Discussion of 'A Social Insurance Perspective on Pandemic Fiscal Policy, and Implications for Monetary Policy' by David Romer

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Introductory comments

Thank you to the RBA for the opportunity to discuss David Romer's paper (co-authored with Christina Romer) and his presentation. This is an extremely important contribution to our thinking about both fiscal and monetary policy in extraordinary times such as produced by the COVID-19 pandemic. I'm particularly grateful to David and Christina for formalising my strong (but intuition-based) convictions about the role of macroeconomic policy during the pandemic.

The key insight of the paper is that the primary purpose of fiscal policy in these circumstances is social protection, not stimulating aggregate demand. In the US context, this is largely achieved through boosting and extending the duration of unemployment insurance payments and expanding eligibility for these payments to groups not normally eligible. However, an important role for government-provided hazard pay for essential workers at increased risk of infection is also identified. The authors show that market wages will not sufficiently adjust to compensate these workers in the absence of government intervention.

In his presentation, David argued that there is less role for monetary policy than fiscal policy. Monetary policy is not well suited to achieving social protection other than by adopting a broadly (and hence untargeted) stimulatory stance. Consequently, while monetary policy is not distributionally neutral, there is not much scope for factoring distributional effects into policy decisions.

Relating the paper to the Australian context: Australia's Fiscal Policy Response to COVID-19

In my discussion, I want to mainly focus on relating the paper to the Australian context and in particular assessing the extent to which the Australian Government's fiscal policy responses achieved social protection as opposed to stimulus.

As with other countries, Australia implemented a raft of fiscal measures in response to the pandemic. These measures included $236 billion in 'direct economic support' between March 2020 and June 2022 (Treasury 2021), as well as many health-related fiscal measures.

There were a number of components to the direct economic support, but the most significant was JobKeeper, a hybrid wage subsidy and income support scheme under which $89 billion of payments were made. The scheme represented a wage subsidy for those who kept working and income support for those who stopped working or previously earned less than JobKeeper (to the extent JobKeeper boosted their earnings). It was paid in respect of four million workers of one million businesses. While notionally it was payable only to businesses with a large decline in turnover, in practice it went to many businesses with minimal or no drop in turnover. In its initial phase (first six months), it was $1,500 per fortnight per worker regardless of previous earnings.

The fiscal response also included a range of other business subsidies and income support payments. Business subsidies included cash flow boosts and accelerated depreciation allowances. The main initiatives in income support payments were the introduction of the Economic Support Payment, made to existing recipients of various government benefits, and an increased payment rate and expansion in eligibility for JobSeeker. The COVID Disaster Payment was also introduced in 2021 for people who lost their jobs due to a 'COVID-19 lockdown' in their region.

JobSeeker is the closest Australia has to unemployment insurance. However, unlike most unemployment insurance schemes, it is universally available (subject to income and assets tests), is not time-limited and it is paid at a flat rate irrespective of past earnings. Nonetheless, in the initial phases of the pandemic, it was quite effective in supporting a large number of people. Job-search requirements were removed, means tests were relaxed, and the payment rate (excluding Commonwealth Rent Assistance) was doubled via the 'Coronavirus Supplement'. The number of recipients doubled between December 2019 and May 2020 from approximately 700,000 to approximately 1.4 million.

That said, as a flat-rate payment, even when doubled, JobSeeker had a low replacement rate for higher-income earners. The increase in payments and relaxed eligibility requirements were also quite short-lived. The pre-COVID means tests and activity requirements were restored in September 2020 and the Coronavirus Supplement was substantially reduced from September 2020 and completely eliminated in March 2021.

It is significant that JobKeeper, rather than unemployment assistance, was the biggest component of the fiscal measures. While JobKeeper played an important role in supporting incomes of Australians in the first year of the pandemic, it was very much positioned as a scheme to protect businesses and reduce longer-term economic damage from lockdowns. Indeed, it had three stated goals: (1) support business and job survival; (2) keep employees connected to their employers; and (3) support individuals. Only the last of these goals is explicitly concerned with social protection.

There were no significant measures by the Australian Government that could be interpreted as hazard pay. There were a limited number of ‘bonus’ payments from federal and state governments to some workers, such as nurses in aged care, and JobKeeper may have effectively provided hazard pay for a number of low-wage workers, but compensation of workers exposed to increased risk of infection was not an explicit feature of Australia’s policy response.

Overall, while the fiscal policy measures were stimulatory in effect relative to the no-policy-change scenario, that was clearly not their main goal. In many ways, the Australian Government’s focus was indeed on social protection. Targeting of fiscal policy, especially via JobKeeper, was relatively poor, but largely still managed to help most the people most in need of help. However, it is also true that the measures had other goals. In particular, they were also very much concerned with mitigating longer-term economic damage through reducing business insolvencies and loss of firm-specific human capital. Indeed, it is arguable more weight was given to business protection than social protection in the Australian Government’s fiscal policy response.

Reflections on the implications of the paper

My reflections on the paper and its implications are, again, mostly thinking about the Australian context. My first observation is that, if social protection rather than fiscal stimulus is the main game, targeting measures to the most needy is advisable. That is, assistance should be focused on households most adversely impacted and least able to self-insure (although in practice it can be difficult to design well-targeted measures that get to everyone who needs help).

This matters, because there are significant costs of ‘overdoing it’. It bears noting that the ceasing of a significant fraction of economic activity necessitated by a pandemic must, on average, reduce living standards. In this context, fiscal stimulus is likely to fuel increased saving. Put simply, many types of consumption, particularly leisure activities, are simply not possible in a pandemic. This increase in saving in turn acts to create excess aggregate demand as the pandemic eases and restrictions are lifted. (That said, it is not clear that the post-pandemic overheating of demand witnessed in many countries was avoidable even with milder stimulus during the pandemic.)

Greater fiscal stimulus will also produce a higher debt bill. This implies higher taxes and/or lower spending in future, with associated (and possibly adverse) distributional implications for future years.

With the benefit of hindsight, it does seem the Australian Government's fiscal response was, in aggregate, excessive. For example, it is estimated by Murphy (2023) that fiscal measures overcompensated for income losses by a factor of two.

My second reflection is on the question of whether unemployment insurance and hazard pay are 'enough' as social protection measures. In principle, they could be, although it especially depends on eligibility criteria for unemployment insurance being sufficiently loosened. In Australia, while JobSeeker Payment eligibility was expanded considerably, this was not sustained for the entire duration of the pandemic. Moreover, as noted, its flat rate is not sufficient for most people: even when doubled, it represented s a low replacement rate for most workers.

Third, David and Christina's paper does not address whether protecting businesses should be a goal of fiscal policy in a pandemic. However, this was clearly a concern of policymakers in Australia and other countries, and there does seem to be merit in trying to mitigate long-term economic damage through measures to keep businesses afloat. That said, I am not convinced that JobKeeper was a good instrument for achieving this. In part this is because there were significant costs of preserving connections between firms and workers, largely through inhibiting efficient reallocation of labour. It is an open question whether, by preserving ties been workers and firms, the scheme produced a quicker economic rebound than an approach that didn't tie workers to firms. While it may have resulted in less loss of firm-specific human capital, it is also likely to have slowed down labour reallocation. Moreover, its scale and lack of targeting meant it was probably implicated in the excess aggregate demand Australia experienced in the wake of the pandemic.

Related to concerns about JobKeeper is that the composition of consumption changes during a pandemic. There are industries that grow, requiring additional workers. David and Christina allow for movement of workers in an extension of the base model, showing it requires that unemployment insurance is less than complete. As noted above, the design of JobKeeper means it is also likely to have inhibited labour reallocation.

My final comment is that the primacy of social protection as the focus of fiscal policy is of doubtful applicability to situations other than pandemics. Pandemics are rather unique for the way in which much economic activity is necessarily stopped for an extended period, which is the key feature driving the finding that fiscal policy's main role should be social insurance. It is hard to think of other situations in which such sustained shutdowns could occur, and certainly most natural disasters do not have this feature.

To conclude, I want to reiterate that this is an excellent paper. It should certainly be at the forefront of policymakers' minds should we suffer the misfortune of another pandemic or other crisis requiring a significant fraction of economic activity to cease.

References

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