EconoFact Chats: Understanding Economic Recovery Policies in the COVID-19 Era
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Michael Klein:

I'm Michael Klein, executive editor of EconoFact, a non-partisan web-based publication of The Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Michael Klein:

The COVID-19 pandemic plunged the United States into its worst downturn since The Great Depression. In the late spring, people were wondering whether the recovery would be of the, a Nike swoosh or even an L. That is; a rapid recovery, a slower one or a prolonged period of hard times.

Michael Klein:

Now in the autumn when we're recording this podcast, many people are speaking of a K shape recovery. A bifurcation with a recovery for some and continuing hard times for others.

Michael Klein:

How do policies respond to economic downturns? The CARES Act provided relief to the unemployed but its exploration left people without a lifeline. And beyond the recent challenges, what about places that are hard hit by globalization or automation and don't seem to recover at all?

Michael Klein:

To address these questions, I'm very pleased to be speaking with Jay Shambaugh of George Washington University. Jay has done important research on both responding to economic downturns and analyzing why in the face of a shifting economic landscape, some places adapt while others do not.

Michael Klein:

Jay served as a member of President Obama's council of economic advisors and after that he headed The Hamilton Project at the Brookings Institution. Jay, welcome to EconoFact Chats.

Jay Shambaugh:

Thanks, Michael.

Michael Klein:

Jay, the CARES Act represented an aggressive effort by the government to counter the effects of the downturn caused by the pandemic. But as we've seen, disagreement about continuing support led to the act expiring in August, even as unemployment remained high. So politics played an important role in responding to the economic recovery.

Michael Klein:

You've done research on and advocated for what economists call automatic stabilizers. Can you explain what these are?

Jay Shambaugh:

Sure. So the idea of an automatic stabilizer is it is something that provides more support to the economy in a downturn, and then less support to the economy when things are going well. And so, the idea of it being automatic is as the economy ebbs and flows, the amount of fiscal support in the economy ebbs and flows as well to kind of cushion things.

Michael Klein:

Can you give an example of what serves as an automatic stabilizer?

Jay Shambaugh:

Sure. So in the United States, some of our primary automatic stabilizers are really the social safety net. So, unemployment insurance is probably the greatest example in that when the economy is booming and there aren't very many people who are unemployed, you just don't spend very much money on unemployment insurance. But when a lot of people lose their jobs, you start spending more on this automatic property of it as more and more people qualify for unemployment insurance.

Jay Shambaugh:

Programs like SNAP, which used to be called food stamps is another great example of an automatic stabilizer. More people qualified, they get more food aid often. So there are various programs that do kind of provide more support to the economy automatically. And then just lastly, actually having an income tax is the same thing on the tax side. When people lose their jobs or lose income, they suddenly aren't paying as much in taxes if your tax system is via an income tax.

Michael Klein:

So the automatic part of this is really important because that means it takes politics out of it in a way, right? That you don't have to have congressional debate about whether we should do this or not. The debate is over and done with, we have these in place and unlike the CARES Act, we don't have to renegotiate it each time.

Jay Shambaugh:

Yeah. There're really three huge advantages I think, of an automatic stabilizer. On the one hand, it can happen faster. So you've got this much more rapid onset of the money. In fact, the CARES

Act really was instituted quickly. I think it was so obvious things were so bad that politics was kind of pushed aside and they did things quickly.

Jay Shambaugh:

But the second big advantage is, you've decided ahead of time how programs should work and so the government is ready. So, if the IRS knows it has to send out checks to people when there's a downturn, it will be ready to send those checks as opposed to suddenly turning to them and saying, "Oh hey, figure this out."

Jay Shambaugh:

And you really see that on things like changes to the unemployment insurance program, which then requires the states to do a lot of heavy lifting very quickly in the midst of a downturn. If you make the decisions ahead of time, it's easier. But then most importantly, what we're seeing in this instance is support stays on for as long as it's needed. And that's what we're seeing right now, where a lot of aspects of the CARES Act have just expired, even when there's still a great deal of need.

Jay Shambaugh:

So if you set them to come on and then also come off based on the economy, you would still have support going right now.

Michael Klein:

But, even though we say it's automatic, we saw for example, during the global financial crisis, in the wake of the meltdown in 2008, that there was a fight about the length that unemployment insurance would be in place, right?

Jay Shambaugh:

That's right. And so even unemployment insurance that has an automatic property to it, we often feel the need to extend the duration you're allowed to be on unemployment insurance. There are technically some automatic triggers in that program, but they don't turn on and off very well. And so we've often in this country chosen to pass laws to do it by hand. And that's the type of thing that if you automated it, you wouldn't need to pass these laws. You wouldn't have things expiring and then being picked back up later on. You could actually just have the support you think the economy needs in the form you think it needs it happening automatically.

Jay Shambaugh:

And one other reason that's so important is honestly, every recession is different. Every recession has a specific type of cause. If you've gotten all of your basic kind of blocking and tackling out of the way, you can then turn around and focus on the real crucial matter that's different. You could think in this instance, you'd spend less time arguing about unemployment insurance and more time thinking about testing and tracing and the specifics of the pandemic.

Michael Klein:

So as you mentioned, the CARES Act was put into place very quickly because things were so dire. And now of course there's been much more controversy about it's continuing as it seemed like the economy was recovering. But as I mentioned, people might think it's kind of a K shape recovery.

Michael Klein:

But if we turn from the current crisis to longer-term problems, maybe it's more difficult to have policies for those because they're more chronic than acute. And so even before this downturn, we were seeing something like a K shaped performance across different parts of the country, some doing well and others failing to recover from adverse conditions.

Michael Klein:

Jay, have good economic times over a longer horizon the past couple of decades been limited to a small number of successful cities like Boston or San Francisco while other cities and more rural areas have seen their fortunes sliding?

Jay Shambaugh:

To some extent, yes. You're seeing certain areas of the country booming over a longer horizon and seeing much more rapid income growth than some other places. Even more than just a growth perspective though, I think a big thing you see is just the level of economic activity, the type of economic outcomes people face are just very different in these different parts of the country. It's not that the top is running away so much as there's just a huge gap that is persistently there.

Jay Shambaugh:

Just a couple of examples, property rates are three times higher in the bottom 20% of counties than they are in the top 20% of counties. Prime age employment to population ratios, which is when we say prime age, we're talking about people 25 to 54 that usually aren't in school, usually aren't retired. The gap in how many of those people are working is 15 percentage points.

Jay Shambaugh:

And just for context in The Great Recession, nationally, that number fell 5%. And we thought that was a terrible, terrible thing. It's almost as if counties at the bottom are facing three great recession shocks relative to those at the top on just an ongoing basis.

Michael Klein:

So this employment to population ratio, can you give sort of lay person's idea of what does that mean and how would it show up?

Jay Shambaugh:

Sure. So it's just quite literally, instead of looking at the unemployment rate which takes into account what share of people who want the job have a job. It's just asking of everybody who's the general age people are normally working, what percentage of them are working. And so that, it's a helpful statistic for us to think about because in some places it's not just that the unemployment rate is high it's that a lot of people have just dropped out of the labor force altogether.

Michael Klein:

So there's this well-known, at least well-known among economists, feature of the unemployment rate that if people drop out of the labor force, the unemployment rate actually goes down. So, this measure of the employee to the population is kind of a better indicator of overall what's going on by taking into account the fact that people are dropping out of the labor force.

Jay Shambaugh:

That's right.

Michael Klein:

And you also have this other measure that you've developed called the economic vitality index. Can you tell us a little bit about that?

Jay Shambaugh:

Sure. So, we developed this one. I was at The Hamilton Project and it's pulling together a range of things. It's things like poverty rates, employment to population rates, also unemployment rates, household income, also things like vacancy rates amongst houses or for that matter life expectancy. And you pull those things together in statistical stew and come up with one index of how you're doing economically.

Jay Shambaugh:

And what we find is that there're really large, large gaps between those places that are doing well and those places that are struggling across the country.

Michael Klein:

And so what you see is that this is correlated with other measures like unemployment, but it's actually a richer measure in that it's capturing many more things.

Jay Shambaugh:

That's the goal, right.

Michael Klein:

And so what we're seeing in the last few decades, is that similar to what we've seen say, over the course of the 20th century?

Jay Shambaugh:

So, the idea that there's a large gap between the places that are doing well and the places that are struggling, that's not new at all. We've always had richer areas and poorer areas. The thing that's really different is the fact that it used to be that the poorer places were catching up. There was what economists referred to as convergence.

Jay Shambaugh:

The places that were poorer were growing faster and you saw this over long stretches of time. You see this, if you just say, look from 1960 to 1980, the places that were poorest in 1960 grew fastest in terms of their income. And so they were catching up to the places. Since 1980, that seems to have flattened out though.

Michael Klein:

So like the South had historically been poorer than the Northeast, but it caught up quite a bit and the so-called Sunbelt area had been poorer, but it caught up, is that correct?

Jay Shambaugh:

That's exactly right. And instead, what we've seen since around 1980 is that convergence has stopped. And if anything, we've started to see a little more divergence where those richer areas are the ones growing a little bit faster. So these big level gaps we see between places, they're not going away anymore. And instead they're more and more entrenched.

Michael Klein:

So you said the 1980s, I'd like to talk a little bit about your research with Kadee Russ. Kadee recently joined me for an episode of EconoFact Chats. And in your work with Kadee, you focused on what you called the China shock of the 1990s, which persisted into the early 2000s. And you distinguish this from what you call the Japan shock of the 1970s until the early 1980s. Can you explain what the China shock and the Japan shock were?

Jay Shambaugh:

Sure. The China shock is something that some other economists developed a way to think about looking at what happened in the United States in particular, across places in the United States when China started exporting more to the rest of the world. And so basically in the mid to late 90s into the 2000s as China really started to export a lot more, looking at the types of products China was exporting, and then looking at the types of places in the United States that typically made those goods who started to face that import competition.

Jay Shambaugh:

And then we created a parallel metric doing the exact same thing with Japan and looking at the exports from Japan in the 70s and into the early 80s. And the really key finding that we came across was that the China shock was very, very disproportionately hitting places that had a lot less education in terms of their population.

Jay Shambaugh:

And so it was hitting the places that were in some sense, weakest already. Conversely, the Japan shock was more spread across the country in terms of the types of places that got hit. High education, low education, in the middle, all got hit. The Japan shock to some extent or not, it was somewhat more randomly allocated. And what that led us to see is that maybe the places with more education were able to pivot to different types of goods and services.

Jay Shambaugh:

Pittsburgh kind of the classic example. It's not to say that Pittsburgh didn't get knocked down by the Japan shock. It's just, it was able to get back up. And what it seems like is places like say Northern Alabama that got hit really hard by the China shock had struggled in terms of coming back out of it. And so you get these really persistent losses, high unemployment for a long time, declining labor force participation, really hitting these places hard. And these were already the places honestly that were rich to begin.

Michael Klein:

So Pittsburgh, for example, has Carnegie Mellon and the University of Pittsburgh and is like an innovation hub. And I imagine that Northern Alabama didn't have the same kind of resources to fall back on.

Jay Shambaugh:

That's right. And so that capacity to innovate becomes really important. What we found in the work Kadee and I did was you can think of normally a product cycle, economists will talk about that as going across countries. That the high education places spawn all these new products and all this innovation and then over time, those things become more routine and they move to lower cost countries.

Jay Shambaugh:

And we found you could see the same thing in the United States actually moving from the high education places to the low education places. But the China shock in some sense was short-circuiting that process and really hitting the places that should have been getting more manufacturing coming from the high innovation product places. Instead, those products were possibly moving to China.

Michael Klein:

Yeah, Kadee and I discussed that to a certain extent in our episode. So, a simple or maybe a simplistic solution would suggest that people should just move to places where there are better opportunities. And in a way it seems very much in the nature of this country for people to relocate, "Go West young man," and all of that. Was it the case that Americans moved a lot in search of better opportunities in days before than they do currently?

Jay Shambaugh:

The short answer is yes, we used to see more mobility in this country. And in particular, more mobility across States. Used to see, if there was an unemployment shock in one place, it tended to go away. It seemed that, within 10 years, the unemployment rates had no correlation across time. And so you didn't have places getting stuck in a bad labor market outcome. And one of the reasons was because people moved.

Michael Klein:

So why has this changed?

Jay Shambaugh:

So, I think on the one hand, it's gotten harder to move. And so, one way we see this is that you don't see housing supply expand as much in high income, high job growth places as it used to. So there are just land use restrictions in places like New York or Boston or San Francisco that make it hard to build even though there are a lot of jobs available.

Jay Shambaugh:

And so that on the one hand makes housing get more expensive in those places and it makes it harder for someone to move from a struggling area to a booming area because they're facing very high cost of living.

Jay Shambaugh:

On the other hand, it also seems like some research is suggesting that at least for people who don't have a college education, the premium in terms of how much you earn in those booming cities has kind of gone away. You don't make as much in say, New York or Boston as someone with just a high school degree as you used to relative to other parts of the country. So you've kind of got both sides.

Jay Shambaugh:

And then lastly, I think it's always important to recognize not everyone wants to move. People have ties to their place. People have ties to their communities. And so it's important that we think about ways to help people where they are and not just assume they'll move.

Michael Klein:

So Jay, should policy be directed towards helping places or helping people or helping industries? Those are three quite distinct things.

Jay Shambaugh:

They are. And I think often people put, especially those first two in contrast, say, should we help people or places? I would say broadly, the goal is to help people who are struggling in general, but especially help people who are struggling in struggling places. And that's going to take a special type of set of policies.

Michael Klein:

One of our EconoFact memos by David Neumark talks about subsidizing employment for workers in struggling communities. Is that the kind of program you're talking about?

Jay Shambaugh:

Yes, exactly. Honestly, that specific proposal is somewhat near and dear to my heart because when we were working on this issue at The Hamilton Project, we often commissioned papers from outside academics and found that David Neumark had written a lot of papers that were very critical of other place-based policies pointing out why they didn't work that well.

Jay Shambaugh:

And so we reached out to him and said, "You seem to understand why programs don't work. Could you design one that would work?" And his initial reaction was to say, "I'm not sure that's what I do." And then a few days later he called and he said, "I'm so excited. I really do have a good idea for how to do this."

Jay Shambaugh:

And the idea is you subsidize jobs for not just in high poverty places, but for people who themselves were in poverty in those places to try to build up labor demand. Because that's one of the real differences across these places is, there seems to be just less demand for labor in the places that are struggling. And so you can have policies like David Neumark's or other ones.

Michael Klein:

What's an example of building up labor demand. How would you on the ground do that?

Jay Shambaugh:

So, on the one hand you could work with non-profits to literally subsidize labor and say, we'll pay for people to do work. And in particular, if what you're doing is say, rebuilding public goods in the area, rebuilding parks, community health centers, schools, things like that where there's a need to have those things happen, but you may not have anyone doing it and funding it and so you could fund that and directly fund the jobs. And then eventually in his program, you would transition that over to saying you would subsidize the wages for private employers who wanted to hire people.

Michael Klein:

Jay, one of our EconoFact memos is by Jeff Frieden and a couple of other political scientists. And they show that they're important political implications of the decline in manufacturing. The counties that had the biggest decline in manufacturing employment, they show in their analysis, had the biggest switch in voting to Trump in 2016 as compared to their voting in 2012.

Michael Klein:

As I mentioned in the introduction, you have very high level policy experience in the U.S. Government. You also headed The Hamilton Project at the Brookings Institution. How do you see politics affecting the kinds of policies that we've been talking about today?

Jay Shambaugh:

I think in two ways. I think on the one hand, politics can sometimes get in the way. And so in particular, it can make it hard to channel resources to the places that need them most because instead it may be the most politically connected places get the most support or for that matter, the most politically connected people in those areas getting the support, as opposed to say, helping out the people who are in poverty or helping out the places that could really use help.

Jay Shambaugh:

I think the flip side to it is work like the work you mentioned showing real dissatisfaction with how the American economy is working for many types of people and places has, I think led a lot of people to take place-based policies more seriously and to say, okay, we can't assume the labor market works itself out. We can't assume people just move. We need to really take seriously, the idea that many people are getting left behind and many places are getting left behind and we need better policies to deal with that.

Michael Klein:

So Jay, we've been talking about government support, both in acute crises and for more chronic problems and these of course are really important issues. So I thank you very much for joining me today on EconoFact Chats and sharing your insights from your research and from your experience with me.

Jay Shambaugh:

Thanks very much Michael, it's a fun conversation.

Michael Klein:

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