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What can trillions in Covid stimulus spending teach us in preparing to head off a future financial disaster?

Karl Polzer – Center on Capital & Social Equity

As the new Congress begins scratching the surface of the fraud that sapped a significant portion of the $6 trillion of Covid-related government spending over the past three years, a more fundamental issue is whether funds that reached businesses and people as intended were wisely and fairly spent. The same goes for the estimated $7 trillion the Federal Reserve Bank pumped into the economy during the crisis. With the advantage of hindsight, what could policymakers do better when the next catastrophe looms?

To put the combined figures in perspective, in 2021 at the midpoint of the pandemic, $13 trillion was more than 50% of US GDP or more than three-quarters of what was needed to fill Social Security's long-term financing gap.

Congress authorized Covid relief and stimulus in a series of bills spanning both the Trump and Biden Administrations. The three biggest sources of spending were $800 billion for the Paycheck Protection Program (PPP), $680 billion for enhanced unemployment insurance (UI) benefits, and $800 billion in stimulus checks. Each of these programs was roughly comparable in size to the entire American Recovery and Reinvestment Act of 2009, enacted in response to the Great Recession. Covid spending has pushed the national debt to new heights. Some call it a financial disaster. Others credit Congress with preventing a major recession.

Not only was the PPP riddled with fraud, the free "loans" to prevent businesses from closing and laying off staff were a "fire hose" of untargeted, unaudited spending. Much of it went to businesses and non-profits that already had adequate financing and to high-income people. With the nation in a panic and recession looming, Congress' main goal for the first PPP tranche was to get money out the door as fast as possible, said economists, who helped design and evaluate the program, during a recent panel discussion.

A study by MIT labor economist David Autor, Fed staff, and others found that only 23-34% of PPP dollars went directly to workers who would otherwise have lost jobs. Most ended up as profit for business owners, shareholders, and their creditors and suppliers. Businesses and non-profits that had relationships with banks, which Congress used to distribute the cash, had greater access to limited funds. Many small firms at greatest risk missed out.

About three-quarters of PPP funds accrued to the top quintile of households. "This compares unfavorably to the other two major pandemic aid programs, enhanced UI benefits and Economic Impact Payments (i.e. stimulus checks)," the study concluded. "PPP's breakneck scale-up, its high cost per job saved, and its regressive incidence have a common origin: PPP was essentially untargeted because the United States lacked the administrative infrastructure to do otherwise."

The researchers were surprised to find that the extra UI payments were weighted towards both the upper and lower tails of the income distribution. The top fifth of households received a bit more than one-quarter of the benefits. Only about half of the federal UI outlays went to the bottom two-fifths.

Of the three major Covid programs, stimulus checks were the most progressive (weighted toward the bottom). Still, Congress faced criticism that too much of the money went to high-income households. Covid relief legislation passed just after President Biden's election, for example, stemmed from a compromise proposal that offered very little for the lowest income groups; $600 checks were included during last-minute negotiations after public criticism. Congress' one-year expansion of the otherwise regressive child tax credit to include more low-income families has not been extended.

Distributing so many resources to well-off people and healthy businesses is not only inefficient and unfair. It also added to excess savings that, along with money by injected the Fed, created heightened demand that spurred inflation when supply chains were strained. Low-income workers now may be hurt again as the Fed raises interest rates to dampen the economy and increase unemployment in order to drive down inflation.

Through what economists call "Cantillon effects," a central bank's expansion of the money supply often provides an advantage to those with first access: typically banks and, in the case of bailouts, corporations. If inflation results, they are positioned to benefit and raise prices first before the new money trickles through the rest of economy. Workers then may face criticism when they react by demanding wage increases needed to meet the rising cost of living.

Picking through the morass of Covid spending to prepare for the next crisis will take some time, especially since Congress often lacks an appetite for exploring past decisions. Exercising more fiscal caution and better targeting funds to families and businesses in greatest financial jeopardy would result in less debt and possibly lower inflation. To be ready for the next time, the US might consider improving administrative systems and data infrastructure which other high-income countries deployed to target their Covid spending. When it stimulates the economy, the Fed might consider developing conduits to expand the money supply through households and small businesses alongside the usual goliaths of the financial establishment.

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