Working Paper No. 1059

Three Lessons from Government Spending and the Post-Pandemic Recovery

by

Pavlina R. Tcherneva
Bard College and Economic Democracy Initiative

November 2024

Originally issued as EDI Working Paper No. 01, 2021

The Levy Economics Institute, in collaboration with the Economic Democracy Initiative, presents research in progress by affiliated scholars and conference participants in jointly sponsored events. The series aim to disseminate ideas to and elicit comments from academics and professionals.

Levy Economics Institute of Bard College, founded in 1986, is a nonprofit, nonpartisan, independently funded research organization devoted to public service. Through scholarship and economic research it generates viable, effective public policy responses to important economic problems that profoundly affect the quality of life in the United States and abroad.

Levy Economics Institute
P.O. Box 5000
Annandale-on-Hudson, NY 12504-5000
http://www.levyinstitute.org

Copyright © Levy Economics Institute 2024 All rights reserved

ISSN 1547-366X

Three Lessons from Government Spending and the Post-Pandemic Recovery

Pavlina R. Tcherneva
Bard College and Economic Democracy Initiative

The central lesson of the COVID-19 fiscal response is that money is not scarce. Without delay, governments around the world appropriated budgets that dwarfed any other postwar crisis policy. In 2020, Japan passed a stimulus package equal to 54.8 percent of GDP, while in the U.S., it was equivalent to 26.9 percent and in Canada to 20.1 percent. Italy, France, and Germany spent 10.1, 10.4, and 10.7 percent of GDP, respectively (Dziedzicki et al. 2021).

Lesson 1: The funding is always there
These governments budgeted anywhere from one tenth to more than one half of their economies to fight the pandemic. No taxpayers were called upon to foot the bill, no creditors were asked to lend them money. Governments voted for the budgets they considered to be necessary and their central banks made the payments. The size of the response was all the evidence one needed to grasp the monetary reality. Governments, which issue and control their own currencies, face no financing constraints and no threat of insolvency or default. They use their fiscal and monetary institutions (Ministries of Finance, Treasuries, Exchequers, and Central Banks) to make all necessary payments. Whatever policy priority a monetarily sovereign government has, the funding is always there.

Governments, which do not have monetary sovereignty, tried to recreate it. The Eurozone, which was designed to restrict government spending, broke its own rules. Countries were allowed to breach the Maastricht debt and deficit limits and, more importantly, there was no possibility of default on pandemic bonds because the European Central Bank guaranteed them through the Pandemic Emergency Guarantee Program.

Modern Money Theory (MMT) focuses on the undertheorized aspects of the currency as a public monopoly and its implications for public finance (Wray 2012). It studies the financial architecture of different policy regimes to understand the available policy space for tackling urgent economic concerns, such as financial crises, climate disasters, unemployment, and poverty, among others. When the world faced the mother of all crises, none of the institutional intricacies of public finance presented an obstacle to funding the pandemic response.

MMT recognizes that finance is not a limited resource. It is manufactured and created in the act of spending. In the modern world, the exclusive monopoly to issue the currency endows governments with unparalleled spending power. For MMT, that the issuer can spend without technical constraints is a rather trivial observation. What MMT stresses is that taxes and borrowing cannot pre-fund the issuer of the currency, as the currency must be provided *before* it can be used for tax collections or bond purchases. The substantive question for MMT then is how to deploy this spending power for achieving the two central macroeconomic goals: full employment and price stability.

The pandemic offered some insights here too. While funding was rapidly mobilized across the globe, the way these large budgets were spent differed greatly. In many European countries, governments offered to pay a portion of the salaries of affected workers, with wage replacement rates ranging from 50% to 90%. In Denmark, for example, the government covered 75% of the earnings of

salaried workers and 90% of wage workers, who were impacted by the pandemic. Germany's social insurance policy, Kurzarbeit, paid 60% of wages for any hours that were cut due to the pandemic.[1]

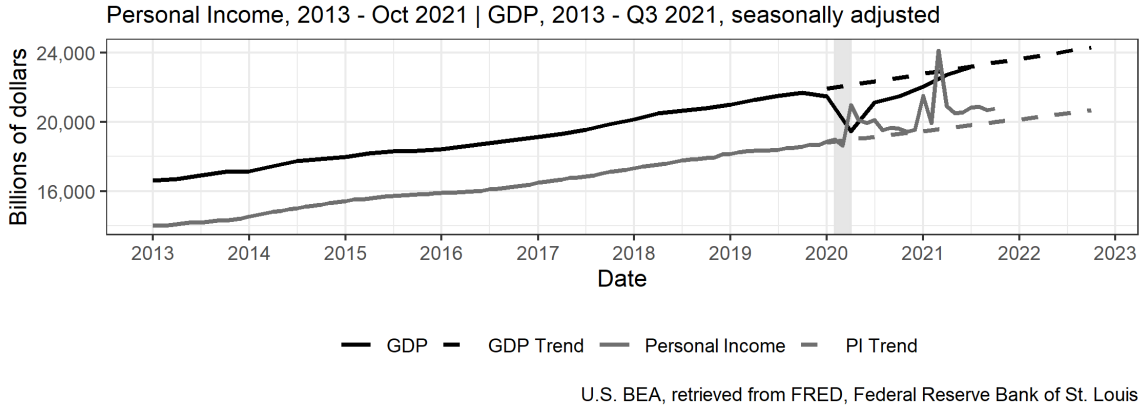
Scandinavian countries used another policy to support labor markets. Governments participated in tripartite negotiations with firms and unions, working to minimize the number of layoffs and offering to pay the wages of those workers whose jobs would have been eliminated, thus effectively becoming the employer of last resort (ELR). Such tripartite negotiations had been used in the past to maintain long run full employment, and in countries like Sweden for example, until the early 1990s, the government had played the ELR role by directly employing the unemployed.

By contrast, the U.S. offered weak and provisional salary support in 2020. The government provided business loans to firms, which could be forgiven if used to pay wages, but many small businesses could not access the lending programs and, even those who could, ended up slashing employment. The countries that protected payrolls directly, saw a smaller increase in the unemployment rate. In Germany, unemployment rose from 5 percent in March 2020 to 5.9 percent in April 2020, while in the U.S., it soared from 4.4 percent to 14.7 percent during the same period. It was the highest jump in unemployment among all of the above-mentioned countries, even though the U.S. had passed one of the largest fiscal packages.

Funding was not the issue. The initial $2.2 trillion CARES act was large enough to pay every single wage in the U.S. for 3 months, with funding to spare that could have employed every unemployed person at a living wage (Tcherneva 2020a). Had the U.S. attempted a direct payroll subsidy, like those in Europe, and the government paid a portion of the wages, the budget could have protected jobs through the end of 2020, and likely even longer. Another sizable budget ($900billion) followed later in 2020 and, still, the U.S. experienced its worst labor market shock in postwar history.

In the first month and a half of the pandemic, the U.S. lost 22 million jobs, or the equivalent of all jobs created in the previous 11 years of recovery after the 2008 Great Recession. At the time, the Federal Reserve had forecast that unemployment could exceed Great Depression levels if the government failed to act swiftly (Bullard 2020). Fortunately, unlike after the Great Recession, the government response was immediate and large: income bounced back to its previous trend (Figure 1) and the economy experienced its shortest-lived postwar recession.

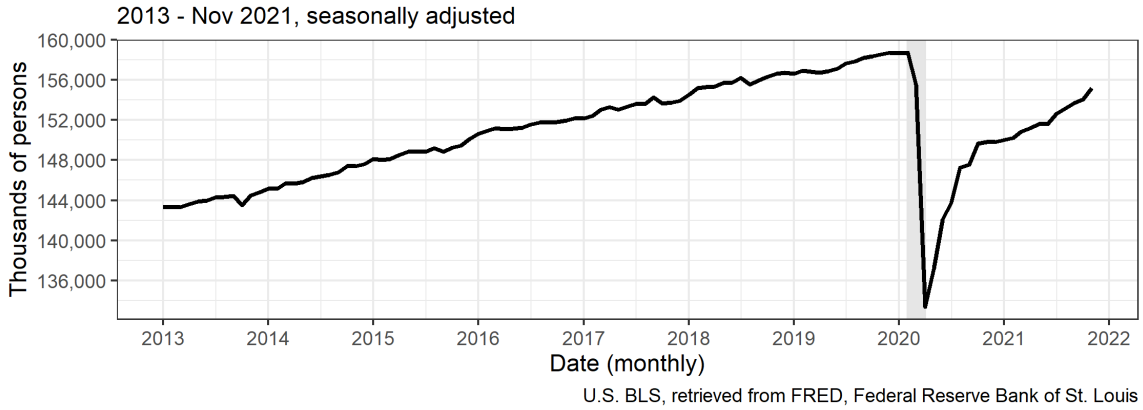
Figure 1 Personal Income and GDP



[1] By contrast, the Chinese government provided a full and unconditional wage guarantee for all workers.

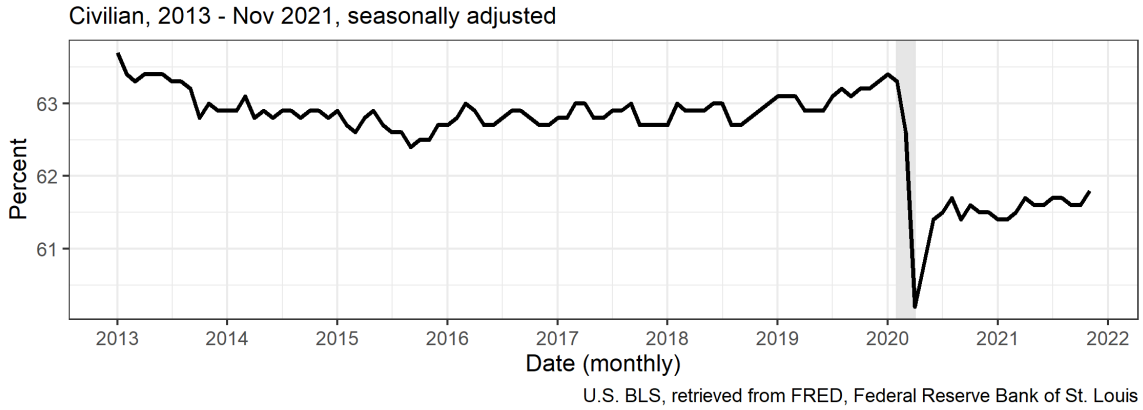
Government expanded unemployment insurance and provided additional cash assistance, keeping many families out of poverty and helping reduce child poverty by 50 percent. The eviction moratoria helped prevent a spike in homelessness. What this fiscal support did not achieve, however, was a return to pre-pandemic employment levels (Figure 2).

Figure 2 Employment level



While the unemployment rate fell quickly as the economy 'reopened', largely due to a collapse in the labor force participation rate (Figure 3), it has become typical for companies to complain of labor shortages. Yet, as of October 2021, total nonfarm employment is still 4.2 million jobs short of its pre-pandemic high.

Figure 3 Labor force participation rate



Meanwhile, evidence suggests that firms which are able to offer good pay with benefits do not face the same difficulties finding workers (Black 2021). What the pandemic has revealed is that there is an acute shortage, not of workers, but of well-paying jobs (Shierholz 2021).

The conservative argument that government pandemic checks discouraged people from working, is also not supported by the evidence. A recent survey shows that the vast majority (60-70%) of jobseekers during the summer 2021 months were ready to take employment immediately. The main reasons why the rest delayed returning to work were: 1) having a financial cushion or a working spouse, 2) COVID fears and 3) having care responsibilities (Bunker 2021). Unemployment

insurance payments were the *least* important factor for not seeking work straight away, accounting for a negligible 6% of jobseekers in September 2021.

Lesson 2: Unemployment is a policy choice

Given the differences in pandemic-related job losses across the globe, the second lesson of the pandemic was that unemployment is a policy choice. Many governments appropriated budgets that were large enough to protect jobs and employ the unemployed, yet all came out with elevated levels of unemployment. Countries which offered direct salary support experienced smaller spikes in unemployment, while the U.S. allowed mass unemployment to develop. None pursued aggressive employer of last resort policies to eliminate unemployment altogether. The sole exception was China, which provided unconditional wage guarantees to all workers (Dziedzicki et al 2021), effectively becoming the employer of *first* resort.

From a macro perspective, in a market-based economy, the policy maker faces two options: either close the output gap or close the employment gap. These are distinct outcomes that do not usually coincide, even though economists often mistake one for the other. Aggregate demand management typically pushes growth to potential output around some 'acceptable' level of unemployment (the so-called NAIRU), which amounts to supporting jobless recoveries (Tcherneva 2014). Often the output gap is closed, not because growth has returned to previous trend, but because of hysteresis effects that push potential output below its previous highs, and in either case it is not the result of closing the jobs gap. And as noted, in the US, that has also meant a steady decline in the labor force participation rate during the last three recessions.

The second policy option is to focus on the employment (or labor demand) gap and close it via direct employment of the unemployed. This can be accomplished via programs that provide public service employment options to all jobseekers on an as-needed basis, including mass mobilization, large-scale public investment, employer of last resort (ELR), and job guarantee (JG) policies.

The modern money approach emphasizes that these are structural macroeconomic stabilization responses, not just job creation programs, and are superior to conventional stimulus methods (Tcherneva 2020b). Mass mobilization is a critical intervention in times of crises, but it is not a guarantee of tight full employment. ELR and JG can accomplish this task, though they are somewhat separate, even if related, policies.

With employer of last resort programs, the government could temporarily and partially nationalize the payroll (as European nations did during the pandemic), but typically ELR is a government policy that provides employment to those who have not found private sector employment. In the literature, ELR and JG are often used interchangeably and share many common characteristics. The 'last resort' in the ELR name suggests, however, that public employment would be offered when all other options have been exhausted. If the available private sector opportunities are punitive or pay poverty wages, the ERL would surely not be an adequate solution. The JG by contrast is an explicit alternative to them. It is also often motivated by a human-rights claim to decent employment for all. It is available to all job seekers wanting to take the living wage-benefit job offer in the Job Guarantee. While both the JG and ELR could serve as transitional employment offers for the unemployed, the ELR implies a conditionality, whereas the JG is a public option and an assurance (it provides a choice among alternatives and a guarantee of an 'opt-out' from bad jobs). The ELR offer of public employment is provided when and if the individual has been unsuccessful in securing (usually) private sector employment. ELR could also mean a subsidy to private firms to retain

workers, which is why the policy is typically associated with the tripartite negotiation model of Scandinavian countries, and Sweden in particular. ELR had worked reasonably well there, as the country had comparatively stronger labor laws that regulate private sector employment.

Countries like the U.S., however, where the labor market is more precarious and unequal, could benefit from a more robust labor policy such as the job guarantee (JG). Unlike the Scandinavian model, the JG is an explicit public employment option for any jobseeker. Participation in the JG is not conditional on one's inability to secure a private sector employment offer. The JG offers a minimum living wage and is an alternative to 'bad' jobs. While it may be more 'disruptive' to the private sector than the ELR, it does exert pressure on firms to match the pay and benefits offered by the JG, thus establishing an effective wage floor for the economy as a whole, and strengthening the bargaining power of the most vulnerable workers.

Faced with the need to restore jobs quickly after the pandemic, the newly elected U.S. government has begun pursuing large-scale public investment programs (i.e., President Biden's Infrastructure and Build Back Better bills). While this approach would help improve the labor market further, creating quality jobs across the wage spectrum, it is not a policy that would benefit all last-in-first-out workers, or those with systematic barriers to employment. Therefore, a comprehensive job preservation and job creation strategy would consist of mass mobilization, Employer of Last Resort, and Job Guarantees, because only the latter can secure enough employment opportunities for all workers in every community. Furthermore, the JG and ELR proposals explicitly aim to provide on-the-job training and assistance with transitioning to other employment opportunities.

As MMT stresses, only the JG and ELR would vary with changes in economic conditions, thus offering a more robust automatic stabilizer than the conventional approach (ibid). Standard policy uses unemployment and income transfers as economic stabilizers, allowing them to expand in downturns and shrink in expansion, providing a floor to collapsing aggregate demand. This is not a very robust stabilizer, as mass layoffs create the very conditions that discourage hiring and prolong the downturn. By contrast, the job guarantee sustains jobs at living incomes, allowing spending, profits, business sentiment, and consumer expectations to recover faster. Put simply, an automatic *unemployment* stabilizer is weaker than an automatic *employment* stabilizer.

For MMT, the latter is the preferred policy option for several reasons. First, the government helps create monetary unemployment (Mosler and Silipo 2017) and is thus responsible for eliminating it. Second, the unemployed are already part of the public sector and the government is already responsible for addressing the associated real social costs. Third, as the single supplier of currency, it can choose the manner in which it spends. By employing the unemployed, it can establish the effective minimum wage in the economy, stabilizing one systemically important price – the base wage (Tcherneva 2002). Fourth, by doing so, the JG raises the wage floor by establishing a labor standard for pay and working conditions for all jobs. Fifth, it is a policy that provides an alternative to precarious and poorly paid work and increases competition in the labor market for workers. As an alternative to the most precarious private sector work, the JG pressures firms to improve their pay and benefits if they wish to retain and attract employees. Many private sector workers will get a pay raise, which in turn will boost spending, growth, and firm profits. The JG makes the poverty-paying business model unworkable. Sixth, the JG removes the 'threat of the sack' from employment practices that often create difficult working conditions and labor market pathologies (wage theft, discrimination, harassment). Seventh, while the JG gives workers the power to say 'no' to abusive employers, it also serves as a more robust transitional program for people seeking employment. It is

a stepping stone for young people entering the labor market, an employment opportunity for caregivers who wish to return to paid work, and a bridge to civilian employment for former inmates and veterans.

Payroll protection can effectively prevent mass layoffs in a pandemic, but without a JG, it is inadequate for combating unemployment and poorly paid employment. Nevertheless, because the government was essentially bankrolling private firms through large firm subsidies and pandemic lending programs, it had the full prerogative to extract other demands in exchange: hazard pay for workers, guaranteed paid leave, and an increase in the minimum wage to $15/hour, thus helping ongoing local legislative efforts to raise the minimum wage. In the U.S., nearly half of all workers earn below $10.22/hour (Ross and Bateman 2019), which is below the poverty level for a family of three. Such conditionalities would have had the effect of fortifying working conditions across large swaths of the labor market during the pandemic and beyond.

Lesson 3: Large government spending is not the inevitable source of inflation

The third lesson of the pandemic is that despite the large-scale fiscal support, inflation was not a consequence of the unprecedented fiscal budgets. When private activity stopped, governments supported incomes and maintained purchasing power, preventing the deflation that would have occurred otherwise. While aggregate demand received much needed life support, as of November 2021, there was no evidence of demand-pull inflation. All evidence indicates that current price pressures are due to widespread global disruptions on the supply side: shutting down of factories, transportation routes, and ports; a slow resumption of production and working through backlogs in the supply chain; a shift in the structure of private demand away from services to goods, and price setting in the energy sector by OPEC. Price increases came from bottlenecks, logistical challenges, oil cartel production and pricing decisions, not from government spending beyond full employment. At the micro level, some firms exploited their market power (and media-stoked inflation worries) to raise prices, not only to cover rising costs, but also to pad profits, emboldened by the fact that customers had already begun to perceive price increases as 'unavoidable' (Terlep 2021). In just Q2 and Q3 of 2021, U.S. non-financial corporations posted the largest profit margins since 1950, up 37% year-over-year, compared to the 12% increase in total compensation during the period (Boesler et al, 2021). Further, the global benchmark Brent Crude oil had risen 38% in 2021, propped up by curtailed production from the OPEC+ group of producers. Despite global calls to alleviate rising oil prices, as of November 2021, OPEC has declined to revise production quotas. Price setting power of monopsonies, near-monopolies, and cartels, supply chain bottlenecks, lower level of production and structural shifts in private demand have so far been responsible for the observable price increases, not government spending.

As MMT stresses, inflation is often a supply-side phenomenon with multiple causes (Fullwiler et al. 2019). Inflation generated by strong aggregate demand beyond full employment is rarely observed, apart from the immediate post-WWII period. The pandemic experience so far seems to bear this out. As new variants of the coronavirus continue to impact production in different parts of the globe, it is unclear how long it would take for the supply-side challenges to resolve. This will also determine if inflation remains transitory or becomes entrenched. And if it does become entrenched, MMT would not advise raising interest rates to fight it. On the contrary, MMT argues that the standard inflation-fighting tool (raising rates) likely has the reverse effect (Mosler and Armstrong 2019). What would raising interest rates do today to stop the inflation processes described thus far? Would raising rates alleviate problems emerging from the supply chain, firm pricing power, OPEC decisions, or the shortage of truck drivers? Clearly not. If anything, raising interest rates would

increase the cost of production further, thus feeding the inflationary process. As it was the case under Volker, rates and inflation kept rising lockstep for years, until double digit rates eventually plunged the economy into a recession. MMT rejects the conventional view that an economic slowdown, a reduction in wages, and unemployment are 'solutions' to inflationary pressures. There are multiple ways to tackle a sustained increase in the price level, including investments that can alleviate bottlenecks or shortages on the supply side (which means more, not less, government spending), while maintaining full employment through an anti-cyclical employment stabilizer like the Job Guarantee.

The pandemic necessitated a fiscal response that was not seen since WWII. It revealed many fault lines in the economy: poorly paid and vulnerable essential workers, an integrated global supply chain that can lock up, low levels of public health preparedness, and inadequate mobilization. But it also revealed some possibilities by corroborating some key MMT tenets: 1) money is not scarce, 2) unemployment is a policy choice, and 3) inflation is rarely a result of large government spending. This suggests concrete steps for rethinking policy, since the question is clearly not whether we can financially afford to act, but how. MMT insists that full employment need not be sacrificed for price stability and that there are many tools available to the policy maker to start thinking about the things that matter – not budgets and accounting ratios, but public health, jobs, and the environment. To tackle these, we would do well to heed the lessons of the pandemic.

REFERENCES

Black, T. 2021. "Highly paid union workers give UPS a surprise win in delivery war", *Bloomberg*, November 4.

Boesler, M., Deaux, J. and Dimitrieva, K. 2021. "Fattest profits since 1950s debunk wage-inflation story of CEOs" *Bloomberg*, November 30.

Bullard, J. 2020. "Assessing second-quarter unemployment amid the pandemic," May 28, *Federal Reserve Bank of St. Louis*.

Bunker, N. 2021. "Indeed Job Search Survey September 2021: job search stays stagnant", *Indeed Hiring Lab,* October 21.

Dziedzicki, K., Drame, I., and Gevorkyan, A. 2021. "COVID-19 Economic Response Packages – A Cross National Comparison", *Henry George School of Social Science Dynamic Tracker*, https://www.hgsss.org/covid-19-economic-news/

Fullwiler, S., Grey, R. and Tankus, N. 2019. "An MMT response on what causes inflation", *Financial Times*. March 1.

Mosler, W. and Armstrong, P. 2019. "A Discussion of Central Bank Operations and Interest Rate Policy," GIMMS Working Paper, The Gower Initiative for Modern Money Studies.

Mosler, W. and Silipo, D. 2017. "Maximizing Price Stability in a Monetary Economy", *Journal of Policy Modeling*, 39 (2): 272-289.

Ross, M. and Bateman, N. 2019. "Low-wage work is more pervasive than you think, and there aren't enough "good jobs" to go around", November, *Metropolitan Policy Program, Brookings Institute, Washington, D.C.*

Shierholz, H. 2021. "U.S. labor shortage? Unlikely. Here's why." *Economic Policy Institute*, May 4.

Tcherneva, P.R. 2020a. "What if we nationalized payroll?" *Levy Economics Institute*, March 30.

----------. 2020b. *The Case for a Job Guarantee*. Cambridge, UK: Polity Press.

----------. 2014. "Reorienting Fiscal Policy: a Bottom-up Approach," *Journal of Post Keynesian Economics,* 37 (1): 43-66.

----------. 2002. "Monopoly Money: The State as a Price Setter," *Oeconomicus*, Winter: 124-143.

Terlep, S. 2021. "U.S. corporate giants bet shoppers will keep paying higher prices," *Wall Street Journal*, October 24.

Wray, L. R. 2012. *Modern Money Theory: A Primer on Macroeconomics for Sovereign Monetary Systems*. New York, NY: Palgrave Macmillan.