June 30, 2020

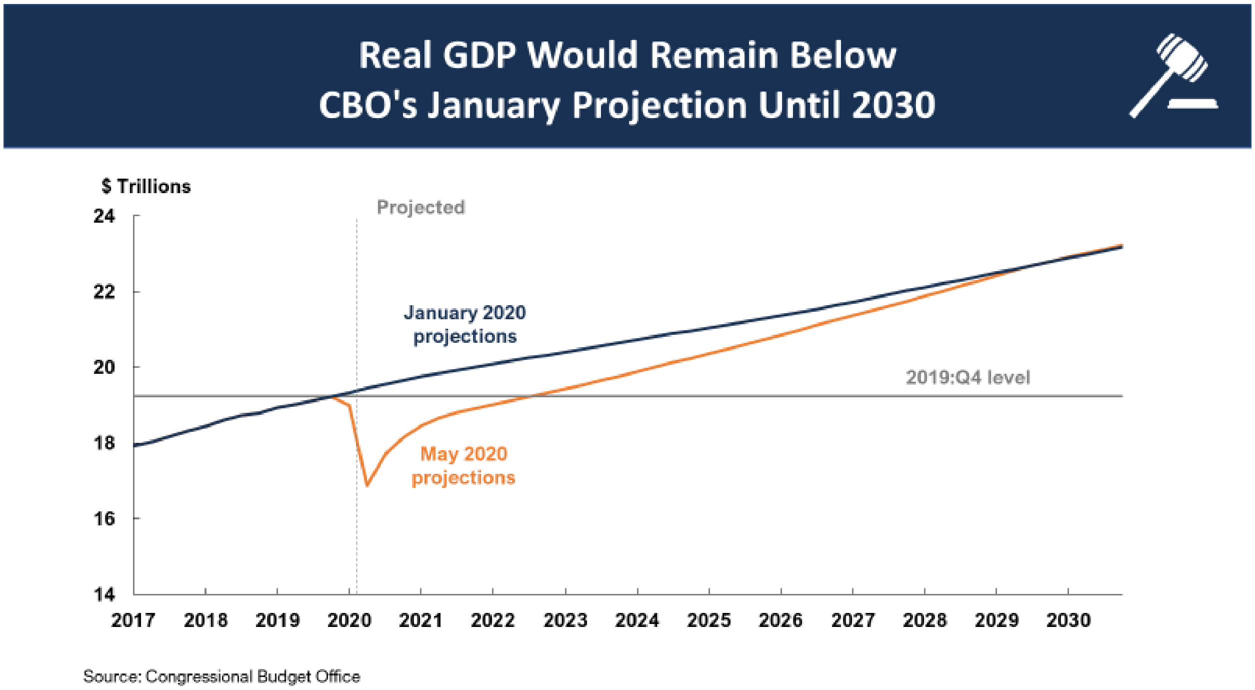
The Economy Needs More Fiscal Support, Now

Over the last four months, more than 2.6 million Americans have been infected with COVID-19, and more than 129,000 have died. The pandemic and the social distancing measures needed to contain it have also led to the most abrupt and severe recession in recent history, with unemployment rising to levels not seen since the Great Depression. In a hearing earlier this month, the House Budget Committee heard testimony from two former directors of the Congressional Budget Office (CBO) on how Congress can further mitigate the economic fallout and foster a strong and equitable recovery. Both witnesses agreed on the urgent need to provide additional aid to families and communities as our nation battles the coronavirus. In particular, witnesses stressed the critical importance of supporting unemployed workers, state and local governments, and small businesses while bolstering our public health infrastructure.

Our Economy Faces a Long Road to Recovery

As Dr. Doug Holtz-Eakin, president of the American Action Forum and CBO director from 2003-2005, testified, "The U.S. economy is enveloped in an economic downdraft of unprecedented magnitude." The economy contracted by 5 percent in the first quarter of the year, reflecting record drops in economic activity across the board. There were nearly 20 million fewer jobs economy-wide in May than in February. The unemployment rate, at 13.3 percent, was the second-highest on post-war record – lower only than the rate in April. As of late June, more than 33 million Americans – more than 1-in-5 workers – are receiving or have applied for unemployment benefits. Nearly half of adults live in households that have lost income since March, leading the number of families living in poverty, experiencing food insecurity, and lacking health insurance to soar. These blows to workers' economic security have fallen severely and disproportionately on racial minorities and low-income families, threatening the well-being of our most vulnerable communities.

Forecasts suggest that while the economy has begun to recover, it will not return to its pre-pandemic state for several years. Assuming no further action by Congress, CBO projects real GDP would not exceed its level at the end of 2019 until the end of 2022 and would remain below the agency's January projection until 2030. Unemployment would be 8.6 percent by the end of 2021 and would not fall below 6 percent until 2026. Federal Reserve members expect unemployment at the end of 2021 to still be 3 percentage-points higher than it was in February. As Dr. Doug Elmendorf, Dean of the Harvard Kennedy School and CBO director from 2009-2015, noted, "We are not at the end of the Covid-19 health crisis; we are only, to quote Winston Churchill during a different sort of war, 'at the end of the beginning.'"



Fiscal Support Is Helping – But We Need More, Fast

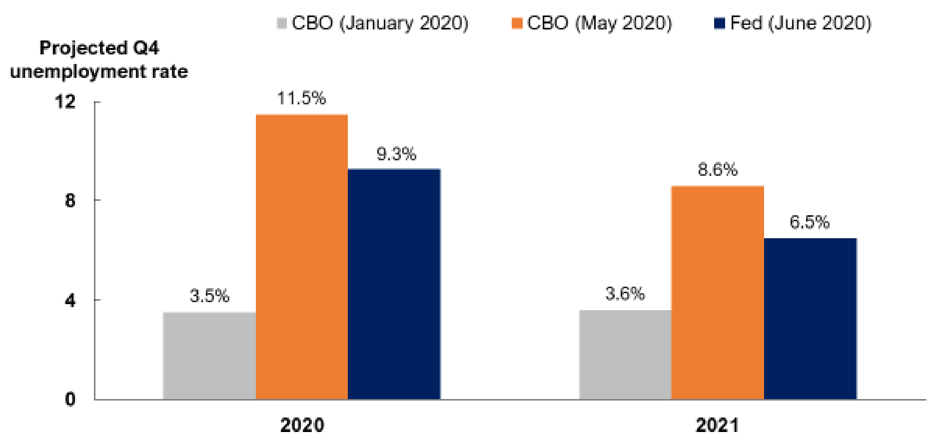
The $2.4 trillion in fiscal relief provided to date – including the Families First Act and CARES Act – has been critical to mitigating the pandemic's damage and averting worse economic and budgetary outcomes. As CBO notes, the four laws enacted since March "will partially mitigate the deterioration in economic conditions" and lead "real GDP and employment to be higher over the next few years than they would be otherwise." According to one analysis, had these laws not passed, the unemployment rate would have been nearly 2 percentage points higher in the current quarter and more than 4 percentage points higher in the third quarter.

Nevertheless, as both witnesses stressed, the economy will need much more support. The boost from the legislation passed to date is fading fast, with 70 percent of direct aid already disbursed. Unemployment at the end of this year would still exceed the worst months of the Great Recession. Over the next decade, CBO estimates cumulative nominal GDP will be $15.7 trillion lower than it projected in January. This weak and protracted recovery would inflict needless suffering on millions of Americans and threaten permanent damage to our economic potential. Yet while "more economic suffering will inevitably occur," Dr. Elmendorf advised, **"the extent of that suffering is not preordained, but depends crucially on economic policies."**

Fiscal support is not only critical, it is urgent. Several rapidly approaching developments threaten family pocketbooks and the recovery, including severe budget cuts as many state and local governments begin their new fiscal year on July 1 and the expiration of the supplemental $600 Unemployment Insurance (UI) benefit on July 31. Averting these and other looming cliffs will require immediate action.

"More fiscal support for the economy is warranted until at least 2022" — In his testimony, Dr. Elmendorf warned that "although the country is beginning to re-open following widespread shutdowns, a great deal of economic suffering still lies ahead of us, because **bringing people back to work will take much longer than pushing them out of work**." Under current policies, he noted, CBO projects that only 30 percent of jobs lost will be restored by the fourth quarter of this year, and only 60 percent by the fourth quarter of next year; in fact, the unemployment rate is not expected to return to its pre-pandemic level even by the end of 2030. While additional fiscal support "cannot fully offset people's hesitation to come into close contact with each other," Dr. Elmendorf said, "it can sustain household incomes and business operations until health conditions improve, which will not only improve people's well-being in the short run, but increase the pace of economic recovery and put us in a better position in the long run."

Labor Market Will Not Have Recovered By the End of 2021



Source: Congressional Budget Office, Federal Open Market Committee (FOMC)
Note: CBO forecast assumes current law. FOMC forecast reflects median estimate and likely assumes a "modest" amount of additional fiscal support.

"At this moment, the suffering is too great to sit idly by" — Dr. Holtz-Eakin stressed the need for Congress to act in order to alleviate the highly disproportionate impacts of the pandemic and its economic fallout on communities of color and low-income families. Even if "we get a good recovery with very good policies," he said, "when you reach the end of 2021 there will be a large number of Americans – 8 percent, 9 percent – who will still be unemployed, and will have been unemployed for a long time. My expectation is that will be disproportionately borne by these same minorities. **There needs to be not just a hope, but a strategy and an effort** to provide them the skills and opportunities to get back to work as quickly as possible, because it…historically has not happened fast if left up to its own devices." Dr. Elmendorf agreed, noting that unemployment spells can easily turn into long-term disruptions: "a moment of job loss can lead to a lack of jobs for a long time…That will be particularly true for people who come into this cycle with less buffer against the vicissitudes of our very dynamic economy."

"We should not be fooled by rapid growth rates into believing that the economy has healed or that people's suffering is over" — Dr. Elmendorf also urged caution when interpreting economic data in the months ahead – a prescient warning in light of the faster-than-expected rebound in the May jobs report, which President Trump cited when declaring victory over the pandemic. As Dr. Elmendorf explained, the "economy has fallen so far in the past few months that we might see exceptionally rapid growth during the third and fourth quarters. But even rapid growth will still leave the number of unemployed Americans unacceptably high, and the American economy operating way below its productive capacity." Indeed, the 2.5 million jobs gained in May account for only 11 percent of all jobs lost since February. Policymakers must measure progress against whether employment and output have returned to pre-pandemic *levels*, rather than focus solely on month-to-month percent changes, in tracking the recovery.

"There is a great efficiency, and the ability to enhance confidence, if you set in place now a set of policies to last as long as unemployment remains high" — To ensure against policy fatigue, Dr. Elmendorf – echoing his testimony at a Committee hearing last fall – urged policymakers to tie the extension of fiscal support to economic conditions. "By writing a trigger of that sort into law," he explained, "you do not need to pick an end date based on uncertain economic forecasts, and you will enhance confidence that fiscal support will not be withdrawn prematurely." Maintaining enhanced benefits until the unemployment rate nears its pre-recession level would ensure that aid continues until the economy is back on its feet and would also improve upon the CARES Act, which lacked "a recognition of how long this episode will go on for." As he cautioned, "This is not just a three-month crisis. This is a multi-year event."

The Best Economic Policy Is Health Policy

Both witnesses repeatedly stressed that COVID-19 remains the source of our economic crisis and will dictate the path our recovery takes. Even as states reopen, economic activity will remain depressed if workers do not feel safe going back to work or if consumers do not feel safe shopping at stores. Despite the Trump Administration's repeated efforts to discourage – and even stop – coronavirus testing and mislead the public about the source of new outbreaks, saving the economy will require that we listen to the scientific experts, improve our capacity to manage the virus, and restore Americans' confidence in public health.

"We are not done" — Dr. Holtz-Eakin emphasized that fiscal support for workers and businesses will continue to be necessary, but that Congress also faces a new challenge that requires more intensive public health efforts: "We now have to find a way to operate this economy in the presence of a virus that remains active, for which there is no vaccine, for which we are searching for adequate therapeutics and where contact testing and contact tracing is not yet sufficient." To achieve a full recovery, substantially increasing our capacity to test and trace the virus, investing in the development of a vaccine and affordable treatments, and implementing workplace safety measures will be paramount. Dr. Elmendorf agreed, arguing that the "unprecedented loss of jobs cannot be reversed simply by declarations that people are allowed to go back to work and commerce," – a point borne out in recent data that shows that official state reopening orders have had little impact on economic activity. "Instead, **people need to become confident that they can go back while remaining mostly safe from COVID-19. This will take time, money, and hard work.**" Consequently, the "most important thing we can do for a strong economic recovery is to find ways to corral the health risks from COVID-19."

"This is not the last virus" — Dr. Elmendorf further noted that "we have seriously underinvested in public health measures in this country," which left us significantly more vulnerable to COVID-19 in the first place. Strengthening our public health capacity today – in terms of equipment, expertise, and Americans' overall health and well-being – will make us more resilient to a potential resurgence of COVID-19 and future pandemics, he argued. Dr. Holtz-Eakin further highlighted that "we have a chance to get ahead" of the next public health crisis, so that "you can have much greater health mitigation come the next time."

Extending Support for Unemployed Workers is Vital

Both witnesses urged Congress to continue providing enhanced support for the record number of Americans who lost their jobs in the wake of the pandemic – and, as forecasts suggest, may be out of a job for some time. The CARES Act extended the duration of benefits and expanded UI eligibility through the end of this year while also providing a $600 increase in weekly benefits until the end of July. Data shows these measures have been extraordinarily effective at supporting family incomes, cushioning the collapse in GDP, and protecting the public health.

Extending these benefits is not only critical for the millions of Americans unable to return to work because their workplaces are not yet open, they are caring for children or other family members, or because they worry it is not yet safe to do so – but also for the millions of Americans who no longer have a job waiting for them. As the number of permanent job losses continues to climb and workers grow more pessimistic that they will be able to return to their old employers, strengthened UI benefits will be needed to carry them through what is likely to be one of the worst job markets in U.S. history.

"The combination of checks sent to households and pandemic unemployment insurance has supported households dramatically"— Dr. Holtz-Eakin noted that the Economic Impact Payments and the enhanced unemployment benefits enacted in the CARES Act have "done a great job of insulating the household sector from the downdraft." Household incomes in May were nearly 4 percent *higher* than before the pandemic, even though wages and salaries were down nearly 9 percent. UI alone – driven by the $600 weekly supplement – has more than fully offset the decline in wages and salaries since February, buttressing consumer spending and helping families meet their basic needs. Indeed, as one study shows, the expanded UI benefits have been the *most valuable aspect* of the CARES Act for plugging family income shortfalls and strengthening financial security: just 57 percent of families are likely able to cover three months of expenses with savings and standard UI benefits; with the expanded UI benefits, that number rises to 83 percent of families. Among Black and Latino families, who have been hardest hit by the pandemic and the economic fallout, the number of households able to cover their expenses roughly doubles thanks to expanded UI benefits.

"I think the worst thing you could do is let these benefits expire at the end of next month"— While Members discussed various proposals to modify the $600 supplemental UI benefit, Dr. Elmendorf stressed that whatever Congress decides to do, it must provide enhanced benefits beyond July 31 and until unemployment falls from its elevated levels. Extending benefits is "crucially important because of the fact that the second half of the year into next year there are still going to be millions and millions of people who can't find jobs, and they need and deserve support for their own sake and for the sake of the economy," Dr. Elmendorf said. Allowing the expanded benefits to expire would not only abruptly eliminate a critical lifeline for a record number of unemployed Americans – effectively guaranteeing a pay cut of 50 to 75 percent overnight – but would also undermine our nation's economic recovery. According to a recent analysis, the expiration of the $600 benefit at the end of next month would lower GDP in the second half of this year by 2.5 percent – more than a typical year's worth of economic growth – and reduce employment by an average of 2 million jobs over 2021.

"The people I talk to who are unemployed are grateful that they are able to make the decision to protect themselves from this virus by staying at home" — In response to claims that the $600 weekly benefit could be disincentivizing work, **Congressman Dan Kildee (MI-05)** reminded Members that it is serving a critical public health function by relieving pressure on Americans who are not yet able or do not yet feel safe returning to their workplaces. As he explained, "most of the anxiety that I hear from people about whether they should stay on unemployment or go back to work has to do with fear of being exposed to the virus, not some sort of calculation that if they stay unemployed…until July 31 they would be willing to risk the job that they could have for years in exchange for that return." Indeed, in a Census survey, fewer than 4 percent of adults who were not working in mid-June cited their reason as not wanting to be employed at this time. By contrast, all other workers said they were either furloughed or laid off, afraid of getting the virus, sick, taking care of children or other family, or retired. Recent research, moreover, suggests that states with more generous UI benefits saw shallower economic declines and are experiencing faster recoveries – undermining claims that extending benefits will hinder the recovery. May's job gains, of course, further suggest that the $600 supplement is not holding Americans back from work.

"I think that problem" of disincentives, Mr. Kildee said, "is being overblown relative to the more central issue, and that is that people are afraid to go back to work if they don't believe they are going to be protected in the workplace." While potential work disincentives could become a more pressing concern further into the recovery, the most immediate challenge is ensuring that workers are not forced to choose between their health and their livelihoods after July 31. The pandemic – not “overgenerous” benefits – remains the source of our economic crisis.

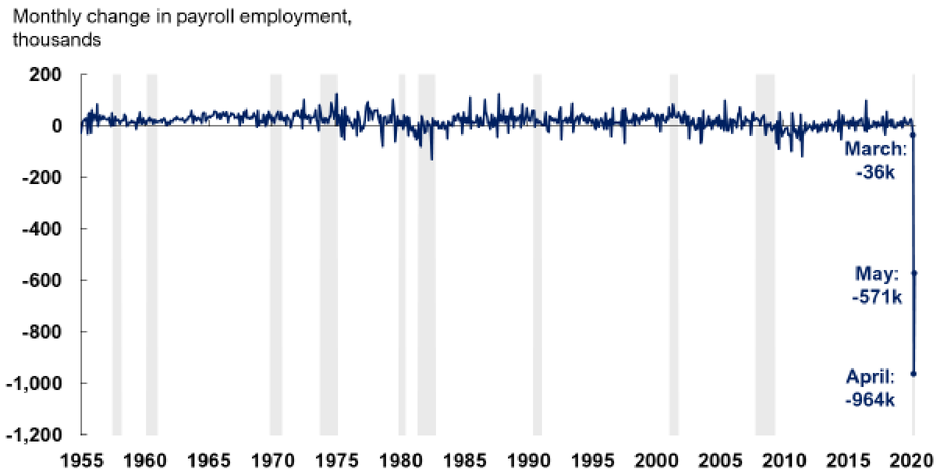
Our Recovery Depends Upon State and Local Governments

Both witnesses also agreed on the need to provide relief to state and local governments, which are facing an estimated $900 billion budget shortfall through the end of 2021. States and localities play a critical role in providing public services – which are even more essential during a public health emergency – as well as in supporting economic growth. But with nearly all states constrained by balanced budget requirements, and with most facing a new fiscal year on July 1, many will be forced to cut critical services and lay off teachers, firefighters, and other government workers. These cuts to services and jobs would further endanger our health, exacerbate underinvestment in education and other public goods, and undermine our recovery. In fact, every dollar that states and localities cut in the wake of the Great Recession shaved as much as $2 from the economy and ultimately delayed the recovery in employment by 4 years.

“They are going to need a bridge. There is no question about it” — Dr. Holtz-Eakin clarified that the pandemic has put direct and severe pressure on state and local governments’ budgets, irrespective of their fiscal health before the crisis. As he explained, “when the customers went away and the businesses' revenues went away, so did the sales taxes. And when the layoffs started, the income taxes and payroll taxes.” These declines, coupled with the delay in income tax filing deadlines, led state tax revenues in April alone to plunge by nearly 50 percent compared to the previous year. Beyond the collapse in revenue, Dr. Holtz-Eakin added, there “are also a lot of additional expenditures that states and localities have undertaken to combat the virus and the effects of the pandemic. That is in the national interest, and I think it is appropriate that the taxpayer pick up that tab in whole or in part.”

“We want to keep people at work in state and local governments, as well as in businesses now, so that, as health conditions improve, we can have people spending money to create a strong recovery” — Dr. Elmendorf emphasized that, given state and local governments’ role as a major employer, failure to provide support for their budgets “would be very bad for the economy and for the workers directly involved, and also for all of restauranteurs and shop owners who would be serving those people if they had income to spend.” State and local governments – which together employ more than one in every eight American workers, with disproportionate shares of women and people of color – have already shed 1.6 million jobs since February, *two-thirds of which were in education*. By the end of next year, state and local budget cuts could result in more than 5 million workers – across both the public and private sectors – losing their jobs. Failure to protect these jobs would, Dr. Elmendorf said, “accentuate a downward cycle” for our economy, “rather than helping to keep us on an upward trajectory.”

State and Local Governments Shed Nearly 1.6 Million Jobs Over the Last Three Months



Source: Bureau of Labor Statistics
Note: Gray shading denotes recession.

"I think we need some direct aid" — Dr. Elmendorf also underscored that while the Federal Reserve's new program to lend to state and local governments is an important source of support, "it is not enough." States and localities have little capacity to repay loans, he explained, because "they are not just suffering from a temporary shortfall that will be made up somehow next year. They are losing a lot of money that is not going to be made up in the future." Consequently, "it is entirely appropriate and very useful for strengthening the economic recovery for the Congress to provide direct grants to state and local governments."

Small Businesses Are in Dire Need of Help

While both witnesses lauded Congress' efforts to support small businesses in the CARES Act and in subsequent legislation, they also stressed that small businesses remain severely vulnerable. The payroll support that many small businesses received from the Paycheck Protection Program (PPP) will wane over the coming months, heightening the risk of a new wave of small business failures, bankruptcies, and layoffs. Moreover, many small businesses had difficulty accessing PPP support or were shut out of it entirely – including those in areas hardest hit by the pandemic and those owned by minorities.

We are already seeing the toll on the small business landscape. At least 2 percent of small businesses nationwide are estimated to have closed permanently as of early May. More than 40 percent of Black business owners said they were no longer working in April, compared to just 17 percent of white small business owners. Small businesses in the most affluent ZIP codes – which tend to provide services to high-income customers, who significantly cut their spending in the wake of the pandemic – lost more than 70 percent of their revenue through April and laid off more than 70 percent of their (low-wage) workers. Stemming further business closures and job losses will clearly require more and much better-targeted support.

"I would expect that we will continue to lose some small businesses and we will see increases in the ranks of the unemployed" — Dr. Holtz-Eakin warned that even among small businesses that received PPP loans, depressed demand will continue to weigh on their operations and threaten additional layoffs. "I am very worried about our small to mid-sized businesses in the United States…I think there is going to be some real distress." While Congress' recent moves to enhance flexibility for PPP recipients are providing much-needed help, he noted, more must be done to support small business lenders and further increase flexibility for loan recipients.

"There are businesses that have not been able to access funds…And I think this is a problem we should be very concerned about" — Dr. Elmendorf argued that the PPP was not enough: "It doesn't cover businesses above a certain size, doesn't cover businesses that already have large amounts of debt. And so I think more is needed." But going forward, he recommended, Congress should consider providing direct subsidies to small businesses, particularly those that were unable to access funds through the PPP or the Federal Reserve's Main Street Lending Facility. As he argued, "many businesses need grants, not just loans, because they will never make up the revenue they are losing now, they hope only to resume normal activity in the future." Indeed, according to a Census survey of small businesses fielded in mid-June, 41 percent said they believed it would take more than six months for their business operations to return to normal levels. Keeping "businesses afloat during this period, when potential customers are unable or unwilling to turn up is crucial, both for reducing suffering today and for enabling a more rapid economic recovery when health conditions improve," Dr. Elmendorf said.

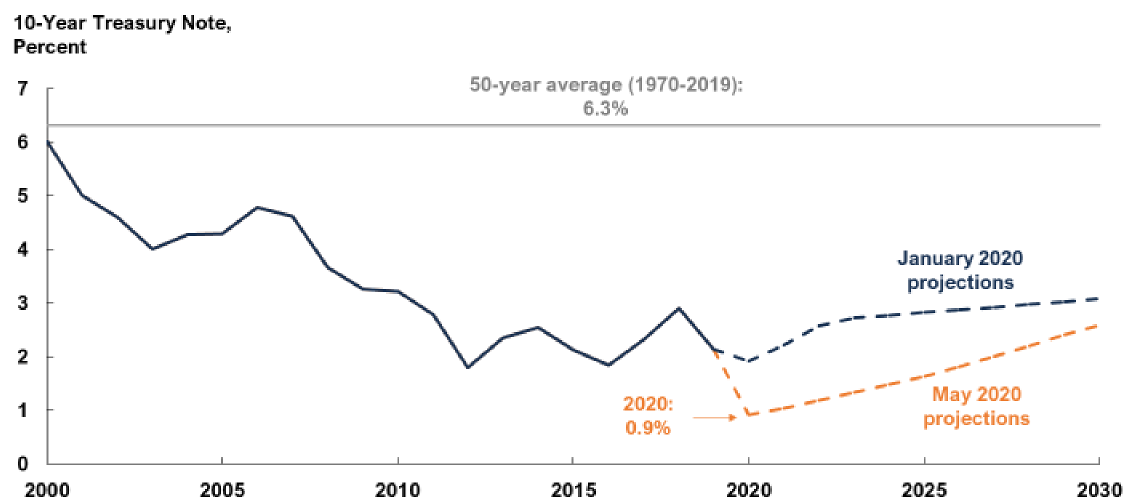
We Have Fiscal Space to Do More

There is no doubt that the economic collapse and Congress' efforts to counter it to date will increase deficits over the next several years. According to CBO's preliminary projections, sharply lower revenues and higher spending will raise deficits as a share of GDP to 18 percent in fiscal year 2020 and 10 percent in 2021. Debt as a share of GDP is projected to be 101 percent by the end of 2020 and 108 percent in 2021, exceeding the record levels set in World War II.

Both witnesses emphasized that this sharp rise in the debt must be understood in context: of the scale of the emergency we face today; the macroeconomic environment; and the consequences of not spending enough. In the face of an unprecedented crisis, protecting lives and our economy in both the near and long term must be the priority, and it will inevitably require an aggressive and sustained fiscal response.

"As a big downturn, it necessitated a very big response, and we have seen, as a result, large increases in the deficit. I want to just emphasize that they were necessary, they were appropriate, and that, going forward, more may yet be needed" — Dr. Holtz-Eakin urged policymakers to consider the fiscal response to the pandemic – which to date has totaled nearly 12 percent of GDP – in context of the unprecedented economic shock: an abrupt shuttering of an estimated 30 percent of the economy, unemployment rising to heights not seen since the Great Depression, and nearly half of American adults – as many as 120 million – living in households that lost employment income. “In light of the size of the problem,” he said, “it is appropriate that the policy response has been unprecedentedly large as well.” Dr. Elmendorf agreed it “was appropriate for the Congress to provide very substantial fiscal support” and urged Congress “to provide more, because our people and our economy need it.”

Projected Interest Rates on Federal Borrowing Have Fallen Further



Source: Congressional Budget Office

“The U.S. Government has sufficient fiscal capacity to provide trillions of dollars of further stimulus” — Despite the sharp rise in deficits, Dr. Elmendorf emphasized that we are not at risk of exhausting our fiscal space. As he noted, interest rates on Treasury debt are exceptionally low, not only because of the pandemic and recession, but also because of long-running economic trends. The United States can now take out a 10-year loan at an interest rate of 0.7 percent – a fraction of the 6 percent rate it paid to borrow 20 years ago, when the government was running budget surpluses. Adjusted for inflation, the cost of borrowing is actually negative. With interest rates so low, Dr. Elmendorf explained, “outstanding debt can be much larger, and interest payments will still be manageable.” In fact, in this economic environment, “The federal government should borrow more than it would otherwise.”

“A premature fiscal tightening of federal fiscal policy in 2011 was a significant mistake. I hope that policymakers do not make the same mistake again” — Dr. Elmendorf stressed that fiscal support must be sustained until the economy recovers – a lesson that was ignored during the

Great Recession to our long-term detriment. Congress' abrupt and unnecessary turn to deficit reduction in 2011, even as the unemployment rate remained over 8 percent, shaved more than a percentage point off of economic growth that year, slowed the recovery for years after, and likely *worsened* our fiscal outlook. As Dr. Elmendorf put it, this early withdrawal of stimulus was "one of the most significant mistakes of economic policy in the past half-century." Congress must remember that when economies are weak, fiscal support "can spur economic activity and keep people at work and put people back at work. That is the lesson that was forgotten in 1937…it was forgotten in 2011. It is crucially important that Congress not forget it now."

"This is an ideal time to be doing investments in our economy" — Dr. Elmendorf also noted that not only do we have the fiscal capacity to fight the pandemic and support the economic recovery, we also have an opportunity to invest in our longer-run prosperity. He explained that while strong demand will encourage businesses to boost their investments, "some very important investments need to occur in the public sector" as well – investments that are especially affordable for the government today given low interest rates. **Federal investment in research and development, education, and infrastructure "can help build a stronger society" and "spread the benefits of a growing economy across our population."** "So for both the short term and the long term," he said, "government spending can play an absolutely critical role."

Heroes Act Would Significantly Improve the Outlook

The support Congress has provided to date has alleviated hardship for millions of Americans and helped avert an even worse economic collapse. However, COVID-19 remains a severe public health risk that will continue to weigh on families and the economy in the months ahead. Failure to provide immediate and sustained support would aggravate suffering, exacerbate already stark health and income racial disparities, and all but guarantee a slow and needlessly painful recovery – jeopardizing our longer-term economic and budget outlook.

Fortunately, the Heroes Act passed by the House in May would go a long way toward meeting the economy's needs. According to a recent analysis, the unemployment rate would fall to 6 percent *by the end of this year* if the Heroes Act were to become law, compared to 10 percent if it were not. The economy would recover all the jobs lost to date by the middle of 2023, *1.5 years earlier* than would be the case if no additional fiscal support were provided. Real GDP would grow significantly faster in the second half of this year and into 2021, allowing us to avoid another economic downturn. The Senate must do its job and pass the Heroes Act immediately to protect public health, support families and communities, and secure a successful economic recovery.