Economist.

Expected U.S. Macroeconomic Performance during the Pandemic Adjustment Period

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The coronavirus has the potential to create catastrophic health outcomes in the U.S.I take as a baseline for my analysis Ferguson et al. "Impact of Non-Pharmaceutical Interventions (NPIs) to Reduce COVID-19 Mortality and Healthcare Demand." Imperial College, COVID-19 Report 9, March 16, 2020. In order to mitigate this, public health officials have recommended a variety of social-distancing policies to slow the spread of the virus. In addition, social interaction has declined dramatically due to voluntary withdrawal by individuals, corporate work-from-home policies and government restrictions.

These actions and policies have had the effect of engineering a controlled, partial and temporary shutdownof certain sectors of the U.S. economy. The productive capacity of the U.S. economy is fundamentally strong and resilient—nevertheless, this organized "throttling down" radically changes the way we need to think about and gauge the health of the U.S. economy in the near term.I recommend the following analogy: Suppose you are driving your car down the freeway at 70 mph, but then you encounter a construction zone. You have to slow down in the construction zone, perhaps quite significantly, work your way through the construction zone, and then resume your previous speed. There is nothing wrong with your car, but you nevertheless have to slow down. The U.S. economy will, by design, behave very differently than what is conventionally assumed in ordinary times—so differently, in fact, that ordinary business cycle analysis will be ineffective and cease to make sense. The goals of macroeconomic policy will need to be very different, in some ways the opposite of what we would normally try to accomplish.

A National Pandemic Adjustment Period
I begin by recommending that the President and Congress declare a "National Pandemic Adjustment Period" (NPAP), providing a natural focal

point for the expectations of policymakers and Americans at large concerning what is happening. The NPAP would initially extend from now until the end of the second quarter of 2020, and would be flexible enough to be shortened or extended as necessary depending on how the virus progresses. Special policies would be in effect for the duration of the NPAP, and the dates that these special policies would expire could be tied to the end date of the NPAP.

There are three broad goals to be accomplished during the NPAP.

1. Greatly Reducing Economic Activity

The first goal during the NPAP is to intentionally reduce (reduce!) economic activity in order to meet public health objectives. Production is to be carried out only if (1) the good or service is deemed “essential,” or (2) the good or service can be produced in a way that does not risk transmission of the virus. If production is reduced in this way, this will be considered successduring the NPAP.

My rough initial estimate of the level of U.S. real GDP (and hence national income) that meets this public health objective is up to 50% of normal production. In other words, we need to throttle back the U.S. economy to produce at only half its normal pace.I intend to update this value going forward as it becomes clearer which parts of the economy actually shut down and which parts do not.

It would be inappropriate to characterize that outcome as a recession because it is undertaken intentionally to meet public health objectives. In particular, it is inappropriate to argue for “economic stimulus” intending to ramp up production or create new demand in this situation, as that would work at cross-purposes with the goal of reducing the level of economic activity in order to meet public health objectives. A better concept is that we should strive to “keep everybody whole” during the NPAP, as described in more detail below.Macroeconomic policy should seek to align household and business incentives with national health goals, not to work against those goals.

A normal quarter of production of goods and services in the U.S. recently, in very round numbers, is about $5 trillion. Producing only half would mean that national income is cut to about $2.5 trillion during the second quarter of 2020 when the NPAP is in effect. This is a quarter-over-quarterdrop of 50%, well outside historical experience in the U.S.

This outcome is expected and temporary and simply reflects the large investment in public health that will be made in the U.S. This change in magnitude is something to be expected and to prepare for, reinforcing the point that standard business cycle tracking serves little useful purpose in the near term. For example, economists often translate quarter-on-quarter growth rates in variables, such as GDP or consumption, into annual rates by (roughly) multiplying by four. In the current environment, one could see a quarter-on-quarter change in a variable of 50%. Annualized, this would be called a “200% decline.” Annualizing serves little use in the current environment. Data during the NPAP will be coming from a special situation.

2. Keeping Households and Firms Whole

The second goal of policymakers is to prevent destruction of livelihoods and firms during the NPAP. This planned, organized partial shutdown will clearly have very uneven effects across households and firms during the NPAP. Some types of businesses are closed down completely, while other types continue to operate.

On the household income side, the goal is to keep households whole. We already have government income maintenance programs, popularly known as unemployment insurance (UI). I recommend using these programs extensively and changing the label on these programs to “pandemic insurance” (PI) during the NPAP to more appropriately reflect what is happening. Heavy use of this facility by individuals—to the extent that it helps to maintain laid-off workers’ income—should be used as a metric of policy successduring the second quarter. Heavy use would mean that the government is making the proper transfers to those who have been disrupted by the health objectives of the country. To help accomplish this, benefit replacement rates could be increased substantially from the current average rate in the U.S. of about 45% to a value close to or equal to 100%.

Moreover, every state has a well-established UI system with rules already in place. Stress will be placed on these systems as the number of claims made in the upcoming weeks may be unprecedented; nonetheless, this facility is much better than the alternative of trying to set up a new system on the fly.

My initial estimate of the level of pandemic insurance that may be appropriate during the NPAP period is 30%.I intend to refine this estimate going forward based on pandemic developments. That is, up to 30% of the workforce could be using this program as part of an optimal policy response to the pandemic.

The intentional, partial reduction in production means capital will also be unemployed during the NPAP. Conceptually, factories will shut down for a period of time and then reopen once the pandemic has passed with the capital intact. National policy, therefore, needs to make the owners of capital whole during this period. Most proposals in this area under consideration in Congress provide loans to businesses, large and small, to tide businesses over until they can start up again after the NPAP.

3. Paying for the Pandemic Response

The third goal is to pay for the pandemic response. If national income falls by 50% during the NPAP, households will not be able to maintain their normal lifestyles. In other words, consumption is likely to be much lower than normal for most households during the NPAP. Most of this reduction will come as a result of the health objectives themselves—many avenues for ordinary consumption will simply be closed, and in addition people are being asked to remain in their homes. To a large extent, national income will be down, but national consumption will be down in tandem with national income. This is the nature of “hunkering down.”This may also be viewed as what macroeconomists call “home production,” that is, the movement of production from the market sector, where it is counted in GDP, to the home sector, where it is not counted in GDP. Famous and familiar examples of services that move back and forth between sectors are meals, which are sometimes eaten outside the home and sometimes produced in the home, as well as child care, which is sometimes provided at home and sometimes provided in a market setting. The federal government is certainly borrowing, but most of this is oriented toward maintaining market functioning and extending loans to businesses to tide them over until full-speed production can once again resume.

Summary

Just as incoming macroeconomic data should be interpreted in light of the unprecedented nature of the public health policy response to COVID-19, so too should the macroeconomic policies be understood and conducted. For example, the phrase "stimulus" may not be entirely appropriate now: Many people may not want to fly out of caution or be able to dine out because of legal decree. The goal of macroeconomic policy, at this stage, is not to "stimulate" them to do these things. Rather, at this stage, macroeconomic policy could be better described as maintenance and support, more a matter of insurance than stimulus. For example, enhanced unemployment benefits help maintain the income of workers temporarily laid off because of a change in demand in the sector where they had been employed.

Looking ahead, July 1 may provide an important checkpoint. At that point, there is a reasonable chance that public health needs will be reduced, allowing health authorities to ease the throttling down of U.S. economic activity. As of today, the situation remains fluid, and the views expressed here could easily change with events in the days and weeks ahead.

Notes and References

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5Macroeconomic policy should seek to align household and business incentives with national health goals, not to work against those goals.

6For example, economists often translate quarter-on-quarter growth rates in variables, such as GDP or consumption, into annual rates by (roughly) multiplying by four. In the current environment, one could see a quarter-on-quarter change in a variable of 50%. Annualized, this would be called a "200% decline." Annualizing serves little use in the current environment.

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- **March 6, 2020**. Remarks. "How the World Achieved Partial Consensus on Monetary Policy," delivered at the Shadow Open Market Committee Meeting Current Monetary Policy: The Influence of Marvin Goodfriend, New York, N.Y.
  Remarks (pdf) (bullard_somc_new_york_6_march_2020pdf).

How the World Achieved Partial Consensus on Monetary Policy

March 6, 2020

Remarks:

In remarks at the Shadow Open Market Committee’s spring meeting in New York, St. Louis Fed President James Bullard discussed the work of the late economist Marvin Goodfriend and his influence on monetary policy.

“Marvin Goodfriend was a brilliant economist who helped the profession