

United States House of Representatives

Committee on the Budget

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“How the American Rescue Plan Saved Lives and the U.S. Economy”

Written Testimony of Julia Coronado

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Thank you for the opportunity to testify. My name is Julia Coronado, I am the Founder of the macroeconomic research firm MacroPolicy Perspectives, a Clinical Associate Professor at the McCombs School of Business at UT Austin, and a former economist at various financial firms and the Federal Reserve Board. It is my pleasure to talk about how the American Rescue Plan contributed to the outperformance of the US recovery from the global pandemic.

At the beginning of 2021 the outlook for the US economy was positive but still highly uncertain. Vaccinations for COVID-19 were just getting underway and were not yet widely available. Social distancing and work from home were still the norm for many, while those who could not work from home faced elevated personal health risks. The recovery from the sharp, short recession associated with the global lockdown of 2020 had been impressive, but real GDP growth on balance in 2020 was only 1.1% y/y and employment was still 10 million jobs below pre-pandemic levels at the start of the year.

The American Rescue Plan was signed into law on March 11, 2021, exactly one year after the World Health Organization declared a global pandemic. Before expectations for the plan’s passage began to build private and government forecasters were looking for a solid GDP performance in the neighborhood of 4.0% for 2021 and for the unemployment rate to fall from 6.7% at the end of 2020 to a still elevated rate of 5.0%. In the event, real GDP grew 5.7% in 2021, the fastest pace since 1983 and the unemployment rate fell to 3.9%, the fastest one-year decline on record.

In the midst of the pandemic the approach of both fiscal and monetary policy makers was that it was better to err on the side of doing too much rather than doing too little. It is important to revisit why that approach became the consensus. The recovery from the housing crash and Great Recession featured too little policy support and as a result a labor market that left millions of Americans on the sidelines of the economy or underemployed for years. It took more than six years for the labor market to regain the 2007 level of employment, and only after we regained that level did we see the labor force participation of prime aged workers (25-54) which had fallen to the lows of the mid-1980s begin to recover. During the pandemic, prime aged labor force participation again fell to the lowest rate since the early 1980s in April of 2020 and while the recovery in labor force participation has been held back by repeated waves of COVID, a decisive recovery in both jobs and participation has been ongoing in the past twelve months. At the pace of hiring and rising prime aged participation registered over the past three months we are on track to exceed pre pandemic levels of employment and participation over the next six months, which would be the fastest labor market recovery in the past four decades, a fact made more impressive by the fact that we started from the highest unemployment rate since the Great Depression.

There is an extensive literature in economics that documents what we call labor market scarring, defined as the permanently lower earnings trajectories realized by people who experience long spells of unemployment or labor force disengagement. People who experience longer spells of unemployment have a harder time restoring their pre unemployment trajectories of earnings and are more vulnerable to becoming unemployed again. Labor market scarring

was a serious concern early in the pandemic given the sharp rise in unemployment and labor force disengagement. It is also well established that unemployment adds to income inequality, that is lower wage and nonwhite workers see higher unemployment rates in a recession and experience slower recoveries. These well established findings coupled with a disastrously slow labor market recovery from the Great Recession led to a reorientation in fiscal and monetary policy that prioritized the speed of the recovery to minimize scarring and income inequality. The ARP was a manifestation of this orientation and has been wildly successful in achieving its labor market objectives.

A strong labor market and fiscal support has meant a broader based and more inclusive recovery for more people. Workers have had more financial space to bide their time, change employers and find the right job situation for them and their families. We are seeing younger, nonwhite, and lower wage workers hit harder by job losses during the pandemic realizing by far the biggest wage gains and obtain full time jobs more readily when they want them.

The financial benefits of supporting households through a pandemic have also been broader based; delinquencies on all loan categories, from auto loans to mortgages to credit cards have fallen through the recession and recovery, the first time we have ever seen household credit quality improve through a downturn reducing the long shadow of financial scarring that often accompanies a recession.

Employers have had to change some of their hiring and business practices to function successfully amid this new stronger labor market dynamic, but they have largely been able to do so. Business profitability and productivity have risen strongly through the pandemic and applications for new business formation have soared to new highs suggesting that it is possible we emerge from the pandemic with a more productive, dynamic economy.

It may sound jarring to describe the US economy in such glowing terms when inflation is soaring, one of the key measures of consumer sentiment that is more tied to inflation is plunging, and there is rising chatter of a recession. But diagnosing the drivers of high inflation is key to developing an effective policy response. One reason some of the initial burst in inflation last year was not expected to last was that during the pandemic consumers shifted their spending sharply to goods after more than fifty years of spending ever more of their budget on services reflecting both restrictions and reluctance on engaging in social activity. That shift strained global supply chains and exposed structural shortcomings. The shift to services and disruptions to production and transportation from COVID related shutdowns were not expected to last, yet here we are in 2022 and China is still closing down factories and ports. Consumers have started to shift back to services, but it has been later and more gradual than expected early in the pandemic.

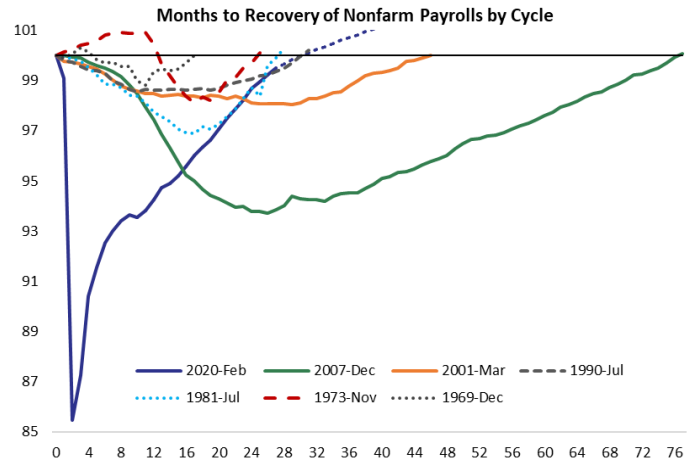
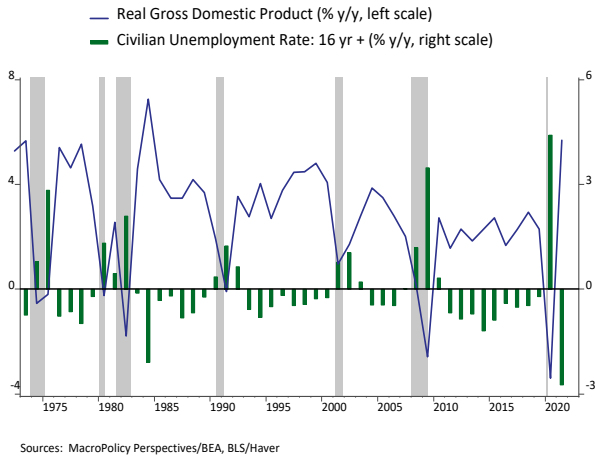
Excluding food and energy and adjusting for differences in methodology, US core inflation rose earlier and higher than other advanced economies, which surely reflects in part stronger policy support. But all countries have seen core inflation that is between 2.5% and 3.5% above pre pandemic norms suggesting that shifts in spending and interruptions to the flow of production and transport of goods tied to the pandemic is also playing a role. At the same time, the US has also experienced one of the strongest recoveries in the world with real GDP 3.7 percent above the pre pandemic level while most other advanced economies are just reaching pre pandemic GDP and many emerging markets are still well below. Australia had a early and aggressive response to containing COVID, an earlier shift back to services spending, and a recovery on par with the US. The more recent spike in food and energy prices is tied directly to the war in Ukraine and will act as a tax on the purchasing power of US consumers.

Based on the strength of the US economy, the Federal Reserve has been pivoting toward a faster removal of monetary accommodation in recent months and higher interest rates and tighter financial conditions should begin cooling demand and inflationary pressures in coming months. Lingering supply chain frictions and the vulnerability of food and energy prices to the actions of despots and dictators who seek to weaken western democracies and economies will not be addressed through monetary policy but require a more structural response. Viewing high inflation primarily through the lens of budget deficits and cyclical support is not likely to be helpful; witness that the federal government ran the largest April surplus in history this year as a strong economy produced much stronger than expected tax receipts and the expiration of ARP programs led to outlays that fiscal year to date are down 18% over last year yet supply chain frictions

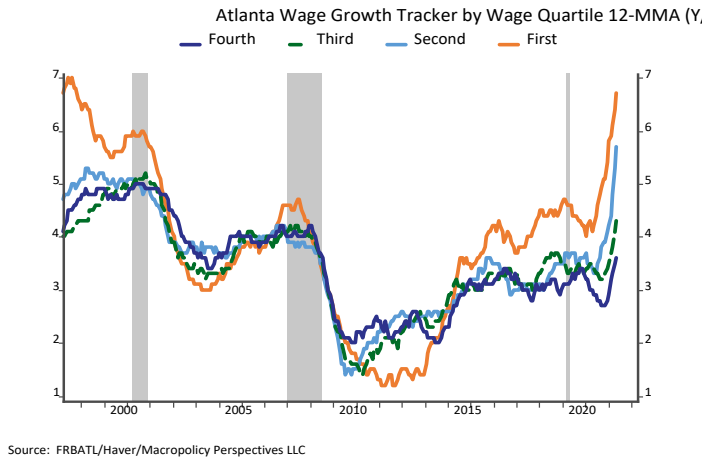
and war inflation are still with us. At least the strong economy has given consumers the best shot possible of weathering tightening policy and the war shock, and that strong recovery came from supporting households and businesses through the pandemic. The pandemic has been a huge shock to the system and left the global economic system grappling with an unexpectedly large amount of lasting disruption. Now is the time to think through some of the complexities of the more structural elements of this disruption which will be key not only to bringing inflation down but meeting the challenges of the energy transition and climate change and preserving western style democracies.

Chart Appendix

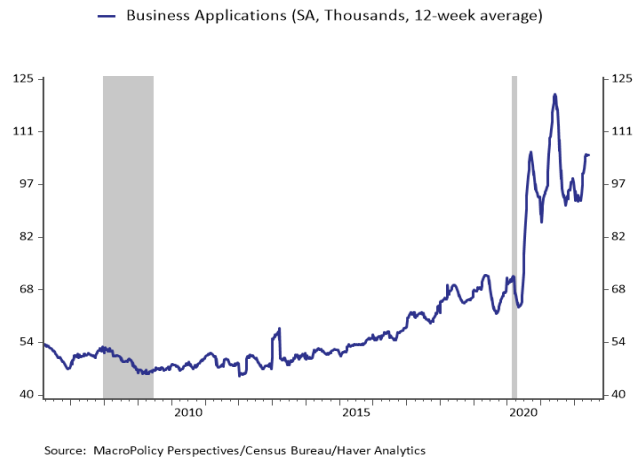
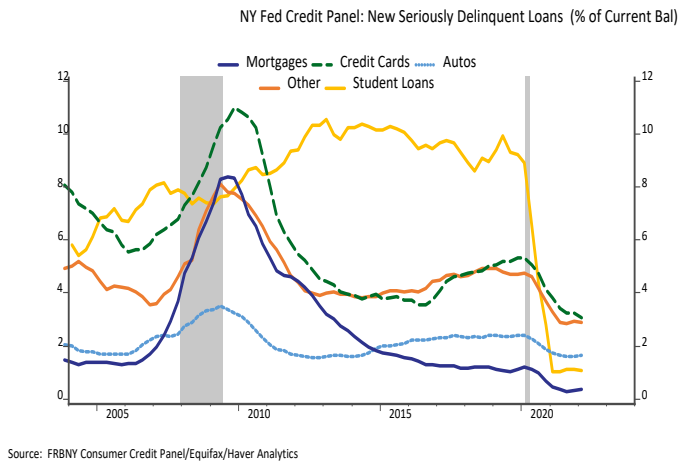
Strong policy support helped deliver one of the fastest recoveries from one of the deepest recessions



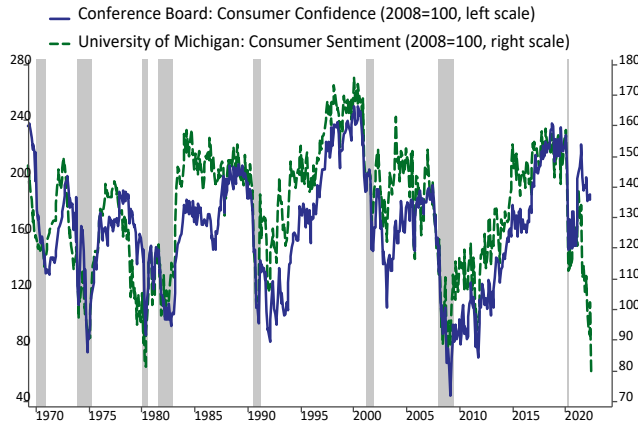
Labor market engagement is recovering rapidly and lower wage workers are seeing the largest wage gains



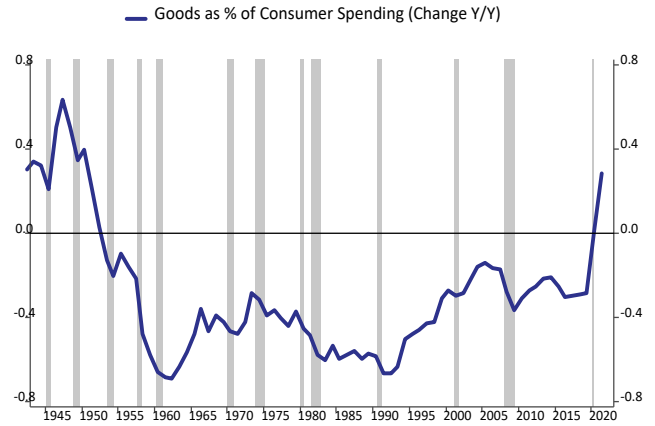
Households have seen fewer loan delinquencies and new businesses are being formed at a record rate.



Measures of consumer sentiment are sending mixed messages. Consumers shifted sharply to goods in the pandemic.

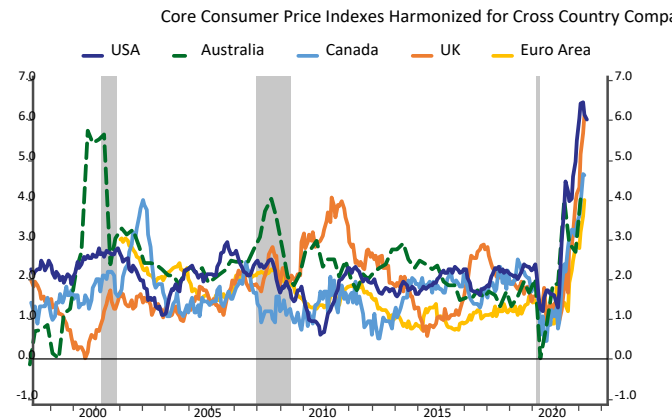


Sources: CB, UMICH/Haver/MacroPolicy Perspectives LLC

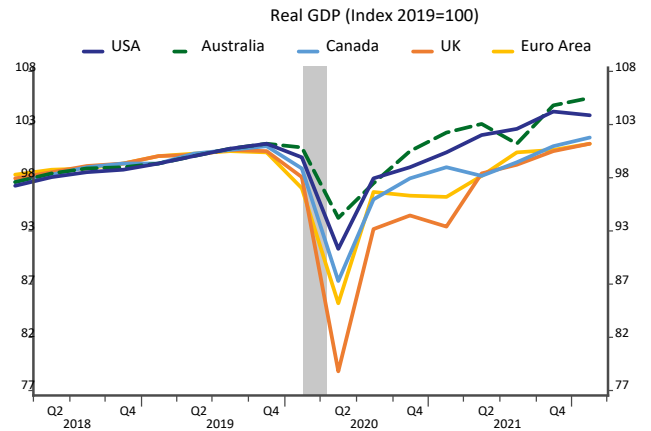


Source: Haver/MacroPolicy Perspectives LLC

Fiscal support meant an added boost to US inflation and growth, disruption is a key part of the inflation story

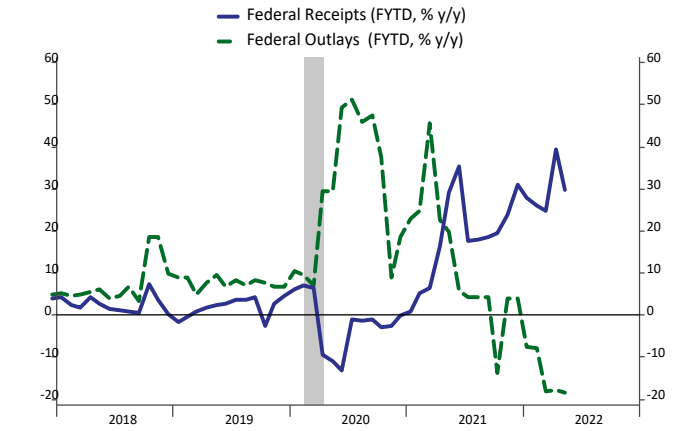
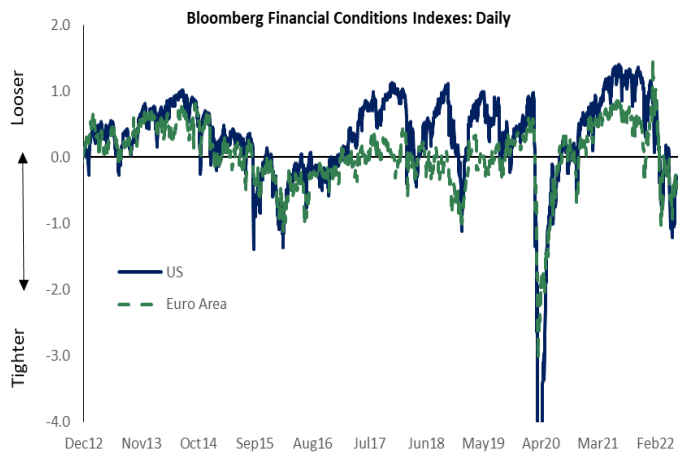


Sources: BLS, ABS/H, SCAN/H, ESTAT/H/Haver/Macropolicy Perspectives LLC



Sources: BEA, ABS, StatCan, ONS, EUROSTAT/Haver/Macropolicy Perspectives LLC

Central banks are tightening financial conditions globally and US fiscal balances are improving dramatically



Source: TREASURY/Haver/MacroPolicy Perspectives LLC