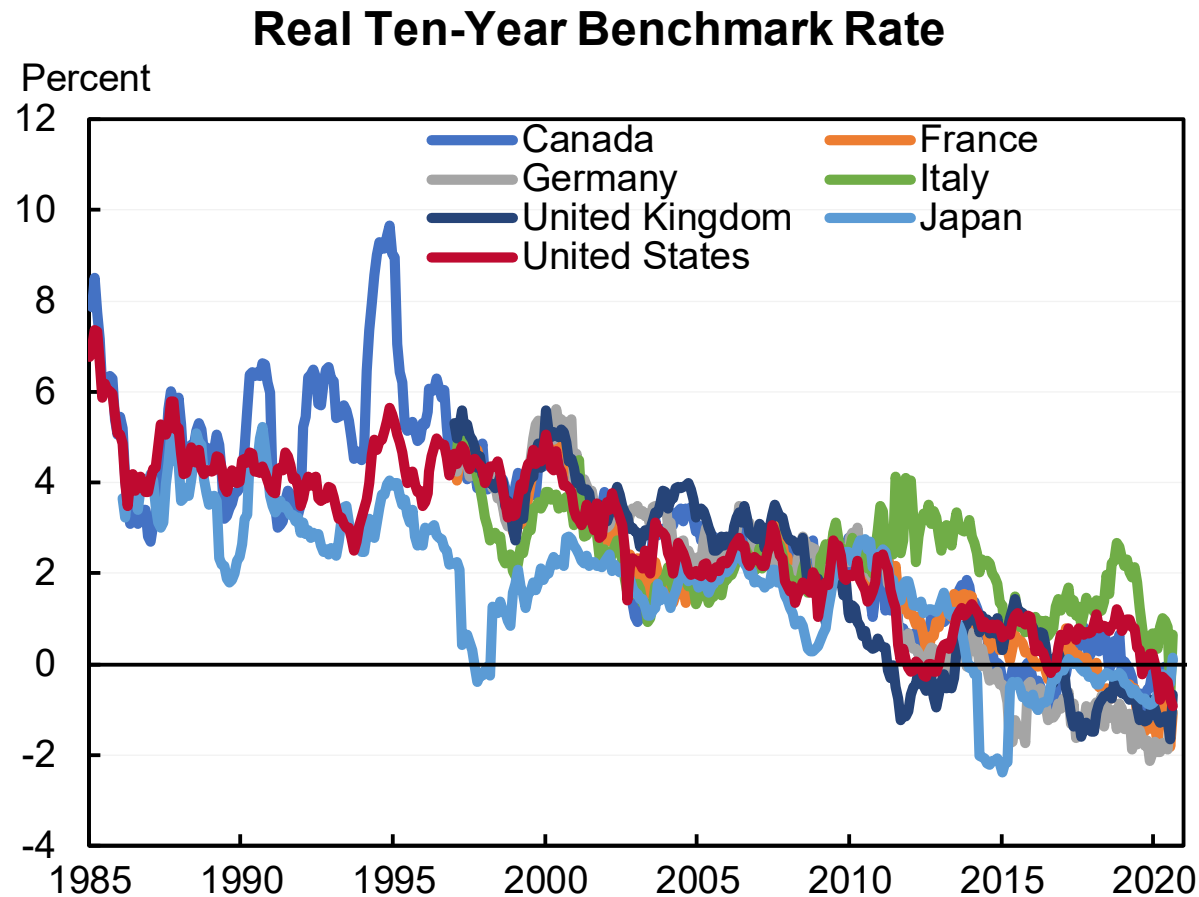
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GDP

Flow

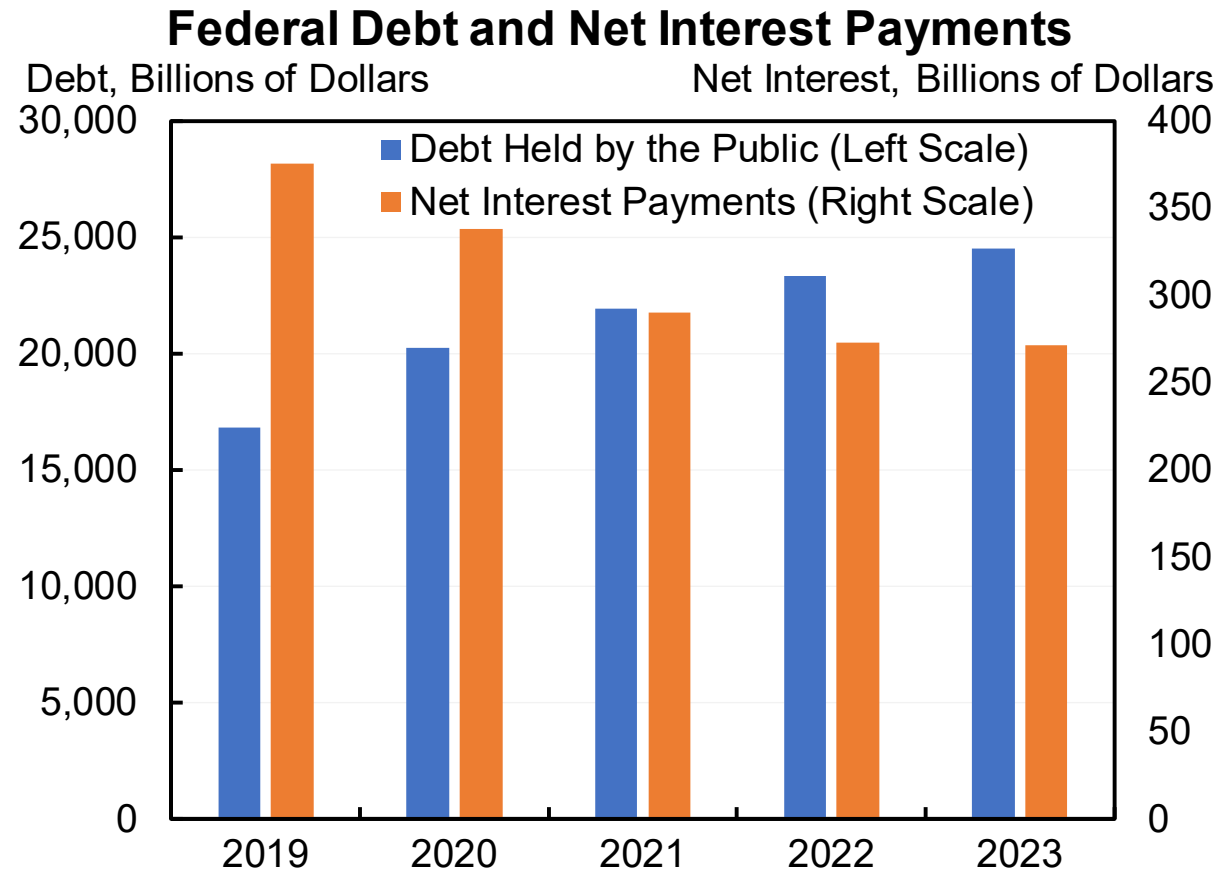
NPV of U.S. GDP is \$3.9 quadrillion (SS Trustees) or  $\infty$  (if  $r < g$ ).

# Medium-term fiscal plans must reflect the long-term & broad-based decline in interest rates



Note: Inflation measured by one-year changes in the core consumer price index (core personal consumption expenditures for United States).  
Source: Calculations based on Bank of Canada; Statistics Canada; Eurostat; Japanese Statistics Bureau; U.S. Bureau of Economic Analysis; Macrobond.

# U.S. debt up but... interest payments down

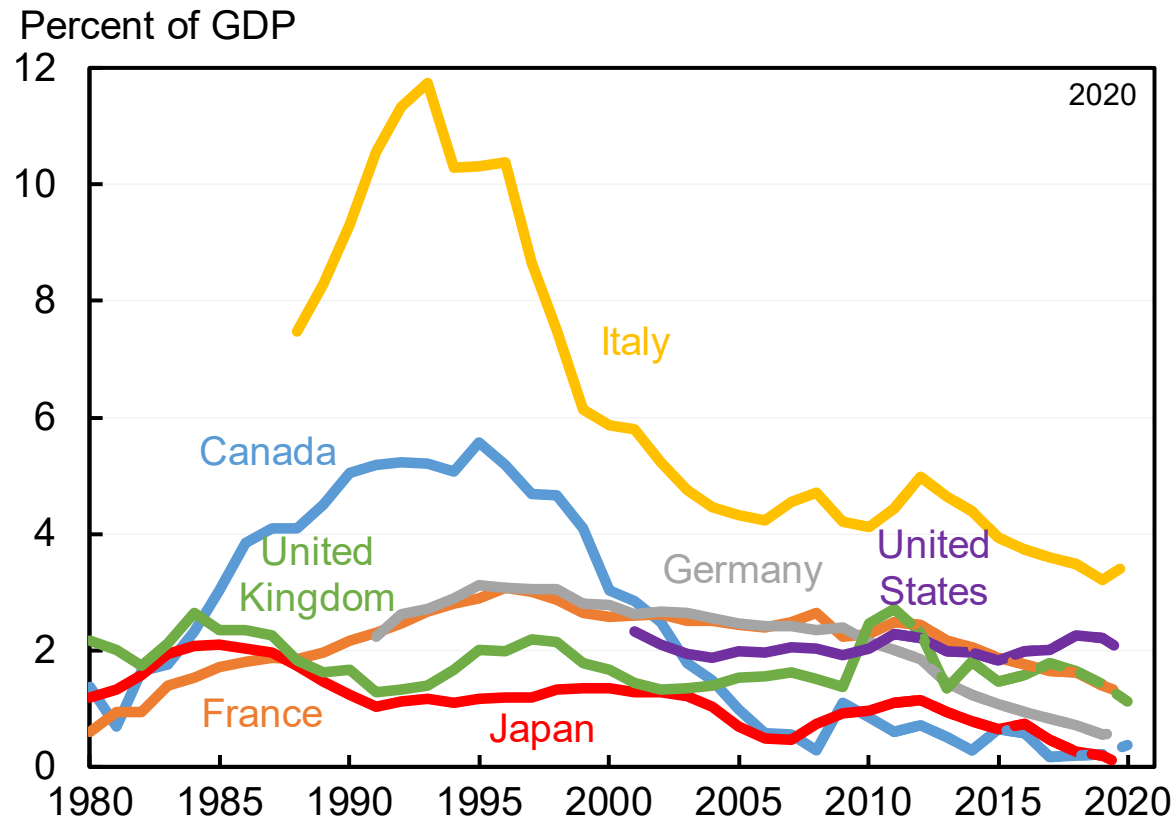


Source: Congressional Budget Office.



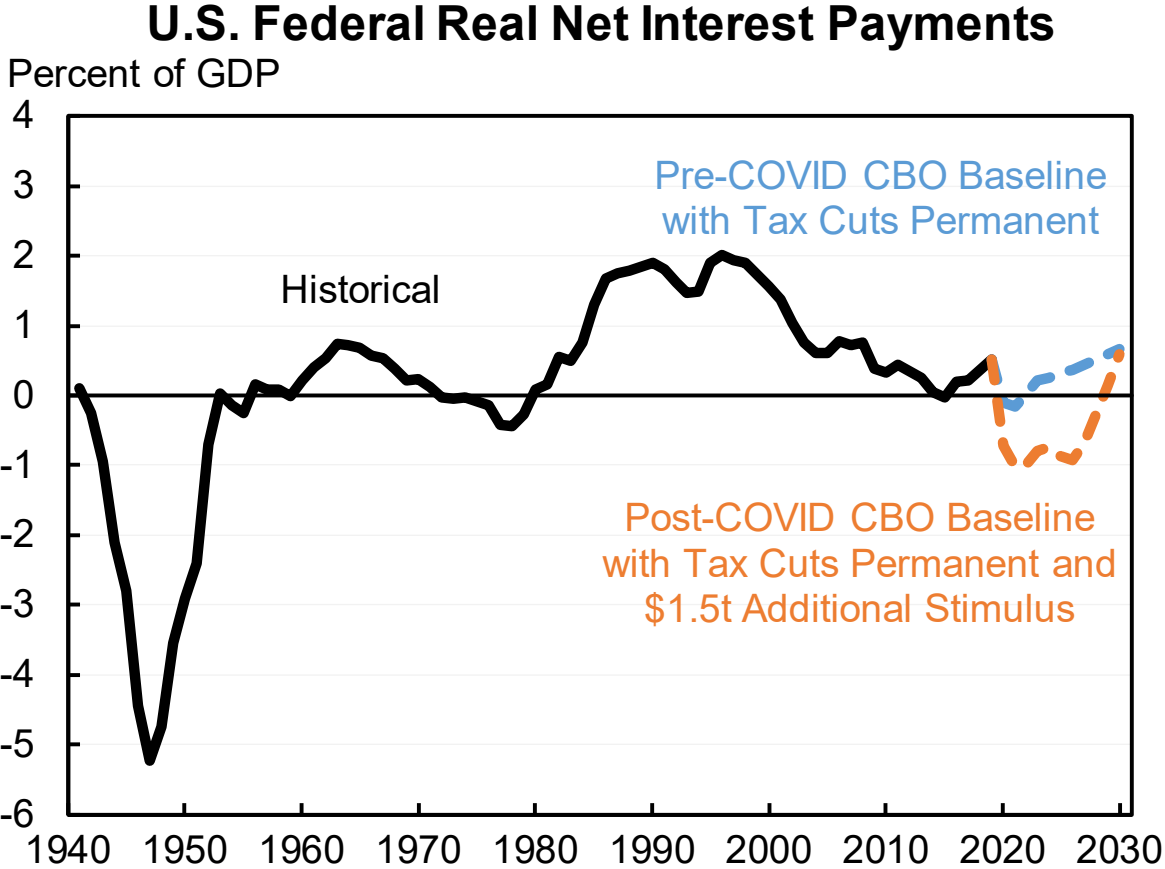
# In fact, debt service has trended down relative to the economy most everywhere

## General Government Debt Service



Source: International Monetary Fund, World Economic Outlook and Fiscal Monitor; author's calculations.

# And debt service is projected to stay low for another decade



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

# What would it take to stabilize the debt?

## Primary balance needed to stabilize at different debt levels

<u>Debt Goal</u>	<u>If <math>g - r = 1.5</math></u>	<u>If <math>g - r = -0.5</math></u>
75%	-1.1%	0.4%
150%	-2.2%	0.8%
250%	-3.8%	1.3%

## Primary Balance in 2019

Canada	France	Germany	Italy	Japan	UK	United States
-0.2%	-1.6%	2.0%	1.6%	-2.6%	-0.7%	-3.6%

Source: International Monetary Fund; author's calculations.

# What should our debt goal be?

