PENN WHARTON
UNIVERSITY of PENNSYLVANIA
Budget Model

Response to the White House's Critique of PWBM's COVID Relief Analysis

Introduction

On February 3, 2021, PWBM released three analyses of the $1.9 trillion Biden COVID relief plan: a budgetary analysis of the direct aid provisions, a macroeconomic analysis of the full relief package, and a background report on the 2021 economy. Critiques of our analysis have focused on two conclusions from this background document: 1) our assessment of the current state of the economy and 2) our results that suggest 27 percent of stimulus checks would be spent on consumption. As always, PWBM welcomes responses to our work, and we are glad for this opportunity to provide additional clarity on our analysis and its results.

Productive Capacity in the 2021 Economy

In the White House press conference the same day as our publication, White House Press Secretary Jen Psaki responded to our analysis, specifically critiquing the idea that the economy is "near capacity."

Throughout our analysis, we demonstrate that many sectors of the economy (particularly those related to in-person services) continue to struggle. For instance, in Table 1 of our macroeconomic analysis, we calculate pandemic related unemployment by age and income, showing the large harm the recession is causing to low income households. As our background analysis shows, many service sectors are far below pre-recession levels. However, that same analysis shows that many sectors of the economy are close to or above their pre-recession levels of consumption and production. A recent report by the Congressional Budget Office is in line with our assessment that most sectors are healing.

As we explain in our background analysis, recovery in the affected sectors is limited by pandemic-related shutdowns and individual behavior. There is no mechanism by which additional household spending will stimulate those sectors until pandemic-related restrictions ease. Additional spending in less-affected, near-capacity sectors will also not have large stimulative effects. These findings are consistent with recent public assessments made by several former Obama administration officials.[1] However, the Biden plan's relief payments would support low-income and unemployed households most affected by the pandemic.

Marginal Propensities to Consume

Other critiques have focused on our model's estimated 27 percent marginal propensity to consume (MPC)[2] for the additional direct payments in Biden's proposal. This estimate is based on the response to the one-time transfer payments by households in our general equilibrium, overlapping generations, incomplete markets dynamic model that has been carefully calibrated to actual economic data. The model includes a detailed description of government policies as well as a rich representation of households that differ by income, wealth, age and other characteristics important for estimating the MPC. We do not set MPC directly in the model; rather, the MPC is calculated by our calibrated model. Our estimate is comparable to many other studies including a 2010 study by Sahm, Shapiro, and Slemrod, who find an MPC of roughly 33 percent for the 2009 stimulus payments. Our estimate is also consistent with a recent Federal Reserve Bank of New York study, which finds an MPC of 29 percent for the 2020 CARES Act checks.

While a low MPC limits the short-term stimulative effects of relief payments, increased savings in the economy have the potential to boost long run growth—inasmuch as additional savings are invested in real productive capital, the economy may be better off *in the long run*. However, as discussed in our background analysis, household savings in 2020 went largely towards purchases of government debt and did not result in investment in fixed assets substantially different from 2019. With little additional change to the capital stock, the long-run growth of the economy does not benefit from this increase in savings.

This response was written by Efraim Berkovich and Richard Prisinzano.

---

1. These include pieces written by Jason Furman, Austan Goolsbee, and Larry Summers as well as an interview given by Steven Rattner. ↩

2. The marginal propensity to consume is the average amount of additional consumption resulting from an additional dollar received by a household. A 27 percent MPC is the behavior we observe from our model's agents, who, on average, consume 27 percent of the payment and thus leave 73 percent as savings. ↩