
CONGRESSIONAL TESTIMONY

“The Economic Impact of America’s Failure to Contain the Coronavirus”

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The economic impact of the coronavirus in America has been unprecedented, and so has the federal response to the crisis. Now almost seven months into the pandemic, any additional aid must continue to be timely, targeted, and temporary. Congress can boost the economic recovery by returning power to state and local governments and reducing barriers to employment, business expansion, entrepreneurship, and capital formation.

My testimony will begin with a brief overview of the economic, fiscal, and health landscape, then outline an appropriate federal agenda to facilitate the recovery, highlight the inability of Congress to stimulate an economic recovery with more spending effectively, and

end by reviewing a few examples of the policies Congress should avoid.

Current Landscape

The COVID-19 pandemic and resulting U.S. public policy responses have been remarkable in their size and scope. Intentionally shutting down non-essential economic activity has had a dramatic effect on the livelihoods of millions of Americans. At the end of March, weekly unemployment claims jumped from close to historic lows of around 200,000 to nearly 3.3 million—the worst week ever recorded.¹ Through the spring, American workers faced continued job losses as public fear of the virus kept consumers at home, and government orders kept businesses closed. In the second quarter of 2020, real gross domestic product (GDP) contracted by 9.1 percent, a 31.7 percent

¹U.S. Department of Labor, Unemployment Insurance Weekly Claims, March 26, 2020,

<https://www.dol.gov/ui/data.pdf> (accessed March 27, 2020).

annualized decline.²

In response, federal and state governments have taken unprecedented actions. Congress passed an emergency appropriations bill in early March, followed by the Families First Coronavirus Response Act (FFCRA), the Coronavirus Aid, Relief, and Economic Security Act (CARES), and an extension of the paycheck protection program (PPP) for small business loans.³ To date, Congress has committed \$4 trillion in coronavirus aid, with an estimated deficit impact of \$2.1 trillion over a decade.⁴ The Federal Reserve also took a number of significant actions to keep debt markets functioning, totaling about \$7 trillion.⁵ State governors have implemented their own wide-ranging programs to slow infections and provide assistance to those in need.

The federal aid, while flawed in many important ways, has served as a floor for the economy to rest on while non-essential functions closed and health officials tried to contain virus spread. Due to significant federal transfers in April, when GDP was contracting and consumer spending plummeted, disposable personal income *increased* by 16.5 percent, compared to April 2019, and remained elevated in the following months.⁶ In the same quarter

that GDP contracted by 9.1 percent, the personal savings rate (savings as a percentage of disposable income) increased from a pre-crisis level of about 8 percent to 26 percent.⁷ At the height of the crisis, Americans spent less and received increased transfers through unemployment, economic impact payments (so-called “stimulus” checks), and other federal transfers.

A powerful one-time action, these temporary programs are not a sustainable solution on an ongoing basis, especially as the path of the virus over the next year remains highly uncertain. New benefits and subsidies can provide short-term Band-Aids, but economic security and opportunity come from markets, not governments. Government programs, even those implemented during crises, have future costs in the form of poor incentives, misallocation of investments, new public debts, and future tax increases. The federal government cannot keep the U.S. economy on life support forever—Americans must be allowed to return to work and school.

The economic shock of COVID-19 is the combined result of public fear of contracting or spreading the virus and government-ordered closures of large sectors of the economy. Unlike

²Annualized figures are adjusted growth rates that represent what the rate would be if the one quarter decline persisted the entire year. Bureau of Economic Analysis, Gross Domestic Product, Second Quarter 2020 (Second Estimate), Corporate Profits, Second Quarter 2020 (Preliminary Estimate), August 27, 2020, https://www.bea.gov/sites/default/files/2020-08/gdp2q20_2nd.pdf (accessed September 16, 2020).

³H.R. 6074, Coronavirus Preparedness and Response Supplemental Appropriations Act, 116th Cong., introduced March 4, 2020, <https://www.congress.gov/bill/116th-congress/house-bill/6074/text> (accessed March 27, 2020); H.R. 6201, Families First Coronavirus Response Act, 116th Cong., introduced March 11, 2020, <https://www.congress.gov/bill/116th-congress/house-bill/6201> (accessed March 19, 2020); H.R. 748, Coronavirus Aid, Relief, and Economic Security Act, 116th Cong., <https://www.documentcloud.org/documents/6819239-FINAL-FINAL-CARES-ACT.html> (accessed March 27, 2020); and S. 4116, A bill to extend the authority

for commitments for the paycheck protection program and separate amounts authorized for other loans under section 7(a) of the Small Business Act, and for other purposes, 116th Congress, introduced June 30, 2020, <https://www.congress.gov/bill/116th-congress/senate-bill/4116/> (accessed September 14, 2020).

⁴Committee for a Responsible Federal Budget, “COVID Money Tracker,” <http://www.crfb.org/project/covid-money-tracker> (accessed September 16, 2020); Congressional Budget Office, “An Update to the Budget Outlook: 2020 to 2030,” September 2, 2020, <https://www.cbo.gov/publication/56517> (accessed September 3, 2020).

⁵Committee for a Responsible Federal Budget, “COVID Money Tracker.”

⁶Bureau of Economic Analysis, Personal Income and Outlays, July 2020, August 28, 2020, <https://www.bea.gov/sites/default/files/2020-08/pi0720.pdf> (accessed September 16, 2020).

⁷Bureau of Economic Analysis, Personal Income and Outlays, July 2020, August 28, 2020.

the financial crisis of 2008, temporary closures, lost wages, and depressed investment is not the result of structural problems in the U.S. economy. In February, employers expanded payrolls by 273,000, the unemployment rate ticked down to 3.5 percent, and average year over year wage growth was 3 percent—all signs of a healthy economy continuing to expand.⁸

Following a steep economic decline, the recovery is already underway. From February's peak, non-farm employment contracted by 22.2 million jobs, and as of August, just shy of half of those lost jobs (10.6 million) have returned. At the end of July, there were 6.6 million job openings, involuntary layoffs and discharges declined 1.2 percent, and the voluntary quits rate rose 2.1 percent, likely indicating workers feel more confident in finding employment elsewhere.⁹ Retail and food service sales for August 2020 increased 2.6 percent over the previous year. Total 2020 sales are only 1.8 percent below the same period last year and are 0.4 percent *above* 2019 when excluding vehicles, parts, and gas stations.¹⁰ Small business optimism in the National Federation of Independent Businesses' (NFIB) survey increased to slightly above the historical average in August.¹¹ The continuation of these positive trends is not inevitable—poor policy can stand in the way. The recovery of lost jobs, for example, has slowed as the virus continues to circulate, and much of the entertainment,

hospitality, and travel sectors of the economy continue to face government restrictions and outsized losses in demand.

While there is still much uncertainty about the virus, what we have learned should inform our public policy response. Most importantly, stay-at-home orders are economically costly, and as three of my colleagues note in a comparative analysis of policy approaches to the coronavirus, “sweeping lockdown orders did not result in better outcomes than more targeted measures, such as isolation of the sick, mass testing, and contact tracing.”¹² Governors and other local officials can successfully allow more Americans to pursue their economic livelihoods by abandoning one-size-fits-all policymaking. Instead, they should focus on targeting geographic hotspots and those who are demographically vulnerable.¹³

Lastly, testing is still an underutilized tool. Early in the pandemic, regulatory hurdles at the Centers for Disease Control and the Food and Drug Administration prohibited timely proliferation of mass testing in the United States. Early testing proved to be a decisive factor in helping countries like South Korea and Iceland contain the virus spread. Still today, federal bureaucracies are standing in the way of private-sector deployment of cheap rapid tests. Without rapid onsite testing, businesses, schools, and universities are forced to use much less accurate temperature tests and other

⁸Bureau of Labor Statistics, Employment Situation Summary – February 2020, March 6, 2020, <https://www.bls.gov/news.release/empsit.nr0.htm> (accessed March 27, 2020).

⁹Bureau of Labor Statistics, Job Openings and Labor Turnover Summary, September 9, 2020, <https://www.bls.gov/news.release/jolts.nr0.htm> (accessed September 16, 2020).

¹⁰U.S. Census Bureau, Advance Monthly Sales For Retail And Food Services, August 2020, September 16, 2020, https://www.census.gov/retail/marts/www/marts_current.pdf (accessed September 16, 2020).

¹¹National Federation of Independent Business, Small Business Optimism Index, August 2020, <https://www.nfib.com/surveys/small-business-economic-trends/> (accessed September 16, 2020).

¹²Kevin Dayaratna, Patrick Tyrrell, and Andrew Vanderplas, “A Comparative Analysis of Policy Approaches to COVID-19 Around the World, with Recommendations for U.S. Lawmakers,” July 20, 2020, Heritage Foundation *Special Report* No. 234, <https://www.heritage.org/public-health/report/comparative-analysis-policy-approaches-covid-19-around-the-world>.

¹³The United States includes large populations who suffer from pre-existing conditions, such as diabetes and obesity, which are linked to significantly higher rates of COVID-19 deaths than for those without comorbidities. Dayaratna, Tyrrell, and Vanderplas, “A Comparative Analysis of Policy Approaches to COVID-19 Around the World, with Recommendations for U.S. Lawmakers.”

screening protocols or wait days or weeks for test results.

Net coronavirus job losses ended in May and began to rebound quicker than most economists predicted. The reversal is not proof that the trillions of dollars of federal spending worked. Politicians and economists alike often overestimate the effectiveness of government incentives. For example, early estimates of the still popular paycheck protection program show that the subsidies “increased employment at small businesses by only 3%, implying a cost of \$290,000 per job saved.”¹⁴ The high cost of saving one job demonstrates governments’ limited ability to revive macroeconomic trends through fiscal policy. Instead, the quicker-than-expected rebound was driven by Americans ready to reengage in their communities and return to work. Private precautionary behavior began shutting down the economy before governments-imposed lockdowns. Likewise, individuals and private businesses now seem ready to reopen, accepting new risks, and mitigating them with new policies and procedures. Any additional fiscal program Congress pursues is a poor substitute for allowing society to reopen and letting Americans adapt to the new normal.

An Appropriate Federal Response

The initial role of Congress in providing timely, temporary, and targeted relief in the face of government-imposed closures is quickly ending. Further federal funding to backfill state and local budgets or more general stimulus efforts are neither timely nor effective at supporting the economy, and extension of temporary programs can effectively shift temporary policy into a state of permanence.

Additional large-scale federal aid threatens to

derail the recovery by interfering with the incentives that are crucial to getting America back to work while improperly adding to the future uncertainty surrounding the federal debt. Lawmakers should resist the temptation to direct economic activity with checks from Washington or other large-scale government purchases. Instead, Congress and the President should focus on clearing the path for American society to adapt and rebuild. They can encourage states to continue letting businesses reopen, encourage schools to reopen for voluntary in-person learning, and help states increase low-cost, rapid testing and isolation of those who are sick.

To facilitate the continued return of jobs, Congress should focus first on removing unnecessary rules that increase the cost of doing business and restrict the ability of people to find fulfilling work. Repairing broken supply chains, reopening shuttered businesses, rehiring furloughed employees, establishing new businesses, and expanding those businesses that survived the crisis will continue to be a challenging task, but Congress is not well suited to direct any of this activity. In some cases, especially in health care sectors, many regulations have already been suspended temporarily; these temporary policies should be made permanent.¹⁵ Elsewhere, long-standing laws and regulations prohibit Americans from pursuing the path that is best for them and their families. While no list is comprehensive, Congress should focus on the following reforms:

Supplement Unemployment and Schedule Reduced Benefits. To address the sudden loss of jobs and wages following fear of the pandemic and wide-ranging business closure orders, it made sense to temporarily expand

¹⁴Raj Chetty, John N. Friedman, Nathaniel Hendren, Michael Stepner, and the Opportunity Insights Team, “The Economic Impacts of COVID-19: Evidence from a New Public Database Built from Private Sector Data,” Opportunity Insights *Working Paper*, September 2020, https://opportunityinsights.org/wp-content/uploads/2020/05/tracker_paper.pdf (accessed September 16, 2020).

¹⁵Romina Boccia and Adam N. Michel, “How Congress Can Enable the Great American Economic Recovery,” Heritage Foundation *Backgrounder* No. 3491, April 30, 2020, <https://www.heritage.org/budget-and-spending/report/how-congress-can-enable-the-great-american-economic-recovery>.

unemployment insurance benefits. In normal times, research shows that larger unemployment benefits result in higher levels and longer durations of unemployment.¹⁶ At the height of the unemployment crisis, work disincentives from expanded unemployment were likely weak, but as businesses reopen and look to staff up, typical concerns about the negative effects of enhanced unemployment benefits become more pressing.

The CARES Act extended the duration of benefits to 39 weeks; made them available to tens of millions of previously ineligible, self-employed, and gig workers; and added a \$600 per week benefit on top of existing state benefits, which usually replace between 40 percent and 50 percent of workers' previous wages. The flat \$600 bonus payments, which expired on July 31, allowed a majority of workers to receive more from unemployment than from their previous paychecks.

My colleague Rachel Greszler has recommended the federal government provide a 40 percent match to state benefits, also applying the match to partial-benefit programs that allow part-time work as employers gradually reopen.¹⁷ Proportional benefits are the right policy to support unemployed workers without unnecessarily reducing employment or making it harder for businesses to recover. However, in light of apparent administrative difficulties, the Senate Republican proposal for a \$200 bonus is a reasonable compromise.

¹⁶Drew Gonshorowski and Rachel Greszler, "The Impact of Additional Unemployment Insurance Benefits on Employment and Economic Recovery: How the \$600-per-Week Bonus Could Backfire," Heritage Foundation *Backgrounder* No. 3490, April 29, 2020, https://www.heritage.org/sites/default/files/2020-04/BG3490_0.pdf.

¹⁷Rachel Greszler, "Tackling COVID-19 Unemployment: Work Opportunities and Targeted Support Beat Windfall Bonuses," July 1, 2020, Heritage Foundation *Backgrounder* No. 3506, <https://www.heritage.org/jobs-and-labor/report/tackling-covid-19-unemployment-work-opportunities-and-targeted-support-beat>.

¹⁸S. 4317, Safeguarding America's Frontline Employees To Offer Work Opportunities Required to

To avoid a sharp cut-off of federal unemployment support at the end of the year, policymakers should gradually reduce federal support and return to fully state-funded and operated unemployment insurance systems in 2021 and beyond.

Protect Workers, Schools, and Businesses Who Follow Reasonable Measures. Liability protection would provide schools and businesses the certainty they need to reopen and not be hit with expensive, frivolous lawsuits if they rely on and attempt to follow government standards and guidance on virus mitigation. The Safeguarding America's Frontline Employees to Offer Work Opportunities Required to Kickstart the Economy (SAFE TO WORK) Act provides these protections while still holding accountable grossly negligent behavior.¹⁸

Increase Access to Capital and Reduce Future Uncertainty. Entrepreneurs will drive the post-pandemic recovery by reopening existing businesses and taking risks on novel ideas to fill new needs in the post-crisis world. As we saw after the Great Depression and the Great Recession, economic crises often induce out-of-work individuals to take the leap and start their own business. The coronavirus recession has already boosted the number of new business applications,¹⁹ and with the right policy, these budding companies could be the next great American firms. Entrepreneurs can access funds for their business by either borrowing or seeking an equity investment from investors. The

Kickstart the Economy Act, 116th Congress, introduced July 27, 2020, <https://www.congress.gov/bill/116th-congress/senate-bill/4317> (accessed September 16, 2020); Adam N. Michel, Rachel Greszler, Lindsey Burke, and Brian E. Finch, "Senate GOP Coronavirus Bill Has Some Good Provisions but Needs Serious Work," Daily Signal, July 29, 2020, <https://www.dailysignal.com/2020/07/29/senate-gop-coronavirus-bill-has-some-good-provisions-but-needs-serious-work/>.

¹⁹Allison Schrager, "Across the South and Midwest, Coronavirus Is Producing a New Generation of Entrepreneurs," Economics21, August 20, 2020, <https://economics21.org/coronavirus-recession-and-entrepreneurship> (accessed September 16, 2020).

current federal tax and regulatory systems create unnecessary barriers and uncertainty for small businesses that need capital. The following reforms can help expand the options for funding small and start-up businesses.

- **Allow permanent full expensing for all new investments** so that businesses can deduct spending on items such as equipment, tools, manufacturing floor space, and new housing in the same way they currently can deduct employee wages, advertising costs, and rent. This change would lower the cost of investing in American and American workers. Under current law, short-lived assets (those with useful lives of 20 years or less) are eligible for full expensing through 2022, and then it phases out over the following five years.²⁰ New buildings are not currently eligible for the benefits of expensing. The Cost Recovery and Expensing Acceleration to Transform the Economy and Jumpstart Opportunities for Businesses and Start-ups (CREATE JOBS) Act would boost long-run growth by making existing expensing permanent and allowing longer-lived investments the ability to use a “neutral cost-recovery system,” which provides a similar economic benefit as expensing.²¹
- **Enact a physical presence standard for tax liabilities** so that out-of-state businesses cannot be forced to collect a state’s sales taxes on goods sold to

customers in the state, if the business has no physical connection—or political recourse—in the customer’s state. Without this protection, the regulatory compliance and tax-assessment risks from state and local revenue collectors in thousands of tax jurisdictions around the country adds to the costs small online businesses face as they attempt to compete with their larger rivals.²²

- **Let entrepreneurs raise capital using finders, private-placement brokers, and peer-to-peer lending platforms** by simplifying rules and lowering barriers that increase the cost of starting or expanding a small business. The Unlocking Capital for Small Businesses Act of 2019 (H.R. 3768) would allow small businesses to enlist help in finding investors.²³ Additional reforms are necessary to appropriately treat Internet lending as a loan and not a security.²⁴ Simplifications should also be made to the U.S. Securities and Exchange Commission’s (SEC) exemption and disclosure framework and the definition of “accredited investor.”

Increase Worker Flexibility. American workers have endured the highest unemployment levels ever recorded, as many businesses cannot afford to keep paying payroll following depressed revenues. To help the labor market continue its rebound, Congress can address many barriers faced by workers and employers to increase flexibility and choice in

²⁰A year earlier, new spending on research and development will also lose the benefit of expensing.

²¹Adam N. Michel, “Why the CREATE JOBS Act Should Be an Essential Part of the Recovery,” The Daily Signal, August 4, 2020, <https://www.dailysignal.com/2020/08/04/why-create-jobs-act-should-be-an-essential-part-of-the-recover/>; Erica York, Alex Muresianu, and Garrett Watson, “FAQ on Neutral Cost Recovery and Expensing,” Tax Foundation, July 10, 2020, <https://taxfoundation.org/neutral-cost-recovery-full-expensing-faq/> (accessed September 16, 2020).

²²Adam N. Michel, “Without These Protections, States Will Tax Small Businesses to Death,” The Daily

Signal, March 4, 2020,

<https://www.dailysignal.com/2020/03/04/without-these-protections-states-will-tax-small-businesses-to-death/>.

²³David R. Burton, “Let Entrepreneurs Raise Capital Using Finders and Private Placement Brokers,” Heritage Foundation *Backgrounder* No. 3328, July 10, 2018, <https://www.heritage.org/sites/default/files/2018-07/BG3328.pdf>.

²⁴David R. Burton, “Improving Entrepreneurs’ Access to Capital: Vital for Economic Growth,” Heritage Foundation *Backgrounder* No. 3182, February 14, 2017, <https://www.heritage.org/jobs-and-labor/report/improving-entrepreneurs-access-capital-vital-economic-growth>.

the labor market.²⁵ While the federal government plays a role, state lawmakers can also make significant reforms by eliminating unnecessary occupational licensing requirements, moving barriers to home-based businesses, and repealing work restrictions such as California’s anti-gig-economy law, Assembly Bill No. 5 (AB5). Congress should focus on the following reforms to increase flexibility for workers:

- **Harmonize the government’s multiple definitions of “employee”** by clarifying the test for independent contractor status under the Fair Labor Standards Act; the National Labor Relations Act; and the tax code using the “common law” test, which bases determinations on how much control an employer exerts over a worker. Similarly, Congress should codify the definition of a joint employer to apply only if one company exercises direct and immediate control over another company’s employees.²⁶
- **Establish a “safe harbor” for contractor benefits** so that contract-based workers, such as Uber drivers and Instacart shoppers, can receive non-wage compensation in the form of paid sick leave or personal protection equipment without triggering an employer-employee relationship that would deprive independent contractors of the flexibility and autonomy that they desire.

²⁵Greszler, “Labor Policy for COVID-19 and Beyond: Recommendations to Get Americans Back to Work.”

²⁶Establishing this change by statute, instead of through the typically partisan National Labor Relations Board, would help to protect the viability of businesses that contract out core functions, those that use temporary staffing agencies, and franchises. James Sherk, “Unions Are Waging War on These Small Businesses,” *The Daily Signal*, December 28, 2014, <http://dailysignal.com/2014/12/28/the-unions-are-waging-war-on-these-small-businesses/>, and Stephen Moore, “Obama, Unions, Trial Bar Take Aim at Franchise Model,” *Heritage Foundation Commentary*, September 23, 2014,

- **Allow hourly wage workers to choose paid time off** by passing the Working Families Flexibility Act, which ends the prohibition on offering workers the choice between pay and paid time off for overtime hours worked.²⁷
- **Allow household employees to elect contractors status** so that individuals performing household work, such as cleaning or childcare, are not required to be treated as employees, allowing workers to benefit through higher base pay from compliance and tax savings for the household they serve.
- **Rollback the U.S. Department of Labor’s recent increase in the overtime threshold** so that employers and workers have the flexibility they need to adapt to the changing work environment.
- **Create Universal Savings Accounts** so every American, regardless of work status, can have access to an all-purpose savings account to build a personal rainy day fund to better weather the risks of a future economic or health crisis. Universal Savings Accounts (USAs) accept post-tax earnings, all withdrawals would be excluded from taxable income, and accrued earnings would be tax-free. Simple and flexible accounts allow more workers at all income levels to save more of their earnings with fewer restrictions on where and when they can spend their own money.²⁸

<http://www.heritage.org/research/commentary/2014/9/obama-unions-trial-bar-take-aim-at-franchise-model>.

²⁷Rachel Greszler, “A Simple Way to Help Workers and Employers Hurt by Coronavirus,” *Heritage Foundation Commentary*, March 15, 2020, <https://www.heritage.org/jobs-and-labor/commentary/simple-way-help-workers-and-employers-hurt-coronavirus>.

²⁸Adam N. Michel, “Universal Savings Accounts Can Help All Americans Build Savings,” *Heritage Foundation Backgrounder*, December 4, 2019, <https://www.heritage.org/taxes/report/universal-savings-accounts-can-help-all-americans-build-savings>.

Structural Reforms, Also Necessary to Sustain a Strong Economic Rebound.

Congress should not stop at removing immediate barriers to economic recovery. A broader pro-growth agenda that tackles systematic impediments to investment, innovation, and employment will be crucial to sustaining a robust economic rebound. The Administration should continue to roll back past expansions of existing laws. Congress should enact systemic reforms to the administrative state to prevent harmful future executive re-interpretation of existing laws. Congress needs to reassert its authority in setting and lowering tariffs and advance new free trade agreements to quiet long-term uncertainty associated with global trade. Congress should also reduce unnecessary environmental barriers to economic development that achieve little to no environmental benefit. Additional specific recommendations can be found in a recent Heritage Foundation *Backgrounder*, “How Congress Can Enable the Great American Economic Recovery,”²⁹ and *Special Report*, “Restoring America as the Land of the Free.”³⁰

Stimulus Spending, a Fool’s Errand

The Great Recession taught a sobering lesson. The government cannot spend its way back to economic prosperity. At best, so called “stimulus” measures are ineffective. At worst, they can delay the recovery and prolong financial hardship.³¹ Additional economic impact payments to individuals, temporary

payroll tax holidays, more federal support to keep state budgets elevated, or new infrastructure spending are all misguided attempts to support the economy.

For stimulus spending to work, new government programs must add to, rather than crowd out, private-sector jobs. That is not what happens. Historically, stimulus spending shrinks the private sector. In a 10-year retrospective on new research following the financial crisis, Valerie A. Ramey investigates the effectiveness of government spending programs as a response to recessions. Chart 1 shows Ramey’s sampling of government spending multipliers (the ratio of increased GDP to government spending). The multipliers come from researchers using a wide range of models, techniques, data, and time periods. A multiplier below one means that additional government spending shrinks private activity and could slow total economic output. Summing up the results, Ramey explains, “The bulk of the estimates across the leading methods of estimation and samples lie in a surprisingly narrow range of 0.6 to 1.” She concludes that stimulus spending likely does “not stimulate additional private activity and may actually crowd it out.”³² Other research shows that government stimulus spending is more likely to be economically destructive when governments have debt-to-GDP ratios similar to that of the U.S.³³

²⁹Romina Boccia and Adam N. Michel, “How Congress Can Enable the Great American Economic Recovery,” Heritage Foundation *Backgrounder* No. 3491, April 30, 2020, <https://www.heritage.org/budget-and-spending/report/how-congress-can-enable-the-great-american-economic-recovery>.

³⁰Nicolas Loris, “Restoring America as the Land of the Free,” Heritage Foundation *Special Report* No. 224, April 28, 2020, <https://www.heritage.org/economic-and-property-rights/report/restoring-america-the-land-the-free>.

³¹Adam N. Michel, “The False Promise of Stimulus Spending: Lessons from the Great Recession,” Heritage Foundation *Backgrounder* No. 3493, May 6, 2020, [https://www.heritage.org/markets-and-](https://www.heritage.org/markets-and-finance/report/the-false-promise-stimulus-spending-lessons-the-great-recession)

[finance/report/the-false-promise-stimulus-spending-lessons-the-great-recession](https://www.heritage.org/markets-and-finance/report/the-false-promise-stimulus-spending-lessons-the-great-recession).

³²Valerie A. Ramey, “Ten Years after the Financial Crisis: What Have We Learned from the Renaissance in Fiscal Research?” *Journal of Economic Perspectives*, Vol. 33, No. 2 (Spring 2019), p. 90, <https://pubs.aeaweb.org/doi/pdf/10.1257/jep.33.2.89> (accessed April 8, 2020).

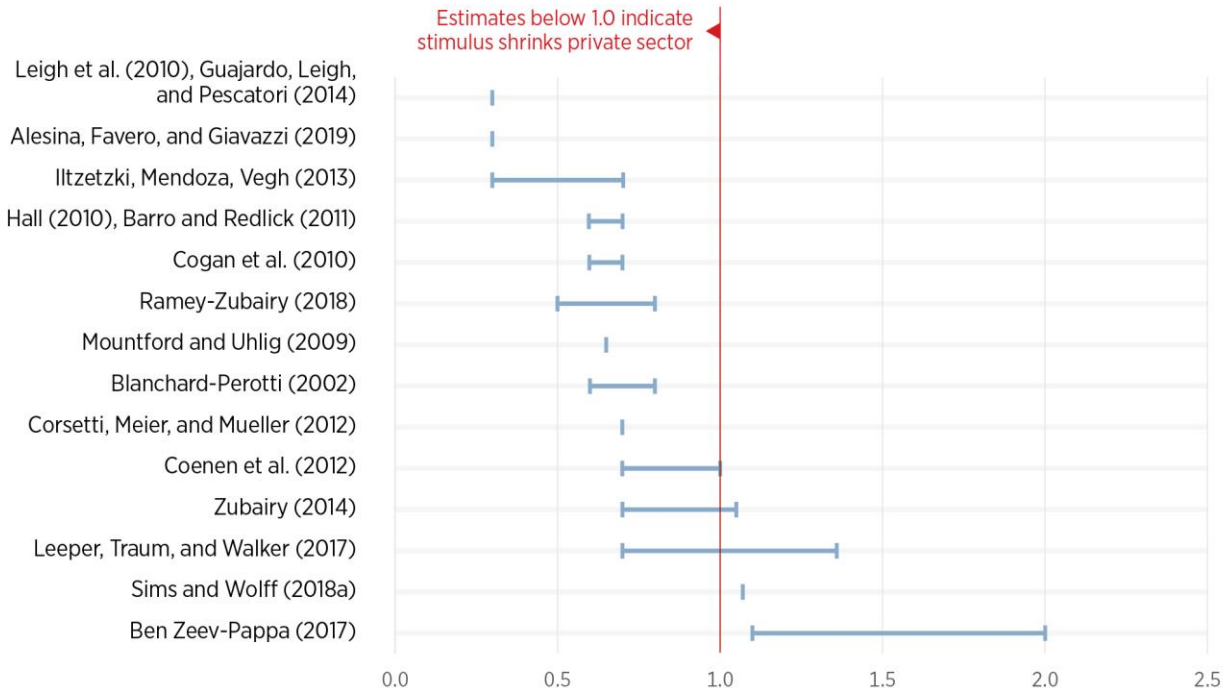
³³Ethan Ilzetzki, Enrique G. Mendoza, and Carlos A. Végh, “How Big (Small?) Are Fiscal Multipliers?” *Journal of Monetary Economics*, Vol. 60 (2013), pp. 239–245, <https://www.sas.upenn.edu/~egme/pp/MendozaetalJME.pdf> (accessed May 5, 2020).

CHART 1

Stimulus Spending Shrinks Private Sector

ESTIMATES OF GOVERNMENT SPENDING MULTIPLIERS

Lower Bound — Upper Bound



NOTES: Estimates use aggregate data, no state dependence.

SOURCE: Valerie A. Ramey, “Ten Years After the Financial Crisis: What Have We Learned from the Renaissance in Fiscal Research?” *Journal of Economic Perspectives*, Vol. 33, No. 2 (Spring 2019), Table 1, <https://pubs.aeaweb.org/doi/pdf/10.1257/jep.33.2.89> (accessed May 1, 2020).

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After the 2009 infrastructure stimulus, a survey of construction firms found that stimulus projects went to businesses that were already busy. Many of them had subsequently turned down private-sector jobs in favor of more lucrative government contracts. Only 4 percent of workers at subsidized firms had been rehired from the ranks of the previously unemployed.³⁴ Most jobs, especially construction jobs for infrastructure projects, require training and skills to be safe and effective. Instead of training

unemployed workers to expand payrolls, federal contractors often hire skilled workers from the private sector at inflated wages. The temporary influx of government money shifts resources within the industry instead of actually expanding it.

By shifting resources, government spending can destroy jobs and shrink private-sector growth while wasting taxpayer dollars. For example, the 2009 stimulus channeled over \$500 million to Solyndra, only to have the solar manufacturer go bankrupt.³⁵ Smaller projects,

³⁴Garett Jones and Daniel M. Rothschild, “The Limits of Infrastructure Stimulus,” *Mercatus Institute COVID-19 Policy Brief Series*, March 25, 2020, <https://www.mercatus.org/publications/covid-19->

[policy-brief-series/limits-infrastructure-stimulus](https://www.mercatus.org/publications/covid-19-policy-brief-series/limits-infrastructure-stimulus) (accessed May 5, 2020).

³⁵Institute for Energy Research, “Recapping the Obama Administration Green Energy Stimulus Failures,” January 9, 2013,

like a Nevada biomass electricity plant, closed as soon as the federal funds had dried up.³⁶ Temporarily pushing businesses and workers to respond to government priorities creates new costs when the public funding ends and industries must again reshuffle to meet private-sector demands.

Congress Should Cut, Not Increase Spending

The U.S. fiscal gap—the difference between revenues and expenditures—is a systemic problem driven by sustained growth in mandatory spending since the early 1970s.³⁷ The current health and economic crisis will only serve to accelerate unsustainable budget trends that have been baked into U.S. fiscal policy for decades. Additional federal stimulus spending will likely result in \$2 trillion average deficits over the next decade.³⁸ If left unaddressed, Congress will eventually have to cut spending growth or increase taxes. Historically, cutting spending results in faster economic recovery and lower debt levels. Tax increases slow growth and fail to reduce debt levels.³⁹

<https://www.instituteforenergyresearch.org/renewable/solar/recapping-the-obama-administration-green-energy-stimulus-failures/> (accessed April 29, 2020).

³⁶Tom Coburn and John McCain, “Summertime Blues,” August 2010, https://www.washingtonpost.com/wp-srv/politics/documents/GOP_simulus_index.pdf (accessed April 29, 2020).

³⁷Jeffery Miron, “U.S. Fiscal Imbalance over Time: This Time Is Different,” Cato Institute *White Paper*, January 26, 2016, <https://www.cato.org/publications/white-paper/us-fiscal-imbalance-over-time-time-different> (accessed July 7, 2020).

³⁸Committee for a Responsible Federal Budget, “Updated Budget Projections Show Fiscal Toll of COVID-19 Pandemic,” June 24, 2020, <http://www.crfb.org/papers/updated-budget-projections-show-fiscal-toll-covid-19-pandemic> (accessed July 6, 2020).

³⁹Alberto Alesina, Carlo Favero, and Francesco Giavazzi, *Austerity: When It Works and When It Doesn't* (Princeton, NJ: Princeton University Press, 2019).

Delaying sustainable budget reforms—by doing nothing or responding with higher taxes—will make the pandemic-induced recession worse and will ensure a longer and more drawn-out economic recovery. Delayed fiscal action will eventually force a debt crisis at an unknown point in the future. In the meantime, the cost and uncertainty of an impending crisis and resulting fiscal adjustment will simmer under the surface for years or decades, dragging down potential growth. The costs of high debt-to-GDP ratios are well documented and have already reduced U.S. growth.⁴⁰ Continued increases in public debt will further shrink business investment, reducing productivity, wages, and economic output.

Following unsustainable budgets, properly implemented fiscal adjustments driven by spending cuts can help boost economic recovery and do not have to be contractionary, as predicted by many mainstream economic models. Implemented correctly, expenditure-based fiscal adjustments can be pro-growth in the short run and long run.⁴¹ Reducing government spending can restore confidence in the government’s fiscal capacity and reassure

⁴⁰Carmen M. Reinhart, Vincent R. Reinhart, and Kenneth S. Rogoff, “Public Debt Overhangs: Advanced-Economy Episodes since 1800,” *Journal of Economic Perspectives*, Vol. 26, No. 3 (2012), pp. 69–86,

<https://www.aeaweb.org/articles?id=10.1257/jep.26.3.69> (accessed July 10, 2020); Thomas Grennes, Qingliang Fan, and Mehmet Caner, “New Evidence on Debt as an Obstacle to US Economic Growth,” Mercatus Center *Working Paper*, March 2019, <https://www.mercatus.org/system/files/grennes-debt-obstacle-growth-mercatus-working-paper-v2.pdf> (accessed August 13, 2020); and Salim Furth, “High Debt Is a Real Drag,” Heritage Foundation *Issue Brief* No. 3859, February 22, 2013, <https://www.heritage.org/debt/report/high-debt-real-drag>.

⁴¹John F. Cogan, Daniel L. Heil, and John B. Taylor, “A Pro-Growth Fiscal Consolidation Plan for the United States,” Hoover Institution Economics *Working Paper* No. 20114, July 9, 2020, https://www.hoover.org/sites/default/files/research/docs/20114-cogan_heil_taylor_.pdf (accessed August 11, 2020).

taxpayers and investors that revenues will not have to increase to cover current unfunded expenditures. Cutting taxes is not always necessary to activate a supply-side response resulting in additional economic activity. Merely removing the threat of future tax increases by constraining current spending can boost private investment and consumption.

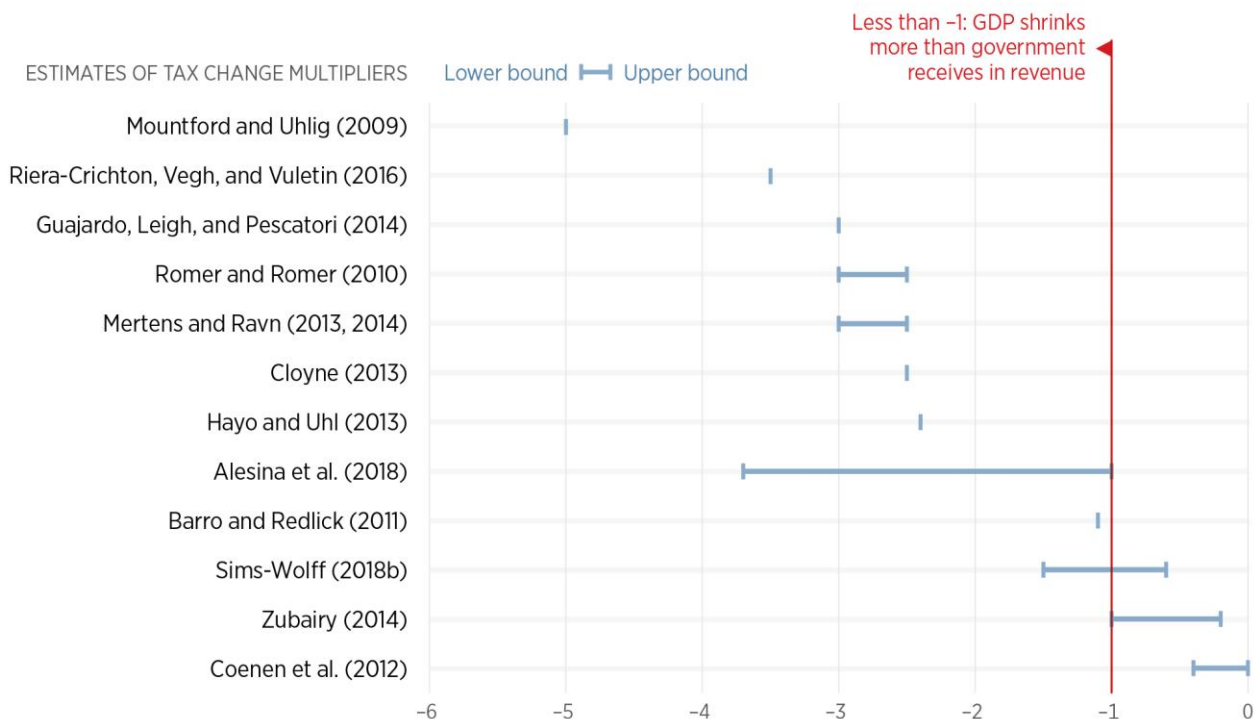
Tax Increases Kill Economic Recovery. Raising taxes as a strategy to balance budgets or pay for new stimulus spending is less successful and more damaging to economic growth than cutting spending. Historically, tax-based pans to balance budgets lead to deep and prolonged recessions. In general, the economic cost of tax increases is high and confirmed by a wide range of estimates. In her review of the literature,

Ramey shows that in most estimates, tax increases reduce GDP by two or three times the increase in revenue. (See Chart 2.) The economic costs of tax increases are often larger than the revenue raised because higher taxes change incentives, making working and investing less attractive. By shrinking the economy, tax increases have historically been self-defeating as budget tools because they ultimately do not raise enough revenue to cover spending growth.

In order to facilitate a robust American economic recovery and ensure that rising government debt does not lead to a fiscal crisis, lawmakers should reduce the growth rate of spending through entitlement reform and prevent taxes from increasing in 2026 when the

CHART 1

Tax Hikes Shrink Economy Two to Three Times More than Revenue Raised



NOTE: Estimates use aggregate data, no state dependence.

SOURCE: Valerie A. Ramey, "Ten Years after the Financial Crisis: What Have We Learned from the Renaissance in Fiscal Research?" *Journal of Economic Perspectives*, Vol. 33, No. 2 (Spring 2019), p. 105, <https://pubs.aeaweb.org/doi/pdf/10.1257/jep.33.2.89> (accessed August 17, 2020).

2017 Tax Cuts and Jobs Act expires. Most importantly, for the current debate, Congress must not approve additional federal spending in hopes of accelerating the recovery. Additional stimulus spending will simply worsen America's budget imbalances without the benefits of the promised economic boost. Some of the most popular proposals for additional federal spending are reviewed below.

Refuse to Bail Out Irresponsible States and Localities. The federal response to the COVID-19 pandemic has already provided \$360 billion to state and local governments in direct aid to cover costs of coronavirus spread and containment, support for education systems, childcare for frontline workers, and subsidies for mass transit systems.⁴² In addition to direct aid, the Federal Reserve has provided \$500 billion in short-term loans for state and municipal governments. Moreover, the \$1.2 trillion in relief for individuals and businesses represent further indirect support for states, which will materialize as higher income and sales revenues. While state and local revenue did fall by about 3 percent between the first and second quarter of 2020, federal aid actually allowed total state and local revenues to increase quarter-to-quarter. Instead of raising taxes or asking for a federal bailout, state revenue shortfalls should be addressed by working to safely reopen local economies, rolling back recent spending increases, and bringing public employee compensation and retirement benefits in line with the private sector.⁴³

⁴²Committee for a Responsible Federal Budget, "COVID Relief Includes \$360 Billion of State and Local Aid," September 16, 2020, <http://www.crfb.org/blogs/covid-relief-includes-360-billion-state-and-local-aid> (accessed September 16, 2020).

⁴³Rachel Greszler, "How States Can Address Their COVID-19 Budget Shortfalls without Federal Bailouts," Heritage Foundation *Backgrounders*, June 8, 2020, <https://www.heritage.org/budget-and-spending/report/how-states-can-address-their-covid-19-budget-shortfalls-without-federal>.

⁴⁴George R. Crowley, Russell Sobel, "Do Intergovernmental Grants Create Ratchets in State and Local Taxes?," Mercatus Center *Working Paper*,

Bailing out state and local budgets with unrestricted federal dollars would not protect state taxpayers from higher taxes as aid simply moves state funding shortfalls into the future. When the federal money runs out, states have historically increased taxes; each dollar of federal grant money resulting in 40 cents of state and local tax increases.⁴⁴ Federal subsidies also undermine local decision-making about the best pace for reopening and set a dangerous precedent that could lead to trillions of dollars in additional federal bailouts of the most irresponsible states and localities. Federal aid tends to expand state budgets and make them less resilient during future crises, perpetuating problems like systematic pension underfunding.

Moving state funding to the federal government does little more than redistribute local costs to federal taxpayers across all 50 states. It certainly does not make sense for the federal government to assume state and local shortfalls when the federal government already has about seven times as much debt per capita compared to state and local governments. Congress can help states by providing flexibility for existing funding sources and lifting unfunded mandates.⁴⁵

Congress should also not authorize additional federal funding for educational institutions. Congress already authorized \$31 billion for schools in the March CARES Act, of which data from June shows that just 1 percent had been spent.⁴⁶ Authorizing an additional \$105 billion as proposed by Senate Republicans would—

September 7, 2010, <https://www.mercatus.org/publications/government-spending/do-intergovernmental-grants-create-ratchets-state-and-local-taxes> (accessed September 16, 2020).

⁴⁵Adam N. Michel, "State Bailouts Create Poor Incentives, Do Not Fix Underlying Problems," Heritage Foundation *Backgrounders* No. 3488, April 17, 2020, <https://www.heritage.org/budget-and-spending/report/state-bailouts-create-poor-incentives-do-not-fix-underlying-problems>.

⁴⁶U.S. Government Accountability Office, "COVID-19: Opportunities to Improve Federal Response and Recovery Efforts," Report to the Congress, GAO-20-625, June 25, 2020, <https://www.gao.gov/reports/GAO-20-625/#appendix19> (accessed September 16, 2020).

combined with past coronavirus federal education bailout money—nearly double the Department of Education’s annual discretionary budget. Congress should instead provide states with flexibility over how existing federal education dollars are spent. School districts need to reprioritize spending, focusing on excessive growth in non-teaching staff, administrative bloat, and unfunded pension liabilities that have been squeezing taxpayers for years.⁴⁷

Do Not Renew Stimulus Payments. The first round of so-called \$1,200 stimulus checks was not a good use of taxpayer dollars, and a second round would be similarly wasteful. One problem with sending checks to most Americans is that the funds are inadequate for those who have lost their jobs and unnecessary for the more than 140 million workers who are employed.⁴⁸ The fact that the savings rate surged from a pre-crisis level of about 8 percent to 26 percent in the second quarter of 2020 suggests that many households do not face income shortfalls and will not spend additional stimulus checks immediately.⁴⁹

The stimulus checks are also not actually stimulative.⁵⁰ In 2008 and 2009, stimulus checks and rebates did not change broad measures of consumer demand, breaking the key link that would predict increased consumption creating a broader government-

induced economic recovery.⁵¹ One reason one-time payments may have little to no impact on aggregate trends is that many individuals spend and save their income based on expectations about their future income.⁵² Looking over their life cycle, individuals factor in things like the possibility of future tax increases to pay for current period benefits and temporary versus permanent changes in income. A similar critique applies to a temporary payroll tax cut.⁵³

Resist New Work Subsidies and Other Tax Credits. Proposals in both the House and Senate include tax credits for businesses who hire COVID-19 unemployment recipients, new credits to cover the costs of employee protection expenses, expansions of the employee retention tax credit, and additional funding for the paycheck protection program, among others. While it is understandable to want to help get people back to work, additional business payroll subsidies would complicate the hodgepodge of previously enacted subsidies. And they would not be an effective use of future taxpayers’ money because back-to-work subsidies would provide windfall benefits to individuals and employers who were already going to find employment or hire back workers. New tax-credit programs are also unlikely to help the most vulnerable and smallest businesses amid mounting complexity in the existing

⁴⁷Lindsey Burke, “In COVID-19 Bill, Schools Need Funding Flexibility, Not Another Federal Bailout,” *The Daily Signal*, July 29, 2020, <https://www.dailysignal.com/2020/07/29/in-covid-19-bill-schools-need-funding-flexibility-not-another-federal-bailout/>.

⁴⁸Rachel Greszler and John Fleming, “4 Charts Show Why Temporary, Targeted Support Beats Checks to Everyone,” *The Daily Signal*, March 27, 2020, <https://www.dailysignal.com/2020/03/27/4-charts-show-why-temporary-targeted-support-beats-checks-to-everyone/>.

⁴⁹Bureau of Economic Analysis, *Personal Income and Outlays*, July 2020, August 28, 2020.

⁵⁰Adam N. Michel, “The False Promise of Stimulus Spending: Lessons from the Great Recession,” *Heritage Foundation Backgrounder* No. 3493, May 6, 2020, [https://www.heritage.org/markets-and-](https://www.heritage.org/markets-and-finance/report/the-false-promise-stimulus-spending-lessons-the-great-recession)

[finance/report/the-false-promise-stimulus-spending-lessons-the-great-recession](https://www.heritage.org/markets-and-finance/report/the-false-promise-stimulus-spending-lessons-the-great-recession).

⁵¹John B. Taylor, “Fiscal Stimulus Programs During the Great Recession,” *Hoover Institution Economics Working Paper* No. 18117, December 7, 2018, https://www.hoover.org/sites/default/files/research/docs/18117_taylor.pdf (accessed April 27, 2020).

⁵²Milton Friedman, *A Theory of the Consumption Function* (Princeton University Press, 1957), pp. 20–37, and Franco Modigliani, “The Life Cycle Hypothesis of Saving, the Demand for Wealth and the Supply of Capital,” *Social Research*, Vol. 33 (1966), pp. 160–217.

⁵³Joel Griffith and Adam N. Michel, “Payroll Tax Suspension Executive Order Is Legally Dubious, Economically Unnecessary,” *The Daily Signal*, August 10, 2020, <https://www.dailysignal.com/2020/08/10/payroll-tax-suspension-executive-order-is-legally-dubious-economically-unnecessary/>.

coronavirus response.⁵⁴ Individuals and employers need to spend their time and money maintaining their livelihoods, regaining their customers, and adjusting their operations to new COVID-19 realities.

Instead, the existing pandemic programs force employers to spend their time figuring out complicated interactions and ambiguous enforcement. New programs expand that complexity, change the rules yet again, and create a new maze of programs to navigate. Many of the smallest businesses cannot afford the tax and legal counsel necessary to comprehend and comply with these programs. Some have even thrown up their hands in frustration and given back the money.

Simple relief is the most effective relief. The congressional response should remain targeted at containing the virus and streamlining programs that already exist, rather than creating new complexity. If Congress decides extended business subsidies are necessary, relief should be targeted through just one program, such as a streamlined version of the employee retention tax credit.⁵⁵ Ultimately, additional subsidies will not save struggling industries unless people are willing and able to return to their communities and resume something resembling normal spending patterns.

⁵⁴Adam N. Michel, “Congress Should Streamline Existing COVID-19 Relief, Not Add New Programs,” *The Daily Signal*, July 7, 2020, <https://www.dailysignal.com/2020/07/07/congress-should-streamline-existing-covid-19-relief-not-add-new-programs/>.

⁵⁵Alex Brill, “Toward a Better Employee Retention Tax Credit,” *AEIdeas*, August 3, 2020, <https://www.aei.org/economics/toward-a-better-employee-retention-tax-credit/> (accessed September 16, 2020).

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