Economic Policy During the Pandemic Recession and Recovery

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The COVID-19 pandemic led to the second devastating global economic crisis of the 21st century

The International Labour Organization estimates that working hours fell by the equivalent of 255 million full-time jobs in 2020—four times greater than during the financial crisis of 2009.

Share of Workers in Countries with Workplace Closures
Percent

[Chart showing the share of workers in countries with workplace closures from January 2020 to December 2021.]

1 Recommended closures
2 Required closures for some sectors or categories of workers - targeted areas only
3 Required closures for some sectors or categories of workers - total economy
4 Required closures for all but essential workplaces - targeted areas only
5 Required closures for all but essential workplaces - total economy

Screenshot from International Labour Organization (2021)
This talk will focus on how we used economic policy to mitigate the economic fallout from the pandemic

Important policy Insights in the years leading up to the pandemic

Key features of the COVID-19 recession

Economic policy steps taken

Risks going forward
Important policy insights in the years leading up to the pandemic
Insight 1: Real interest rates on safe assets had gotten really low

Real Interest Rates on Government Bonds in Advanced Economies

Interest rates had fallen markedly since the early 1990s.

Economists believe this decline has stemmed from trends related to the supply and demand for savings (demographics, technology, income inequality, …) that are not likely to reverse any time soon.

Screenshot from Rachel and Summers (2019); rates implied by inflation-linked government securities.
Some key implications

Monetary policy, which had been many governments’ main tool for fighting recessions, was no longer as useful because “jumping off point” for cutting interest rates when the economy weakens is much lower (the “zero lower bound” problem).

Fiscal policy was less costly as a tool for fighting recessions.
Insight 2: It can take a long time to recover from a bad recession

Unemployment Rates, 2005-2019

Percent

After the financial crisis, it took about a decade for the UK and US unemployment rates to revert to their pre-crisis levels.

It took a dozen years for the Euro area to do so.

Data from FRED (here, here, and here)
Insight 3: “High pressure” (robust) economies have important distributional benefits

For example, the robust US labor market of the late 2010s led to measurably stronger family finances for traditionally low-wealth groups.

[Bar chart showing changes in median net worth for US families from 2007 to 2019, with specific data points for the lowest 20% of income distribution and Black, non-Hispanic and Hispanic groups.]

Data from Survey of Consumer Finances
Insight 4: “High pressure” economies don’t have to have high inflation

Even as labor markets heated up in some economies in the late 2010s, inflation was mostly below central banks’ targets.

Economists think inflation depends not only on the strength of labor markets but also importantly on inflation expectations.

Data from FRED (here, here, and here)
Key features of the COVID-19 recession
Common themes across countries

**Deep plunge** in economic activity as countries shut down in spring 2020

**Sharp partial economy recovery** as businesses that could safely reopen did so

**Sub-normal pace** of economic activity thereafter (weakness concentrated in high-contact services industries)

**Robust recovery only after a large share of population vaccinated**
But some countries have been hurt much more than others

Revisions* to Level of Per Capita GDP

*April 2021 forecast relative to January 2020 forecast

Screenshot from the IMF
Country disparities reflect in large part the path of the virus (and, relatedly, the availability of vaccines)

New Confirmed Virus Cases per Million
Average over week ending May 17, 2021

In emerging market and developing economies, vaccine procurement data suggest that effective protection will remain unavailable for most of the population in 2021.

IMF (2021) p. 11
Country disparities reflect in large part different amounts of fiscal support

It’s difficult to quantify the responses on a consistent basis because enacted fiscal policy has taken different forms, has different timing, and some is open-ended; but this map gives you a general idea.

Countries spent different amounts because of different needs and, importantly, different ability to borrow to finance spending.
The degree to which formal restrictions have contributed to regional disparities is unclear. Some studies, like Goolsbee and Syverson (2020), have compared neighboring areas with different lockdown policies and found very similar declines in economic activity.
Some types of workers have been hurt more than others

Change in Unemployment Rate, 2020
Percentage points

Change in Labor Force Participation Rate, 2020
Percentage points

Data from IMF *World Economic Outlook* (2021)
Economic policy steps taken
Monetary policy may have been limited by low interest rates, but central banks played an important role.

Do you remember the financial crisis of 2020?

(Hint: March 2020 saw severe financial market dysfunction around the world)
Monetary policy may have been limited by low interest rates, but central banks played an important role.

Most people don’t remember the financial crisis of 2020 because central banks stepped in swiftly to provide trillions of dollars of liquidity to markets.

Central banks followed up with various lending programs to make sure that credit continued to flow to key sectors of the economy.

In the absence of such steps, we might have seen a much more severe and lengthy financial crisis that greatly amplified the pandemic economic crisis.
The fiscal policy response (for the countries that could afford it) has been larger than after the financial crisis.
Fiscal support has taken different forms

Measures to protect households—e.g., “COVID checks,” payments to businesses to retain employees, household tax credits, expanded unemployment benefits, enhancements to other safety net programs, in-kind support

Measures to keep businesses from failing—e.g., tax breaks, grants, loan guarantees, subsidized loans

Measures to fight the virus and support the health care system—e.g., money for PPE, testing, vaccine procurement, hospitals
What should the goals of fiscal policy be under these circumstances?

1. **Fight the virus**—money to support the health care system, PPE, vaccine development and distribution

2. **Relieve hardship**—avoid huge cuts in consumption in the face of enormous job loss
Did fiscal policy relieve hardship?

Hardship has occurred, and it will be years before we understand the full extent of it in countries around the world.

However, it would appear that fiscal measures blunted the effects of the massive job and earnings losses (albeit for some groups more than others).

US Households Doing “At Least Okay”

Percent

- Asian
- White
- Hispanic
- Black

Screenshot from Federal Reserve (2021)
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3. **Avoid scarring**—minimize damage to economic structures that will weigh on the recovery or cause a permanently lower level of output over the longer run
### Scarring is what made the last recession the “Great” Recession

<table>
<thead>
<tr>
<th>Households</th>
<th>Businesses</th>
<th>Governments</th>
<th>Financial System</th>
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<tbody>
<tr>
<td>Erosion of skills, loss of labor market attachment due to prolonged unemployment</td>
<td>Loss of organizational capital when businesses fail</td>
<td>Sub-national budget strains because of higher spending + reduced tax revenues + balanced budget requirements</td>
<td>Weakened or failed financial institutions leading to credit crunch</td>
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<tr>
<td>Foregone skill development because of closed schools</td>
<td>Business debt overhang because of limited revenues</td>
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<tr>
<td>Household debt overhang because of limited income</td>
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<td>Unsustainable debt positions for countries hit especially hard</td>
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4. **Fiscal stimulus**—the traditional goal; restore aggregate demand to its pre-pandemic levels

Do we really want this while supply is constrained? I will return to this question in a minute.
Risks going forward
Pent-up demand is expected to power strong economic recoveries once populations are vaccinated.
Risk 1—An ongoing K-shaped recovery

As already discussed, job losses were concentrated among lower-income workers.

Prospects are looking brighter for these workers, but how long will it take to put tens of millions of them back in jobs—particularly as surviving businesses emerge leaner and with more automation?

Economies may emerge from the pandemic with even higher income inequality.
Policy priorities

Focus now on worker reallocation measures (a pivot if previous focus was job retention policies)

Deploy “active labor market policies” such as training and assistance with job search

For the longer-term:

Create stronger social safety nets—particularly in countries with weak ones

“Invest” in poor children and their families—address basic needs (food, housing, health care) and provide access to high quality education (pre-K and college)
Risk 2—A rise in inflation to undesirable levels

Google Searches for “Inflation” over Past Five Years

Yes, everyone is talking about it
How to think about inflation

Economists think **one key determinant of inflation is “slack” in the economy**

It’s not hard to see why people think slack is diminishing sharply—the pickup in aggregate demand in coming months may well exceed the pace at which economies are able to open up (the increase in aggregate supply)

But to have a sustained rise in inflation, **it’s necessary for inflation expectations to rise**

Inflation expectations have risen in recent weeks, but **the level is not particularly high**
Policy priorities

Central banks need to *vigilantly monitor inflation indicators*—especially inflation expectations

Tighten monetary policy *but only if it becomes clear that inflation is undesirably high on a sustained basis* (in the United States, that likely means rising above 2½ percent for a sustained period)

Communicate likely central bank actions well so as not to unsettle financial markets with the move (i.e., try to avoid a “hard landing”)
Risk 3—High levels of government debt

Low government borrowing rates have reduced concerns about the pandemic-drive rise in debt in richer countries but there are more concerns about the rise in debt in emerging market and low-income countries.

Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Concerns about emerging market and developing economies

Already, it’s clear that many lower-income countries are experiencing slow recoveries and humanitarian crises from fiscal constraints.

But, also, there’s potential for sovereign debt crises—and ripple effects on the global financial system if borrowing rates for these countries rise, defaults increase, and lenders take losses.

Read the article here.
Policy priorities to address high debt and fiscal constraints in lower income countries

International cooperation is essential

Higher-income countries need to support that expansion of vaccines in the rest of the world

International institutions need to provide financing and grants for these countries

Government debt payments are eligible for suspension in some countries, but debt restructuring may be needed if the rates at which their governments can borrow rise significantly
Thank you!