Imagining the Post-Pandemic Economy

By George A. (Sandy) Mackenzie *Wed, Aug 26, 2020*

The federal government's deficit will eventually need to be brought down, but it will nonetheless be appropriate for the government to spend more than it would have spent in a pre-pandemic world, writes the founding editor of the Journal of Retirement.

During a severe recession or financial crisis, the necessary conduct of the federal government's fiscal policy may be metaphorically compared to the response of a homeowner whose house has caught fire because of faulty wiring. The first step is not to sue the contractor or lobby for stronger building codes; the fire has to be extinguished first.

So it is with fiscal policy at the moment. The immediate goal of fiscal policy should be to provide more stimulus; shrinking the deficit can come later. More stimulus is needed for two reasons: First, policies of social distancing and localized lockdowns reduce demand not only for services in such sectors as dining out and entertainment, but also for the goods and services that are not directly affected, because unemployed restaurant and travel sector workers cannot afford them.

Second, no one thinks that the unemployed should suffer needlessly. But how much stimulus should they receive? Consider the cost of paying 30 million unemployed an extra $600 a week for just two months. That's about $5,000 per person, for a total of $150 billion. Unemployment is expected to drop, but how fast is highly uncertain, and it is easy to see how this figure could grow.

Similarly, the revenues of states and cities can be expected to be below normal for some time to come, and this shortfall will by no means be confined to "blue" states. Landlords, particularly small ones and small business owners, may also need assistance. So continued stimulus and a flexible attitude to providing it will be called for.

Eventually, the economy will recover, and the need for stimulus will abate. However, federal debt has already grown substantially as a percentage of GDP, and will grow further. Deficits, even with declining stimulus money, will remain high.

The federal government faces the challenge of supporting a recovery without sparking

inflation. The pandemic has obviously affected household, corporate, and state and local budgets. Some, perhaps most, of these effects may be reversed as the economy recovers, but others may not, and fiscal policy must take the irreversible effects into account.

In addition, changes in the political climate may lead to pressures for new expenditure programs or expansions of existing ones. Finally, interest rates may rise, which will constrain how expansionary fiscal policy can be.

The consequences of changes in household spending patterns. A recovery in spending on dining out, travel and other pandemic-affected services is likely to occur as economic recovery takes hold. However, the rebound in spending on the directly affected services will probably not be complete.

Households who have discovered the convenience and lower cost of shopping online may not revert to their old habits. Similarly, lingering fears of contagion may keep many cautious people at home, and home-cooked meals may become a preferred alternative to eating out. Many households may also try to build up or reconstitute emergency reserves.

In addition, the increase in online teaching may not be fully reversed. If it costs less than in-person instruction, virtual education will benefit both state and local budgets. If some of the cost reduction is passed on to students and their families, it will benefit household budgets as well.

More online teaching could also entail a decline in construction of new educational facilities, especially at the university level, where online teaching is less disruptive to the work-life balance of parents. If a decline in expenditure in that area isn't offset by increases in other areas, and if household saving increases, it could create space for more governmental spending at the federal, state and local level.

Consequences of the impact on private commercial investment: The boom in online spending will probably reduce investment in business construction. Investment in bricks and mortar retailing, already on the decline, will be further affected. This decline isn't likely to be offset by increases in expenditure on new facilities by the big online retailers. A similar effect may occur from an incomplete reversal of the recent shift to working from home. Demand for public transportation may also decline (although car sales may increase), which would benefit state and local government budgets.

Repercussions of the current political climate: A change in administration could lead to an increase in public health expenditure, either via an expansion of the Affordable Care Act,

an increase in the numbers of Americans covered by Medicare, or an improvement in the quality of that program's coverage.

Serious steps to deal with the country's income disparities could also lead to both increases in investment in vocational and academic education, as well as changes to the income tax system that make it more progressive. More liberalized grants and loans for students and their families are another possibility.

Interest rates: Despite the major increase in government debt, interest rates have remained low. The increase in borrowing by the federal government has been financed by increased private domestic saving (some of it generated by the increase in incomes associated with the stimulus) as well as by foreign saving. Rates aren't likely to remain low forever, however, particularly if the economic recovery is robust.

Higher rates will restrict the options for fiscal policy because of their impact on interest expenditure and the stock of federal debt, and may crowd out some interest-sensitive private spending, like housing construction. Rising rates could be a sign that the economy is starting to overheat, sending a signal that the monetary and fiscal stance needs to be tighter.

The net effect on the fiscal stance: President Harry Truman, after listening to economists set out the consequences of alterative policies—"on the one hand… but on the other"—is famous for pining after a "one-handed economist." But desirable though one-handedness may be, these are remarkably uncertain times, and it would be foolish to recommend a rigid course for fiscal policy.

That said, some conditional conclusions on the desirable course of fiscal policy may be drawn. It is likely, though not certain, that the pandemic's depressing effects on private expenditure would create room for an increase in expenditure on social programs.

Continued low interest rates would argue for more spending on public infrastructure. However, we need to recognize that a strong recovery's impact on inflation would require some tightening of monetary policy, accompanied by less government spending. Given how low inflation is at the moment, and the pain that would be inflicted on American society by a faltering recovery, it may be best to risk an uptick in inflation.

Both fiscal and monetary policy will have to be far-sighted and nimble. As time passes, it should become obvious which of the pandemic's depressive effects on private spending will have been reversed, and by how much. The federal government's budget is not by its nature

a flexible policy instrument—at least, not compared with monetary policy—but both the overall level and composition of expenditure will need to adjust as our knowledge of the effects of the pandemic grows.

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