

# THE ECONOMY OF TOMORROW: RECOVERING AND RESTRUCTURING AFTER COVID-19

ISSUE BRIEF BY **JOSEPH E. STIGLITZ** | OCTOBER 2020

## INTRODUCTION

The US economy will not have a V-shaped recovery from the COVID-19 crisis. Though some partisans continue to promise a recovery with broad-based prosperity, the data is clear: Upper-income Americans are experiencing an entirely different economy than lower-income Americans (Boushey 2020).

The only questions now are how long and how deep this downturn will be, how much economic and social devastation it will bring, and for whom. The answers depend, of course, on the speed with which the pandemic is brought under control, and the effectiveness of our economic policies.

Even now, more than half a year into this crisis, we can still forestall the worst. Today's preparations for a post-pandemic world can also yield more lasting improvements in our economy—but only if our policy response is well-designed, sustained, and targeted at people and sectors with the most need (Nierenberg 2020).

This brief describes what we know about the economy today, and what we need to do next based on that data. It begins with key lessons from prior economic downturns; moves to what is distinct about this crisis; and ends with policy recommendations.

*It is still far more dangerous, to our economy and to our health, to do too little than to do too much.*

Six months after the \$2.2 trillion CARES Act, the evidence is unmistakable: Those who worry about spending too much should not be concerned. The economic and health effects of COVID-19 have persisted far longer than most experts anticipated when designing the CARES Act's generous but short-term provisions. CARES Act programs—expanded unemployment benefits, checks for lower- and middle-income Americans, and the much-criticized Paycheck Protection Program (PPP) for small businesses—have all expired. But the pandemic remains. Thus, it is still far more dangerous, to our economy and to our health, to do too little than to do too much.



One of the lessons of previous crises is that without early and sustained *fiscal* support, commensurate in size with the shock the economy has experienced, recovery will be anemic. The shape and direction of the current crisis tells us that continuing intervention is essential and must focus on state and local government and other key sectors of the economy that did not get adequate support in previous rounds, including health care and education. The inequality of today's K-shaped recovery demonstrates that the government must provide specific assistance to unemployed people and the many small businesses that have no financial cushion and are struggling with the unique uncertainty of the COVID-19 recession. And because the pandemic is still not under control, expenditures that help control the spread of the disease—such as supporting testing and tracing and helping retrofit schools so they are safer—are absolutely essential.

In all of these efforts, we should not aim to restore the economy of January 2020, with all the conditions that made us so vulnerable during this pandemic. Instead, we should envision a better and more equitable 21st century economy and society and create the policies and structures we need to get there.

## **LESSONS FROM PREVIOUS DOWNTURNS: VICIOUS CYCLES AND DOWNWARD SPIRALS**

We have learned much from past economic crises, including the Asian financial crisis of 1997 and the financial crisis and subsequent Great Recession that began in 2008. Once triggered, economic downturns follow a regular pattern: Businesses that are not selling what they anticipated see their balance sheets weakened, and many go out of business. Firms reduce their investment, stop hiring workers, and lay some off. This deepens the downturn. Families without jobs limit consumption, and this reinforces the downward movement. Uncertainty prevails, and as a result, people save more out of precaution, and businesses further reduce their investment and hiring (Stiglitz 2016).

Access to credit becomes very difficult during economic crises. Bankruptcies, defaults, and foreclosures hurt banks' balance sheets. Additionally, banks set aside funds for future losses and worry about the ability of borrowers to repay. All of this curtails lending. Some firms and households that would be willing to spend can't get the funds they need, at least at reasonable terms.



Deflationary and disinflationary tendencies exacerbate these effects: With prices declining, or at least not increasing as fast as expected, debtors are paying back more than they anticipated in real terms. If creditors get repaid, they get more in real terms than they had thought. But because the gainers expand spending less than the losers contract spending, overall aggregate demand contracts, contributing to a potentially long-lasting vicious circle (Stiglitz 2016). It took a decade to recover from the Great Depression, and almost that long from the Great Recession (CBPP 2019).

## **WHAT MAKES THE COVID-19 CRISIS DIFFERENT**

The current crisis bears many hallmarks of past recessions, from concerns about bankruptcy spirals to decreased aggregate demand across many firms and households. But the COVID-19 downturn has several distinctive aspects as well.

### **DEMAND AND SUPPLY EFFECTS**

COVID-19 has simultaneously decreased the demand for and supply of certain products. Individuals are now nervous about formerly commonplace activities: flying, eating in crowded restaurants, sitting in large classrooms, etc. At the same time, those working in these sectors worry about contagion as well. Teachers, for instance, worry about teaching in large classrooms that have not been properly designed. While some of these services are essential, others are not, and some can be easily postponed until (hopefully) after the pandemic. This means that precipitous declines in demand for certain services in certain sectors—including the arts and recreation, hospitality, transportation, and education—may lead to long-term unemployment for workers in these areas (Dua et al. 2020).

### **DISPARATE SECTORAL EFFECTS: STATE AND LOCAL GOVERNMENT, HEALTH, AND EDUCATION**

Labor and other factors of production are not perfectly mobile. And the goods in different sectors are also not perfect substitutes. If we could easily shift consumption and production from what we label as “contagious” sectors—those high-contact sectors where it is difficult to prevent the spread of disease—to



“noncontagious” sectors, the composition of output would change, but the macroeconomic effects would be limited.

This, however, is not the case. Therefore, a broad-based “stimulus” may not help much for those in the worst-affected sectors. And this is especially true if it is believed that the pandemic is going to be short-lived, say a year or two. Individuals can go without restaurant meals or vacations, at least for a while. Since many of the noncontagious goods are imported commodities, broad-based stimulus may stimulate imports more than domestic production.

## UNCERTAINTY

In every downturn, there is some level of uncertainty that dampens consumption and investment—and thereby deepens the downturn. But additional sources of uncertainty make this COVID-19 recession unique. We don’t know how long the underlying cause of the downturn, the disease, will be with us; we don’t know how it will mutate, how quickly vaccines and therapeutics will be developed and how effective they will be, or how willing the population will be to get inoculated. And because the macroeconomics of pandemics differ in critical ways from the kinds of downturns we’ve experienced in the past, households and firms don’t know how effective government programs will be in restoring the economy; due to the politics of the moment, there is also great uncertainty about the nature and magnitude of support that government might provide.

## DISPARATE IMPACTS

Recessions always have disparate impacts, but the economic effects of the pandemic have been particularly unequal. Low-wage workers, disproportionately people of color, and those with preexisting conditions and poor health, have been the most adversely affected by both the disease and its economic consequences. While higher-income workers have largely continued their work remotely, large fractions of lower-income families have seen at least one member of the family lose their job (Chetty et al. 2020).

These disparities are perhaps best seen through savings and spending behavior. High-income households were spending 17 percent less on August 15 than they were in January, while low-income households, living on the edge, had only reduced their spending by 5 percent. When the federal stimulus payments



reached families in April, low-income families' spending immediately rose by nearly 20 percentage points, while upper-income families' spending only rose by 9 percentage points (Chetty et al. 2020). Though the US savings rate (savings as a fraction of disposable income) reached an all-time high—almost 26 percent—in the second quarter, this was driven by upper-income families. Increased savings were partly a matter of “intertemporal substitution,” postponing consumption of the affected services until the “pandemic tax” disappeared, but they also reflected upper-income individuals increasing their precautionary balances out of fear of what might lie ahead (Chetty et al. 2020).

This is perhaps the most novel aspect of the COVID-19 economic downturn: the degree to which it has exacerbated the disparities within the United States. Some have called the recovery K-shaped, which is a visual way to depict increasing inequality. Upper-income people are comfortable, or even benefiting, while lower-income people are increasingly destitute. Large firms in the right sectors, especially those with access to private and public capital, continue to grow, while small businesses and sectors that are composed of small businesses or organizations—like much of the entertainment, hospitality, and nonprofit and research sectors—wither.

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## HOW TO RECOVER AND RESTRUCTURE: IMPLICATIONS FOR POLICY DESIGN

Targeted and proactive government spending is necessary to arrest the downward spiral and prevent long-term damage to the economy.

As we learned during the 2008–2009 economic downturn, it is essential to design relief so it goes to those most affected. Broad-based support won't suffice to restore full employment to the hardest-hit sectors, and if some important parts of the economy are hurting badly, other sectors will experience large knock-on effects: Those in the contagious sectors won't be able to buy the goods and services from noncontagious sectors. So too for the state and local government workers who are discharged as tax revenues plummet. Such macroeconomic externalities—whereby weak sectors weaken the rest of the economy—would make full recovery and full employment nearly impossible (Battiston et al. 2012) (Hepburn et al. 2020).



The implications of this analysis are clear. Because we can't restore the economy until the pandemic is under control, health must be the first priority: ensuring that sick people don't go to work and that we've reduced contagion in the workplace, at points of consumption, and in schools.

Targeting the most affected sectors for support is essential for macroeconomic recovery. State and local government, education and research, and the health-care sector are all in need of well-designed assistance. With those at the top saving much of any assistance they receive, while those at the bottom spend it, targeting assistance to those at the bottom becomes especially important. This targeting is essential to minimize the economic suffering of the pandemic, but it also makes macroeconomic sense.

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In addition to being targeted, assistance must also be timely. Because of the evolving nature of the pandemic, however, what is meant by timeliness is more complicated than in previous crises.

Interventions designed to restore the economy *after* the pandemic will be different from those designed to protect the economy *during* the pandemic. Now, the first order of business is controlling the pandemic itself, protecting the health and well-being of our households, ensuring the survival of our firms, and positioning the economy for recovery. We must fund tests, hospitals, and protective gear and ensure the safe reopening of our schools and workplaces. We must fund government agencies at the forefront of fighting the pandemic and protecting our citizens, like the Centers for Disease Control and Prevention (CDC) and Occupational Safety and Health Administration (OSHA). And we must do what we can to maintain workers' attachment to their jobs, prevent excessive erosion to household and firm balance sheets, and support those enterprises most essential for our recovery and post-pandemic economy.

After the pandemic is brought under control, the nature of the programs should naturally change. A broader-based stimulus may be effective at that point, but even then, we will need to be sensitive to the disparate circumstances different populations and sectors will be facing.



## LIQUIDITY: LOANS AND VOUCHERS

The CARES Act didn't just give money to people and firms in desperate need; it also extended loans, often working with and through the Federal Reserve. This liquidity assistance included business loans and stays on student debt, foreclosures, and evictions. This was important. The funds prevented liquidity-induced individual and business bankruptcies, home losses, and business shutdowns, and the enormous disruption that would have followed.

Yet as the pandemic continues, the limitations of this early liquidity support have become apparent. It's clear that in many cases, a liquidity problem has morphed into one of solvency. Loans don't address the balance-sheet effects that arise from extended loss of income or business sales, and over the longer term, these will drive bankruptcies, business closures, and reductions in investment and consumption (Farrell, Wheat, and Mac 2020). This is especially true for small businesses. Similarly, the stay in evictions is just that: a stay. Arrears on rent and mortgage payments are accruing, and for many low-income families, the prospects of paying these arrears and other overdue bills are dimming.

Moreover, some of the perversities of such liquidity support for bigger businesses have become clearer over time. Large corporations that had not managed their balance sheets well prior to the pandemic were provided low-interest loans, rewarding profligate behavior. In particular, many of these companies had taken the benefits of the 2017 tax cut and distributed them to shareholders through stock repurchases and dividends, leaving the company in a more precarious position.<sup>1</sup>

They had a choice: They could have used the funds from the tax cut to provide stronger capital buffers—ensuring that they could better withstand the inevitable storms that buffet the economy. They did not make that choice. Now, these companies are asking us to subsidize them, either through grants or low-interest loans. Such subsidies are little more than gifts to the overwhelmingly rich shareholders.<sup>2</sup> Providing such subsidies is not in the public interest—and there is moral hazard in doing so. The benefits of such assistance are questionable: At worst, the company goes into Chapter 11 and the shareholders lose some or all of their investment, but the firm continues on after a corporate reorganization.

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<sup>1</sup> e.g., United Airlines, Delta Airlines, Southwest Airlines, American Airlines (Sloan 2020)

<sup>2</sup> A Chapter 11 bankruptcy may accelerate discharges, and that's why it's imperative to extend the expanded unemployment insurance program and complement that with the other programs described here to help the economy recover as quickly as possible to full employment.





Matters are, of course, markedly different for small businesses, which have struggled to access the PPP loans made available through the Small Business Administration and are at significant risk of permanent closure (Dua et al. 2020). New data shows that among Black and Latinx businesses in communities of color, which already had fewer capital reserves before the pandemic, only 12 percent received the full funding amount requested, and 41 percent received no assistance at all (Lederer et al. 2020). If these businesses fail, neighborhoods, workers, and the broader community will all suffer. We also have seen reports of PPP funds being gamed and going to “small businesses” owned by rich individuals or large corporations (Popken 2020). The PPP program was, in short, badly designed (relying on banks as the intermediaries) and badly implemented, with much of the money going to sectors and firms that were not among the most vulnerable or needy. (More recently, there have been a rash of complaints about the banks’ failures in administering the loan forgiveness provisions of the PPP.)

This suggests that, going forward, liquidity support should be confined to individuals of limited means and businesses owned by such individuals. Future assistance should be administered directly by the Small Business Administration rather than banks, and further support to smaller businesses should be designed along the lines of a Paycheck Guarantee Act, providing funds—both salaries and health-care benefits—for businesses that keep their workers employed.

Additionally, the government should provide assistance to those contagious sectors adversely affected, including with loans to help them retrofit to make themselves less contagious. Such funds would be especially important in those sectors where, without such assistance, employment effects are likely to be most significant—especially for the most disadvantaged. If we can make the workplace safe, it is better to have workers gainfully employed than at home receiving unemployment insurance checks. And because of the large macroeconomic externalities, benefits to these sectors would redound to others.

Assistance would also be vital in sectors viewed to be central to the post-pandemic economy. Education provides a good example: Rich schools have been able to redesign and acquire facilities to maintain social distancing, but this costs money—beyond what poorer school districts can afford.





## RESPONDING TO RISK

As noted, a distinguishing feature of the pandemic recession is a high level of uncertainty that induces strong precautionary behavior. Markets simply don't do a good job of mitigating these risks; in fact, businesses that thought they had business interruption insurance are now being told by many insurers that they should have read the fine print more carefully.

Government is in a better position to absorb risk: Just as it has provided income-contingent education loans, it can provide pandemic-contingent loans, where repayment is made at least partially contingent on the course of the pandemic and its economic aftermath. Such loans would encourage investment.

Finally, it may be desirable for government to provide time-dated vouchers to encourage spending in areas that are being especially adversely affected by the pandemic, particularly if it turns out that fears of contagion persist even after the risks significantly diminish. These would enable individuals to buy domestically made goods and services *now*, while there is insufficient demand for those goods and services.

## SUPPORT FOR STATE AND LOCAL GOVERNMENTS, HIGHER EDUCATION, AND HEALTH CARE

A full and equitable recovery requires greater support for state and local governments and the higher education and health-care sectors.

*Without assistance, state and local budget distress—essentially, austerity—will strongly dampen economic recovery.*

Because state and local governments depend on tax revenues and face balanced-budget frameworks, they are likely to undertake drastic cuts unless federal assistance is provided. Even by 2019, state and local government employment had yet to recover to pre-Great Recession levels. Without assistance, state and local budget distress—essentially, austerity—will strongly dampen economic recovery; as I estimated earlier this year, this austerity could result in four million additional jobs lost (Stiglitz 2020).

To succeed in the 21st century knowledge economy, the US must also support its higher education sector, which is now facing decreases in each of its major



revenue streams: a decrease in fee-paying foreign students, and in many cases, US students; a decrease in donations; a decrease in assistance from states; and, in some cases at least, a decrease in endowment income (Yuen 2020). At the same time, colleges and universities will face increased costs associated with retrofitting to reduce the risk of contagion. The damage to both balance sheets and institutional health could be long-lasting, particularly if distressed schools cannot pay researchers and teachers competitively, making these professions relatively less attractive.

Finally, the health of our economy and people depends on the support of our health-care sector, which has been hard-hit this year. While the demand for COVID-19 “services” has soared, it has more than been offset by declining demand for other health services (Mehrotra et al. 2020). People’s reluctance to obtain these services is not just income-related; it’s because of the implicit dissipative “tax” the virus imposes on the sector, where either consumption or production carries with it an increased risk of contracting COVID-19. Many health-care providers will need assistance both to meet the extra costs of addressing the pandemic and to help it weather current hard times.

## **CONTINUING ASSISTANCE: UI, LOANS, AND DIRECT EMPLOYMENT**

A major reason for the slow recovery after the Great Recession was that assistance was too short-lived. In the COVID-19 crisis, we provided a large amount of money—some \$3 trillion—upfront, but some policymakers are now reluctant to provide more, to continue the support that is so clearly needed.

That early money was but a temporary palliative, distributed for a few weeks in a pandemic that has already lasted months and will likely last many more. It’s like building half a bridge and then stopping construction. Without further assistance, there will still be massive bankruptcies and devastation to firm and household balance sheets, so the recovery will be slow, and there will be much hardship.

The emphasis should be on continuing assistance—providing federal support as long and as much as needed. This is especially true for small businesses and workers. Without such assurance, small businesses can’t and won’t make the investments they need and won’t hire back workers.



Thus, the expanded Unemployment Insurance (UI) program needs to be extended, with an assurance that it will continue so long as the unemployment rate remains elevated. So too for all other programs aimed at protecting the economy and its households and businesses during the pandemic.<sup>3</sup>

This commitment *to do what it takes*—to provide whatever assistance is necessary for as long as necessary—is absolutely essential. Otherwise, we risk an ugly downward spiral: Greater uncertainties about the future induce more precautionary behavior, lowering aggregate demand and deepening and prolonging the downturn.<sup>4</sup>

## WHY WE SHOULDN'T FEAR INFLATION AND DEBT

Some have worried that increased public indebtedness as a result of these continuing government expenditures will offset the expansionary effect of the increased spending, as taxpayers save more in anticipation of increased future taxes. Others are worried that the monetization of the debt will lead to inflation. Neither fear is justified. What we should really fear is the enormous cost of inaction, which would cause both short-term and long-term harm.

The evidence is overwhelming: The increase in federal indebtedness will not have adverse effects on consumption or investment, and this is especially so if the government programs are well-designed (Stiglitz 2020). With real returns to investments in technology, education, and infrastructure—including the green transition—far exceeding the (negative) real costs of borrowing, such recovery-spending strengthens the nation's balance sheet. Expectations of a stronger economy in the future could actually lead to more consumption, reinforcing the expansionary effect of government spending.

Public investments that are complementary to private investments—like better infrastructure or investments in basic research—can “crowd in” rather than crowd out private investment, strengthening the economy further. The more we can ensure that our spending does “double duty”—supporting the economy now while investing in a greener, more equal, more knowledge-based future—the better off we will be.

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<sup>3</sup> Conservatives' argument that the expanded and extended unemployment insurance program discourages work has been thoroughly discredited. See (Dube 2020), (Bartik et al. 2020), and (Marinescu et al. 2020).

<sup>4</sup> Another instrument that should be in the government's tool kit is direct employment programs tied to important investments in our country's future, including infrastructure and climate-related retrofits.



While the debt is increasing, the cost of servicing the debt is negligible and won't impose a burden on our economy or compromise our ability to meet post-pandemic needs. As described earlier, the dynamics of downturns imply that we will be in a low-interest environment for an extended period of time.

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For the same reasons, across-the-board inflation is not a risk any time soon (although supply chain interruptions associated with the pandemic may lead to increases in prices of select commodities). Eventually, if matters are managed well, the economy will recover, and the precautionary balance sheets that wealthier individuals have built up may be spent. If there were a sudden surge of spending out of such precautionary balances, there could be a period of excess demand, and this could result in inflationary pressures. However, this is a distant contingency. Should it arise, there are several tools to counteract these inflationary pressures. First, tightening of monetary policy is far more effective in constraining the economy than loosening is in expanding it. Second, given the low tax rates in the US, there is ample scope for increasing progressive taxes and using such taxes to redirect the economy—for instance, in ways that enable us to operate within our planetary boundaries.



## CONCLUSION

At this critical juncture, federal government assistance is absolutely essential if we are to prevent a deeper and more lasting downturn. It could take a year or more to bring the pandemic under control—likely even if a vaccine becomes available in the next few months. Without government support, recovery from the COVID-19 recession will take years. With well-designed government programs along the lines described in this brief, we can prevent much misery now and lay the foundation for a better and more equitable post-pandemic economy.

We have learned a great deal from the first round of assistance and from what has happened since the beginning of the pandemic.

We didn't ask enough of some sectors (like grants to airlines without requirements for the reduction of their carbon footprint), and we provided insufficient assistance to others (like education, health, and state and local governments). We didn't provide the long-run commitment we needed to make to unemployed people and small businesses. We didn't properly design programs intended to keep workers employed, resulting in higher unemployment that's proven costly to society, individuals, and their families.

We spent some \$3 trillion for some three months' assistance, in the belief that that was all we would need. We know better now. The next round of assistance will also need to be massive, but it must be longer-term, and with a greater vision of the kind of post-pandemic economy we want. A targeted program of some \$2 to \$3 trillion over the next year might suffice—still far less than the rate of our earlier expenditures in the initial response to COVID-19. These should be viewed as investments in our future—investments that yield high returns now and bolster the economy for years to come.



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