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Amanda Bonacasa

Mark Streiber

Peter D'Antonio

Molloy College, pdantonio@molloy.edu

Meryl Rosenblatt

Molloy College, mrosenblatt@molloy.edu

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COVID Stimulus Fails to Benefit Hardest-Hit Sectors

Amanda Bonacasa
Molloy College
Rockville Centre, NY USA.
(516) 361-0442
abonacasa@lions.molloy.edu

Mark Streiber
Molloy College
Rockville Centre, NY USA
(516) 754-9617
mstreiber@lions.molloy.edu

Peter D'Antonio
Molloy College
Rockville Centre, NY USA
(516) 993-5990
pdantonio@molloy.edu

Meryl Rosenblatt
Molloy College
Rockville Centre, NY USA
(516) 512-0592
mrosenblatt@molloy.edu

ABSTRACT

This paper demonstrates the ineffectiveness of the COVID-19 stimulus checks distributed in 2020 under the CARES Act to increase consumer spending and provide economic relief where it was most needed. This is consistent with prior stimulus packages issued during severe economic downturns (1968, 1975, 2001 and 2008), where tax cuts and rebates resulted in increased consumer savings and reduced levels of debt rather than increases in consumer spending. The intensity of the economic impact of the COVID pandemic, and the uneven recovery, was largely due to the need for ‘social distancing’ and the reduction of in-person interactions to help manage the spread of the virus. Social distancing policies resulted in business shutdowns and the voluntary curtailing of face-to-face activities by consumers. Industries hit hardest by the pandemic restrictions were those where work could not be performed remotely or required a high degree of physical proximity (high-touch industries). Based on consumer expenditure data from Q4 2019 to Q4 2020 and supported by the life-cycle and permanent income hypotheses, the analysis presented in this paper suggests that temporary fiscal policies administered during the economic downturn were not effective in stimulating personal consumption expenditures. More income in consumers’ hands could not generate more spending in high-touch industries when social distancing was mandated, so the extra money was mostly saved. Moreover, too much stimulus went to low-touch industries that did not need a boost. As a result, the stimulus checks were an incredibly expensive policy for the limited benefit they provided. Moving forward, we suggest that fiscal stimulus policies should be more specifically targeted and may need to be offered on a more permanent basis.

Keywords

Covid-19, economic stimulus, high-contact industries, consumer spending, saving rate, fiscal policy

1 INTRODUCTION

A review of U.S. stimulus packages administered during the pandemic, and previous economic downturns, reveal similar patterns with regard to their relative ineffectiveness. The failure of temporary stimulus policies, such as tax cuts and rebates, is best illustrated by significant increases in the personal savings rate and a decline in the marginal propensity to consume for every additional dollar received from stimulus as compared to regular income. Tax cuts enacted in 1968 and 1975 illustrate the ineffectiveness of temporary tax cuts in stimulating consumer spending, as the individuals who used the tax rebates were mainly those facing liquidity constraints and had to use the funds to meet their short-term financial needs (Steindel, 2001). The tax rebates issued in 2001 revealed a similar pattern in which the marginal propensity to consume for every dollar of stimulus was much lower than expected (Shapiro & Slemrod, 2003). The 2001 tax rebate was expected to stimulate consumer spending because more permanent tax cuts were announced to follow the temporary tax rebate, but consumption did not live up to expectations. Empirical evidence reveals that the 2008 rebate was also not effective in stimulating the economy, with many people reporting that they saved a majority of the stimulus funds, using the remaining portion to pay off debts rather than spending in those industries having the greatest need (Sahm, Shapiro & Slemrod, 2010). Despite various stimulus packages, consumer spending is suppressed in severe economic downturns such as in 2001 and 2008 because uncertainty and pessimism regarding future economic conditions encourages individuals to save more as a precautionary measure. Since discretionary fiscal policies such as tax cuts are not effective, fiscal policies should focus more on automatic stabilizers, such as unemployment payments, and should be offered on a more permanent basis (Taylor, 2009).

The onset of the coronavirus (COVID-19) pandemic led to unprecedented changes in consumer behavior. Health concerns, stay-at-home orders, restrictions on gatherings, and store closings had a significant impact on consumer spending and the U.S. economy (Garnier, Safir & Schild, 2020). In March 2020, Congress passed the CARES Act (Coronavirus Aid, Relief, and Economic Security), providing the first round of stimulus payments for economic relief, valued at \$1200 for qualifying individuals. To date, three sets of Economic Impact Payments (“stimulus checks”) have been issued to eligible recipients as part of the pandemic relief. However, the current economic downturn stemming from the pandemic differs from past recessions, which were caused by imbalances that curtailed demand. This time, the decline in demand and consumer spending that prompted this recession was primarily due to COVID guidelines and restricted access to certain businesses.

COVID guidelines have allowed industries with minimal restrictions (low-touch) to recover from the initial demand shock, whereas high-touch industries with many restrictions have not been able to do so. Under these circumstances, stimulus that is not targeted towards high-touch industries will be ineffective at increasing consumer spending. COVID-relief stimulus checks are not effective in stimulating the economy because industries that have the greatest need will not recover while restrictions are still in place and consumers seek to avoid contagion. This research attempts to demonstrate that the stimulus checks distributed in 2020 under the CARES Act did not boost consumer spending in high-contact industries, and therefore did not have the desired effect on the U.S. economy.

2 BACKGROUND

In response to the significant drop in consumer spending and the financial instability of many American households, Congress passed the CARES Act to provide economic relief to Americans and to stimulate the economy (U.S. Department of Treasury, 2021). The CARES Act provided \$1,200 checks to individuals earning up to \$75,000 and couples earning less than \$150,000. The stimulus amount was phased out for individuals earning between \$75,000 and \$99,000 and was not provided to individuals earning more than \$99,000. In terms of joint filers, the stimulus amount phased out for couples earning between \$150,000 and \$198,000 and was not sent to joint filers earning more than \$198,000. American households were also provided an additional \$500 for every child under the age of 17 years.

Consistent with previous stimulus packages, the stimulus checks issued under the CARES Act have not been effective in stimulating the economy. Economic theories such as the life cycle and permanent income hypotheses suggest that temporary tax cuts are not effective in changing consumption patterns because individuals spend based upon their life cycle stage and what they perceive to be their permanent income (Deaton, 2005). According to both theories, individual consumption levels reflect expected income throughout one's lifetime, and temporary fluctuations in income (i.e. rebates) will have only small effects on overall spending patterns.

The severity and disparity of the economic impact of COVID across industries was due to the need for 'social distancing', and the reduction of in-person interactions. Social distancing policies resulted in businesses shutdowns and the voluntary curtailing of face-to-face activities by consumers. Industries hit hardest by the pandemic restrictions were those that could not be performed remotely or require a high degree of physical-proximity (high-touch). High-touch industries are those that have a high degree of face-to-face interactions among customers, between employees and customers, and among employees. These industries are contact-intensive and rely upon close proximity to execute the job's essential functions. High-touch industries are unable to transition to home-based work to limit face-to-face interactions. In addition, the essential functions of the job either can't be performed under current COVID protocols (e.g. social distancing) or are executed with notable difficulties and well below productive capacities. Conversely, low-touch industries do not have a high degree of face-to-face interactions and are able to operate under COVID protocols. As a result, low-touch and high-touch industries have experienced notable disparities in their recovery rates. The beginning of the pandemic was characterized by restricted access to virtually all businesses, placing high-touch and low-touch industries on a relatively level playing field (excluding the essential businesses that were not closed down). As restrictions were eased, low-touch businesses were able to resume operations near or at full capacity. The continued physical restrictions placed on the business activities of high-touch industries did not allow them to operate near capacity. Consumers that choose to spend their stimulus checks were most likely to focus spending in low-touch industries. Studies have shown that low work-from-home/ high physical-proximity workers tend to have lower incomes, face liquidity constraints, and have a greater need to spend stimulus funds on necessities (Mongey, Pilossoph & Weinberg, 2020; Leibovici, Santacreu & Famiglietti, 2020).

3 LITERATURE REVIEW

3.1 Life Cycle/Permanent Income Theory

Fifty years ago, Modigliani and Brumberg (1954) hypothesized that people are motivated to accumulate resources to support consumption during retirement. The basic assumption is that people save when they are young and run down their assets when they are old. The life cycle hypothesis (LCH) is a theory of spending based on the idea that people make intelligent choices about how much they want to spend at each age, independent of their income at each age (Deaton, 2005). Several years later Friedman (1957) proposed the permanent income hypothesis (PIH), which suggests that a person's consumption is determined not just by their current income but also by their expected income in future years.

Both theories suggest that the only effects that will influence current consumption are associated with long-term income changes. In each model, temporary increases in income level would be saved or invested rather than being consumed. Where they differ is mainly with regard to the length of the planning period. For Friedman, this period is infinite, meaning that people save not only for themselves but also for their descendants. In Modigliani-Brumberg's model the planning period is finite. LCH and PIH share similar predictions about consumer behavior, and both theories assert that transitory income shocks such as taxes and rebates will have relatively small effects on consumption (Jappelli, 2005). The life cycle/permanent income theories have generated criticism and debate and have been empirically tested to see how well these models perform with regard to temporary

changes in income. Research suggests that life-cycle models have more empirical successes than failures (Browning & Crossley, 2001).

A review of the literature also indicates that current theories of consumption pay little attention to the savings behavior of low-income individuals and households. Those with irregular earnings or low lifetime income expectations are more likely to have limited economic resources. They are more likely to face liquidity constraints that make it difficult for them to weather fluctuations or reductions in income. Further, many low-income individuals may never have earnings that substantially exceed their consumption needs (Beverly & Sherraden, 1999). Using data from the 1998 Survey of Consumer Finances, Hogarth & Anguelov (2003) examine the assets of low-income households and their available resources for meeting short-term emergencies. They conclude that low-income households overall lack the financial resources that could be used to meet emergencies and are therefore less likely to save.

3.2 COVID Stimulus Spending and Savings

A large-scale survey to assess the effectiveness of the 2020 stimulus checks, and how the one-time transfers to individuals from the CARES Act affected their consumption and saving decisions (Coibion, Gorodnichenko & Weber, 2020). The survey found that only 15% of recipients reported spending their checks, while the majority of respondents said that they either saved the money or used it to pay down debts. The survey results also reveal that relatively little spending went to hard-hit industries selling large durable goods (cars, appliances, etc.), and that most of the spending was in non-durable industries (food, beauty, and other consumer products) that had already seen large spikes in spending *before* the stimulus package was passed. Those who spent the stimulus checks faced liquidity constraints and used the funds to finance short-term needs, and the majority of consumption took place in low-touch industries that had already recovered.

Most respondents report that they primarily saved or paid down debts with their transfers, with only about 15 percent reporting that they (mostly) spent it. When providing a detailed breakdown of how they used their checks, individuals report having spent or planning to spend only around 40 percent of the total transfer on average. This relatively low rate of spending out of a one-time transfer is higher for those facing liquidity constraints, who are out of the labor force, are less educated, and those who received smaller amounts. We find no meaningful effect on labor-supply decisions from these transfer payments, except for twenty percent of the unemployed who report that the stimulus payment made them search harder for a job.

The tendency to save the stimulus payments was also reflected in the sharp rise in the personal saving rate. Figure 1 clearly illustrates that the personal saving rate increases resulting from the 2001 and 2008 rebates were clearly dwarfed by the surge in savings that occurred during the pandemic, where the waves of massive stimulus were saved.

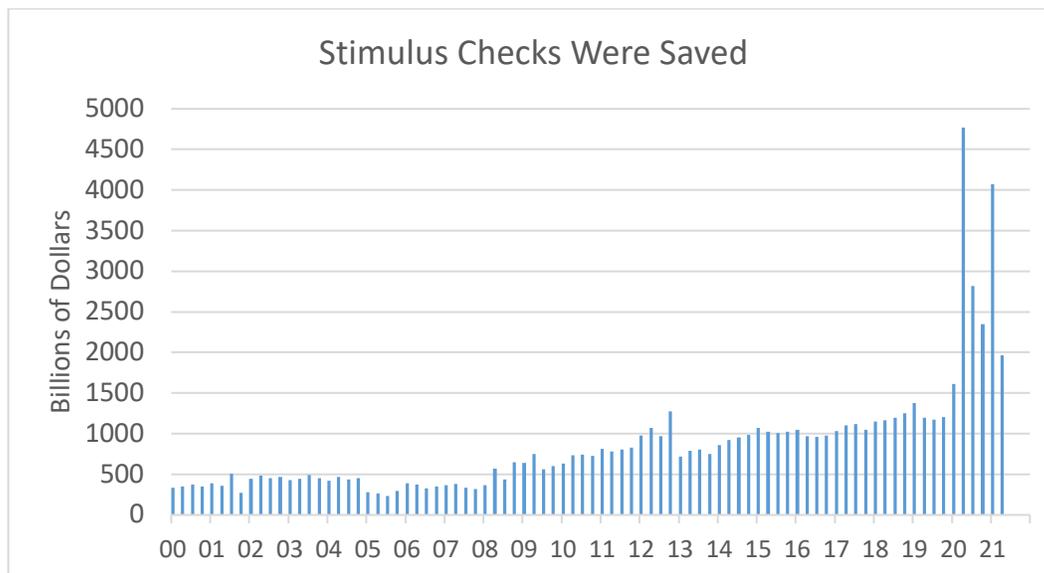


Figure 1. Personal Savings Rate, 1990-2020. Bureau of Economic Analysis/Haver Analytic

4 RESEARCH OBJECTIVE

The objective of this research is to test the following hypotheses:

- H1:** The behavior of the two industry-intensity categories (high-touch and low-touch) was significantly different during the pandemic.
- H2:** High touch industries that rely on face-to-face transactions experienced continued depressed demand, as consumers sought to avoid contagion.
- H3:** Low touch industries where transactions can be done online or in a minimal-contact manner have completely bounced back from the pandemic-induced recession.

5 RESEARCH METHODOLOGY

The quarterly personal consumption expenditures for each sector of the economy from Q1 2010 to Q4 2020 were aggregated into a table representing consumption for the entire economy.¹ Each sector of the economy was given a four-digit code based on (1) the type of products/services sold within the sector, (2) the contact-intensity of the businesses within the sector, (3) the degree of necessity associated with the sector's products/services, and (4) the ability for the sector to support online delivery methods. To categorize consumer spending based on the type of product/service offered within each sector, durable goods, nondurable goods, and services were coded with a 0, 1, and 2 respectively. To bifurcate spending based upon contact-intensity, high-touch industries were coded by a 0 and low-touch industries were classified by a 1. The necessity of each sector was also considered such that essential sectors were classified by a 0 and nonessential sectors were coded by a 1. Lastly, the possibility of online delivery was also weighed by coding those sectors with online delivery options with a 1, and those without the ability to support online delivery with a 0.

The primary bifurcation of the economy studied within this analysis was high-touch and low-touch industries. This breakdown represents a new grouping of data based on our own observations. The total quarterly personal consumption expenditures were broken down into the subtotals for high-touch and low-touch sectors so that further analysis on the influence of contact-intensity of industries on personal consumption expenditures throughout the pandemic could be conducted. Other breakdowns were not analyzed because the type of product, the degree of necessity, and the online options overlapped with contact intensity to such a degree that they were indistinguishable statistically.

6 DATA ANALYSIS

6.1 Consumer Spending Behavior

The economy witnessed a significant drop off in personal consumption expenditures in Q2 2020, which is when much of the nationwide lockdown occurred. Figure 2 illustrates quarterly consumer spending in high-touch/low-touch industry sectors. Although there has been some recovery from the significant decline of consumption in Q2 2020, personal consumption expenditures in high-touch industries have yet to return to pre-pandemic levels. Personal consumption expenditures in low-touch industries experienced a brief decline in consumer spending during Q2 2020 (lockdown); the decline in consumer spending for low-touch industries was smaller compared to that of high-touch industries. In addition, consumer spending in low-touch industries has recovered from its drop off during the national lockdown and is now surpassing pre-pandemic levels. This illustrates how low-touch industries have been able to fully recover from the pandemic because they have not experienced the severe restrictions compared to high-touch industries. Many low-touch industries have been able to operate at or near full productive capacity since the nationwide lockdown, which has allowed them to fully recover in terms of consumer expenditures.

H1 states that the behavior of the two intensity categories (high-touch and low-touch) was different during the pandemic.

To determine this, we found the weight of each of the 15 high-touch industries in the total of high-touch and the 29 low-touch industries in the total of low-touch. We took the percent change of each industry, and finally found the weighted percent change for each industry. From these data, we were able to calculate the expected values of percent changes, the variances, and the standard deviations for high-touch and low touch industries.

Table 1a illustrates the expected percent change, variance of the percent changes, and standard deviation of the percent changes for high-touch industries. The expected percent change in high-touch industries Q4 2019 to Q4 2020 was found to be -15.43%. The expected percent change is negative because high-touch industries were significantly impacted by the pandemic and

¹ Consumer expenditures data was accessed from Haver Analytics Inc., which provides financial and economic time series data. The source of the consumer expenditures data was the Bureau of Economic Analysis. The data accessed and used for analysis was quarterly personal consumption expenditures from quarter one 2010 to quarter four 2020. The magnitude of the data was in millions of real chained 2012 dollars (Whelan, 2000).