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Statement before the U.S. House Committee on Financial Services
On The Need for Additional Covid-19 Stimulus

The American Rescue Plan

Some Good, Some Bad, and Too Large

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Chairwoman Waters, Ranking Member McHenry, and members of the Committee, thank you for inviting me to testify on economic relief, recovery, and stimulus in the face of the ongoing Covid-19 pandemic. It is an honor.

Two ways to assess the need for economic support are “top down” and “bottom up.” The top-down approach attempts to assess the amount by which the economy is underperforming — *e.g.,* the size of the “economic hole” caused by the pandemic and social distancing — and determine how much government spending would be required to bring the level of economic activity back to where it should be. More precisely, the quantity of goods and services that could be sustainably produced given the economy’s underlying technology and labor and capital resources is determined and compared to the economy’s actual production. The difference between the economy’s underlying potential and actual performance is called the “output gap.” The size of the output gap can be used to determine the appropriate size of an economic stimulus package.

Alternatively, Congress could take a bottom-up approach. This way of crafting economic support would pay less attention to the size of the output gap and more to the specific needs facing the economy. Today, those needs clearly involve increasing the nation’s capacity to distribute the vaccine and to test people for Covid-19.

Of course, in practice, applying both approaches often makes the most sense. But judged by either criteria, President Biden’s proposed $1.9 trillion American Rescue Plan is too large and too wide in scope.

According to my calculations, the 2021 output gap will be around $420 billion. From a macroeconomic, top-down perspective, the President’s proposal would fill the 2021 output gap several times.

It is commonly argued that the risk from spending too little is larger than the risk from spending too much. I agree. But this is not the same as arguing that the size of an additional stimulus package should be untethered to estimates of the underlying economic need. Any assessment of the right size for another stimulus should start with a good estimate of the output gap — and given the uncertainty associated with calculating that gap and the balance of risks, it's prudent to err on the side of a slightly larger package.

The future paths of gross domestic product (GDP), the output gap, and prices are very uncertain. Congress should recognize the many risks both from spending too much and from spending too little. From this macroeconomic perspective, the President's $1.9 trillion proposal is clearly too large.

While the proposal contains several important components that Congress should enact, from a bottom-up, microeconomic perspective, many major components of the plan are either unnecessary or would hold the recovery back.

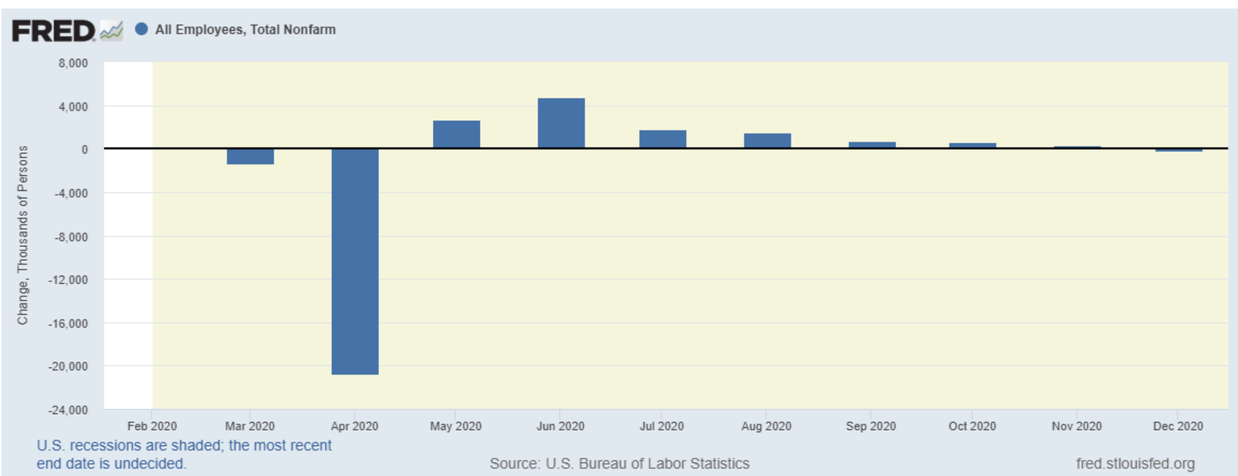
For example, direct checks to households earning six-figure incomes that have not experienced employment loss are an unnecessary and imprudent use of government spending. The proposed $400 federal supplement to standard, state-provided Unemployment Insurance benefits would prologue the period of labor market weakness by incentivizing unemployed workers to remain unemployed. Raising the federal minimum wage to $15 per hour would be devastating to low-wage workers in many states.

As a moral proposition, a bill that would destroy jobs for low-wage workers while handing out checks to employed, upper-middle-class households is problematic.

A bill that was more focused and that did not contain these harmful or unnecessary provisions would also be more aligned with both the overall macroeconomic need and would better address our specific economic challenges. A bill that provided adequate funding for vaccine distribution, expanded testing capability, helped to reopen schools, strengthened the social safety net, and provided relief to state and local governments would be reasonable and advisable. It would cost under $750 billion, would be focused on current economic and social needs, and would be better scaled to the size of the output gap.

THE ECONOMIC AND POLICY OUTLOOK

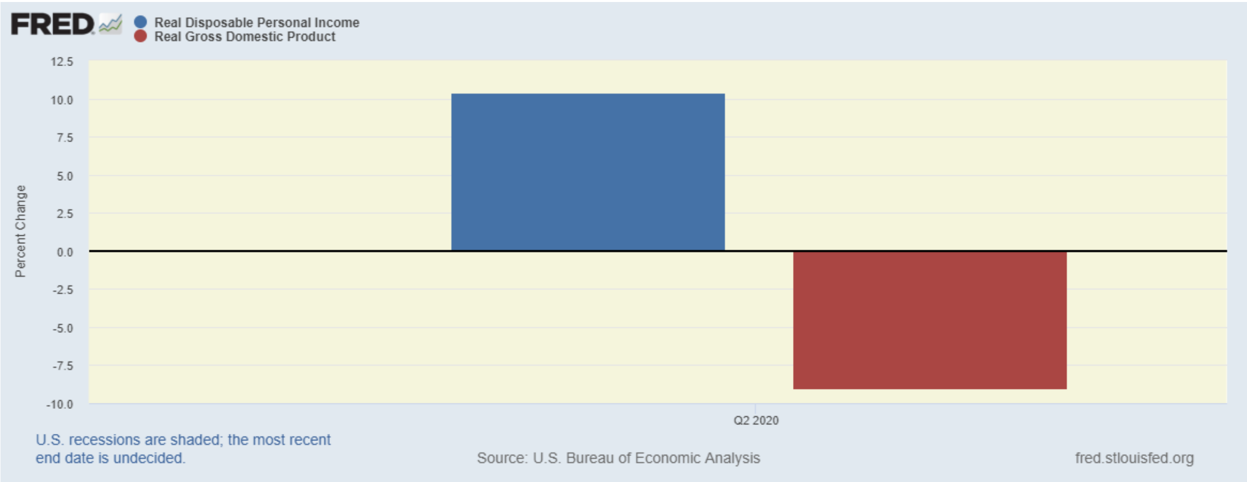
The Pandemic Recession was brutally sharp and sudden. Fortunately, it was also short. The recession began in March and probably ended in May. After contracting at a 31 percent annual rate in the second quarter of 2020, the economy grew at a 33 percent annual rate in the third quarter and at a 4 percent annual rate in the fourth quarter.



Employment followed a similar pattern. After losing 1.4 million net nonfarm payroll jobs in March and a stunning 20.8 million in April, the labor market began adding jobs at an impressive pace: 2.7 million net new jobs in May, 4.8 million in June, 1.8 million in July, and 1.5 million in August.

This pattern reflects a number of factors, including the impressive resilience of American households and businesses in the face of the pandemic, the changing strictness of social distancing orders, aggressive actions by the Federal Reserve to support the economy, and the weather, which affects the level of consumer activity that can take place outdoors.

It also clearly reflects fiscal policy developments. Congress's fiscal policy response to the Covid-19 pandemic has been commendable. The $1.8 trillion Coronavirus Aid, Relief, and Economic Security (CARES) Act, passed in March, gave the economy the support it needed. By providing partial revenue replacement for small businesses and income replacement for unemployed workers and households, Congress kept workers attached to their employers, improved the financial health of small businesses,[1] and allowed consumers to maintain spending.

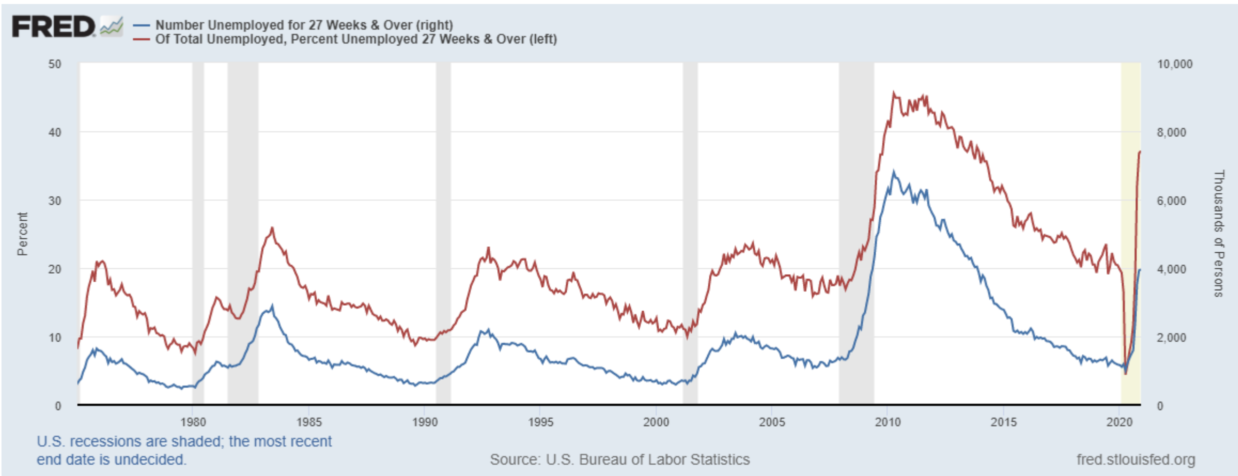


The CARES Act was so successful at replacing household income that disposable personal income soared while GDP violently contracted. In the second quarter of 2020, GDP fell by 9 percent relative to the first quarter, while disposable personal income rose by 10 percent.

When the economy went into recession, there was a widespread expectation that significant damage would be done that would last for many years. Remarkably, the evidence

[1] R. Glenn Hubbard and Michael R. Strain, "Has the Paycheck Protection Program Succeeded?" *NBER Working Paper Series*, no. 28032, October 2020.

suggests that this type of deeper, structural damage has been minor so far. There is little evidence that temporary layoffs are becoming permanent layoffs at a higher rate than in the past,[2] and temporary layoffs still account for a large share of the unemployment. Commercial bankruptcies are below their pre-virus level, and new businesses are forming at a surprising rate.



An exception to this relatively upbeat picture is long-term unemployment. In December there were nearly four million workers who had been unemployed for 27 weeks or longer, and the long-term unemployed constituted over one-third of all unemployed workers. Long-term unemployment is an economic, social, and human crisis. Addressing it is outside the scope of this testimony, but Congress should be following it closely and enact measures to combat it specifically if it does not normalize throughout this year.[3]

Powerful as the CARES Act was, it was not enough to support the economy until Covid-19 vaccines are in wide distribution in the spring and summer of 2021. This is easiest to see in the chart above showing monthly job gains. The economy added over one million jobs each month of the summer (with a high of 4.8 million in June). In September, that streak ended. By

[2] Erin Wolcott, Mitchell G. Ochse, Marianna Kudlyak, and Noah A. Kouchekinia, "Temporary Layoffs and Unemployment in the Pandemic," *FRBSF Economic Letter*, Federal Reserve Bank of San Francisco, November 16, 2020.
[3] Michael R. Strain, "A Jobs Agenda for the Right," *National Affairs*, no. 18, winter 2014.

November, monthly job gains had returned to conventional levels (336,000). In December, the economy actually lost jobs on net.

To address the slowing economy, Congress passed an economic support package on December 21, 2020. The package cost around $900 billion, and it appropriated nearly $300 billion for "second draw" Paycheck Protection Program loans, extended access to Unemployment Insurance benefits, increased the size of those benefits by a federally funded $300 per week through March, and issued $600 per person stimulus checks, among other provisions.[4]

Although parts of the Washington policy debate seem to have forgotten that Congress appropriated $900 billion in economic support just six weeks ago — an amount larger than the 2009 Recovery Act, passed to support the economy following the 2008 global financial crisis and Great Recession — it occurred so recently that many of those funds have yet to be spent. Those funds will give a big boost to the economy.

Economic forecasters expect 2021 to be a year of solid economic growth. The median forecast in the Fourth Quarter 2020 Survey of Professional Forecasters is for GDP to grow at above a 3 percent annual rate in each quarter of 2021.[5] Economists at Goldman Sachs assume Congress will appropriate an additional $1.1 trillion — not the $1.9 trillion proposed by the President — and predict 5 percent GDP growth at an annual rate in the first quarter of 2021, 10 percent growth in the second quarter, 9 percent growth in the third quarter, and 6 percent growth in the fourth quarter. Consensus forecasts are lower but still show the economy robustly growing at about 4 percent for the year as a whole. The Congressional Budget Office expects the

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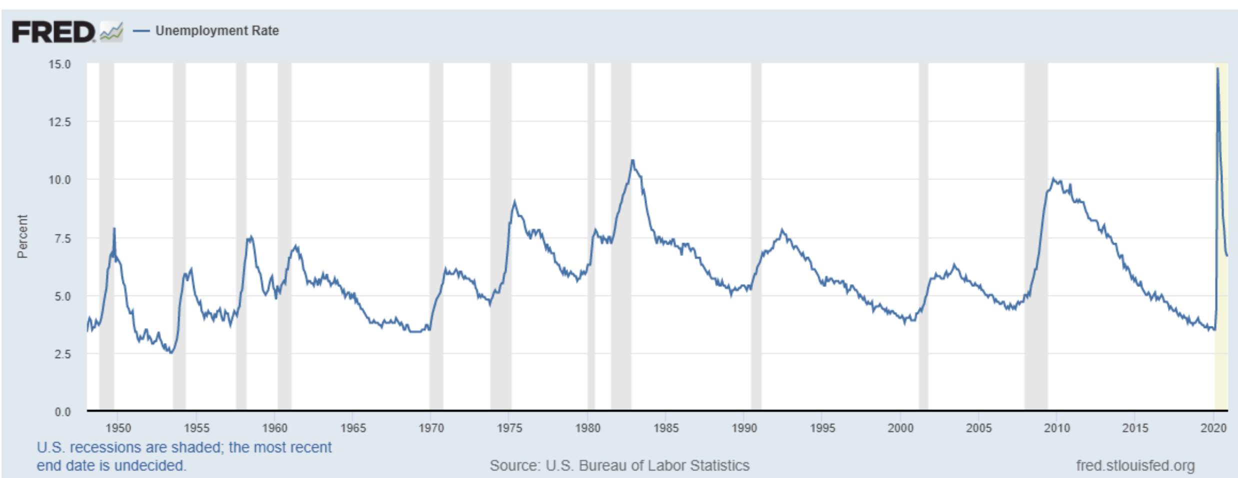
[4] Committee for a Responsible Federal Budget, "What's in the Final COVID Relief Deal of 2020?" December 21, 2020.
[5] Federal Reserve Bank of Philadelphia, "Fourth Quarter 2020 Survey of Professional Forecasters," November 16, 20202.

economy to grow by 3.7 percent from the fourth quarter of 2020 to the fourth quarter of 2021 under the assumption that Congress will not appropriate any additional economic stimulus funding.

To be sure, the economy will still be weak in 2021, with elevated unemployment and economic output below its pre-virus trend. But while concern about a "second Great Depression" was reasonable in March and April — a concern that I shared[6] — thanks to the impressive resilience of the American people and Congress's decisive action, the U.S. economy has transitioned from the territory of a historic economic catastrophe to a period of familiar economic weakness.

The unemployment rate in December was 6.7 percent. That is painfully high, and Congress is right to focus its attention on how to bring down unemployment. But while it is terrible, it is not a historic aberration. In the 866 months between 1948 and the beginning of the Pandemic Recession, the unemployment rate was greater than or equal to 6.7 percent a little over 25 percent of the time.



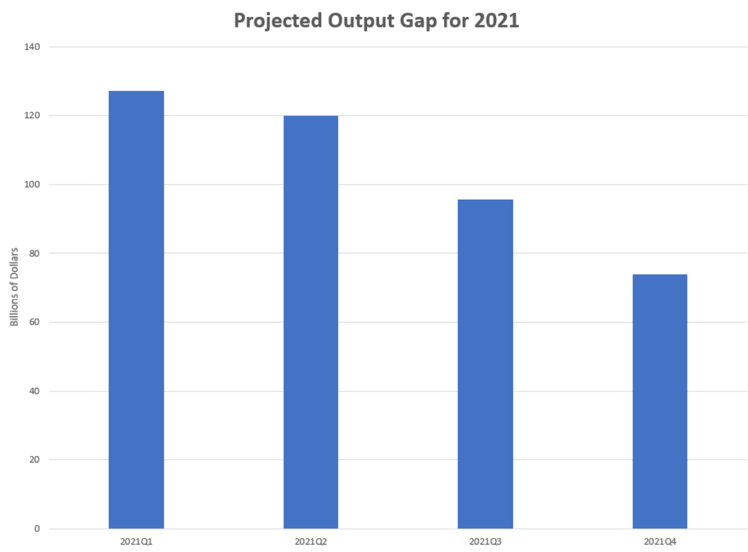
[6] R. Glenn Hubbard and Michael R. Strain, "A Business Fiscal Response to a COVID-19 Recession," *American Enterprise Institute*, March 20, 2020. Michael R. Strain, "The many new indicators of an epic job collapse," *Bloomberg*, April 30, 2020.

THE OUTPUT GAP

The output gap measures the difference between actual economic output and potential economic output. In 2021, I estimate that actual economic output will be around $420 billion lower than the economy could sustainably produce given its underlying resources. This calculation is based on the Congressional Budget Office's (CBO) estimates of the economy's underlying potential and CBO's forecast for actual economic output. Notably, it includes the effects of the $900 billion law Congress passed six weeks ago, but assumes no additional economic stimulus is passed in 2021.

If Congress decides it wants to close the output gap, then it will need to appropriate spending sufficient to that task. But every dollar the government gives to households, unemployed workers, businesses, and state and local governments is not quickly spent. At the same time, the indirect effect on demand of some funds that are spent leads overall economic output to increase by more than the amount of direct spending. Estimates of the effect of $1 of government spending on overall economic output range widely — generally from around $0.50 to $2.50 — and depend on a variety of factors, including the type of government spending and the state of the economy.

The pandemic will decrease this "multiplier effect" because social distancing makes it harder for households to spend. But social distancing will diminish in prevalence and importance throughout 2021. Even under the assumption of a very low overall multiplier of 0.5, the President's $1.9 trillion proposal would still fill the 2021 output gap more than twice.



Source: Congressional Budget Office; author's calculations.

It is commonly argued that Congress should err on the side of spending more, not less, because an assessment of the risk from spending too little is larger than the risk of spending too much. I agree with this view. But this is not the same as arguing that the size of the package should be untethered to estimates of the underlying economic need. Instead, an assessment of the appropriate size for any future stimulus should start with a good estimate of the output gap. Then, given the balance of risks, if you think the gap is, say, $400 billion, (assuming a multiplier equal to one) it's reasonable to prefer a $450 billion stimulus to a $350 billion stimulus.

Moreover, there are real risks to Congress spending too much. Households are sitting on well over $1 trillion of pent-up savings. On top of that, the President's proposal would quickly push economic output above its maximum sustainable level. Once the vaccines are in wide distribution, households may go on spending sprees after being cooped up at home for well over one year. Supply chain disruptions, pandemic-related reductions in productive capacity, and the process of reallocation could all restrain the ability of supply to keep up with surging demand in the second half of 2021.

Sustained price inflation is unlikely, but not impossible. More likely is that there will be months in which inflation temporarily surges. In addition to the economic risks from temporary overheating, the effects of excessive economic demand could lead the Fed to feel pressure to slow the recovery before its benefits can reach low-wage workers and low-income households.[7] Congress should guard against this risk.

There is significant uncertainty about all this. The effect of the pandemic on the economy's underlying potential is hard to ascertain. Congress has already appropriated over $3 trillion to fight the Pandemic Recession — this level of fiscal policy support is unprecedented, and its ultimate effects on demand, prices, and output are uncertain. The virus' evolution is uncertain, as is the timing and overall success of the vaccine rollout. The reaction of consumer behavior to the pandemic receding is uncertain.

Uncertainty about the future path of GDP, the output gap, and inflation suggests that Congress should be prudent and cautious in both directions. Additional economic relief, recovery, and stimulus spending is reasonable and advisable. But the amount of that package should be based on an objective assessment of the economy's underlying need, and of how that spending will affect overall economic output. By that measure, the President's $1.9 trillion proposal is clearly much too large.

THE INADVISABLE COMPONENTS OF THE AMERICAN RESCUE PLAN

Rather than starting from the output gap, Congress could attempt to ascertain specific economic needs and build a package from the bottom up. From this perspective, Congress should have three goals for additional economic support: It should (1) preserve the productive capacity

[7] Jay C. Shambaugh and Michael R. Strain, "The Recovery from the Great Recession: A Long, Evolving Expansion," *IZA Discussion Paper Series*, no. 14017, January 2021.

of the economy while the virus requires social distancing, (2) alleviate human suffering, and (3) help the economy transition to a healthy, post-virus "new normal." With this framework in mind, it is clear that the three most problematic components of the President's American Rescue Plan are the direct checks of up to $1,400 per person, the expanded generosity of Unemployment Insurance benefits, and the $15 per hour federal minimum wage.

Direct checks

The direct checks will accomplish none of these three goals because they are so poorly targeted. Providing checks to households earning comfortable six-figure incomes that have not experienced any employment loss is an imprudent use of government spending — one that would not support the economy's productive capacity, help those in need, or help the economy recovery and transition to its post-virus phase. I have not seen a reasonable economic justification for Congress giving thousands of dollars to households earning, say, $250,000, which the CASH Act and the President's proposal would do.[8]

[8] Committee for a Responsible Federal Budget, "Would $2,000 Stimulus Checks Go to Six-Figure Households?" December 30, 2020.

The best justification for the checks is that they might support overall consumer spending and aggregate demand. Even this justification is dubious. Congress just appropriated $600 per person checks six weeks ago. Recent research finds that households with incomes above $78,000 saved $555 of their $600 check, spending just $45.[9] Their behavior would likely be the same if Congress appropriated additional checks up to $1,400 per person.

Congress should not appropriate funds to help households with six-figure incomes save and pay down their debts. There are much better uses of those funds, including targeted assistance of those who need it. And as discussed previously, from a macroeconomic perspective, the $465 billion that would be appropriated for the checks is not needed.

$400 unemployment benefit supplement

The President's proposal for unemployment benefits is on stronger ground. Unemployment benefits are targeted on unemployed workers, a group that needs support until the vaccines are in wide distribution and labor demand can more fully recover. It is reasonable for the generosity of (and eligibility for) benefits to be expanded during this unusual situation.

But the President's plan to provide a $400 per week federal supplement to standard, state-provided Unemployment Insurance benefits through September would slow the recovery and keep the unemployment rate higher for longer than would be the case with conventional unemployment benefits.

Unemployment benefits can be a boost to the economy by supporting consumer spending, which in turn supports business investment and hiring. At the same time, unemployment benefits can hold the economy back by reducing the number of workers who exit unemployment for paid employment. Which of these effects is strongest — increasing aggregate

[9] Raj Chetty, John Friedman, and Michael Stepner, "Effects of January 2021 Stimulus Payments on Consumer Spending," Opportunity Insights Economic Tracker, January 28, 2021.

demand or reducing labor supply — depends on a variety of factors, including the overall amount of unemployment and the strength of labor demand.[10]

Prior to the pandemic, the ratio of the Unemployment Insurance benefits received by workers to their prior labor market earnings generally ranged from 30 percent to 50 percent. In the CARES Act, Congress augmented standard, state-provided unemployment benefits with a $600 per week federal supplement, with the goal to fully replace the earnings unemployed workers had lost due to the virus and associated social distancing and lockdowns.

Full replacement of lost earnings was a reasonable goal in March, when the lockdowns began. It was appropriate for Congress to help households in the face of a once-in-a-generation economic shock. Moreover, unlike in a typical economic downturn, Congress did not want unemployed workers to search for a job. During the spring's strict lockdown, the goal was for as few people to engage in in-person activity as possible. Fully replacing lost earnings was a way to ensure that unemployed workers were not handing out resumes and contracting and spreading Covid-19.

The unusually large amount of labor market slack and the unusual circumstances from the lockdowns, social distancing, and pandemic created conditions such that the $600 supplement had little effect on the pace of hiring and the level of unemployment last spring and into the summer. Several studies have confirmed this finding.[11]

But just because unprecedentedly generous unemployment benefits did not reduce hiring or increase unemployment during the early months of the pandemic does not mean that they

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[10] Kory Kroft and Matthew J. Notowidigdo, "Should Unemployment Insurance Vary with the Unemployment Rate? Theory and Evidence," *Review of Economic Studies,* vol. 83, no. 3, July 2016.

[11] Alexander W. Bartik, Marianne Bertrand, Feng Lin, Jesse Rothstein, and Matthew Unrath, "Measuring the labor market at the onset of the COVID-19 crisis," *Brookings Papers on Economic Activity*, fall 2020. Ioana Elena Marinescu, Daphné Skandalis, and Daniel Zhao, "Job Search, Job Posting and Unemployment Insurance During the COVID-19 Crisis," working paper, July 2002. Lucas Finamor and Dana Scott, "Labor Market Trends and Unemployment Insurance Generosity During the Pandemic," *Economics Letters,* vol. 199, February 2021.

would not do so in the winter, spring, or summer of 2021. (The President proposes to keep expanded benefits in place through September.) A large literature documents that unemployment duration increases with the generosity of unemployment benefits, even during periods of (historically familiar) labor market weakness.[12] There is every reason to think that this literature better captures what the effect of the President's plan would be than evidence from the unusual circumstances in the spring of 2020.

To be sure, the President proposes to augment standard, state-provided unemployment benefits by $400, not $600. But that would still be unprecedentedly generous. With a $400 federal supplement, around 60 percent of unemployed workers would receive more income from their unemployment benefits than they would from working.[13]

In December, Congress expanded the generosity of unemployment benefits by $300 per week through mid-March. This will likely slow the pace of the recovery. By going even further and providing a $400 per week federal supplement to standard, state-provided unemployment benefits through September, Congress would slow the overall economic recovery even more — and keep many unemployed workers in unemployment for longer.

$15 federal minimum wage

A $15 federal minimum wage is too high even in a strong, healthy economy. In 2019, before the onset of the pandemic, at least one-quarter of all workers in 47 states earned less than $15 per hour. In 20 states, half of all workers earn less than $18 per hour. These simple statistics illustrate how high $15 per hour would be as a wage floor. In Mississippi, Arkansas, and West

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[12] Alan B. Krueger and Bruce D. Meyer, "Labor Supply Effects of Social Insurance," *Handbook of Public Economics*, vol. 4, 2002. Johannes F. Schmieder and Till von Wachter, "The Effects of Unemployment Insurance Benefits: New Evidence and Interpretation," *Annual Review of Economics*, vol. 8, October 2016.

[13] Peter Ganong, Pascal Noel, and Joseph Vavra, "US unemployment insurance replacement rates during the pandemic," *Journal of Public Economics*, vol. 191, 2020.

Virginia — each of which had a median wage below $16.50 in 2019 — a $15 minimum wage would be devastating to low-wage workers. This would be the case in many other states, as well.

The Congressional Budget Office estimates that joblessness would increase by 1.3 million if Congress increased the minimum wage to $15. This is a reasonable estimate, but in my view, it is too low. The CBO also concluded that a $15 minimum wage would reduce business income, raise consumer prices, and reduce GDP.[14]

Even in high-wage states, the available evidence suggests that $15 is too high. Economists found that when Seattle raised its minimum wage to $13 in 2016 (on its way to $15), hours worked in the low-wage labor market dropped by 9 percent. Wages increased by less than hours decreased, so the earnings of low-wage workers fell by $125 per month.[15]

Of course, the President does not propose to raise the minimum wage to $15 this year. But a phase in of even several years would still cause significant damage to the low-wage labor market in many states, and would accrue to the determinant of the least-skilled, least-experienced, most-vulnerable workers in our society.

An abrupt increase would be a significant shock. But it may be that a long phase-in period would reduce employment through a different mechanism. Typical, modest minimum wage increases boost labor costs the year they are enacted, but then are gradually eaten away by price and wage inflation. Businesses may be more willing to reduce the size of their workforces if they think they are in for a period when the minimum wage will ratchet up each year. They

[14] Congressional Budget Office, “The Effects on Employment and Family Income of Increasing the Federal Minimum Wage,” July 2019.
[15] Ekaterina Jardim, Mark C. Long, Robert Plotnick, Emma van Inwegen, Jacob Vigdor, and Hilary Wething, "Minimum wage increases, wages, and low-wage employment: Evidence from Seattle," *NBER Working Paper Series*, no. 23532, June 2017.

may cut employment more aggressively in this circumstance than they have in the face of typical, modest minimum wage increases.[16]

Any increase in 2021 would be ill-advised. The evidence suggests that raising the minimum wage during a recession leads to larger employment reductions than it would during periods of economic growth, likely because in a downturn firms are more willing to make permanent changes to their labor-cost structures and labor demand is depressed.[17]

Eight states and Washington, D.C., have put their minimum wages on a path to $15. Congress should wait to see how those experiments go before increasing the wage floor to $15 in every state.

Economists debate not only whether the minimum wage affects employment, but also the consensus of the literature itself.[18] Economists also debate how that literature — which mostly studies modest increases — applies to a $15 minimum wage. My view is roughly the same as CBO's: The existing evidence suggests that a $15 per hour federal minimum wage would substantially reduce employment. Moreover, the existing evidence, which studies modest minimum wage increases, understates the effect of a $15 per hour minimum wage if the effect is nonlinear — that is, if the magnitude of the effect grows along with the size of the minimum wage increase.[19]

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[16] Peter Brummund and Michael R. Strain, "Does Employment Respond Differently to Minimum Wage Increases in the Presence of Inflation Indexing?" *Journal of Human Resources*, vol. 55, no. 3, 2020.
[17] Jeffrey Clemens and Michael Wither, "The minimum wage and the Great Recession: Evidence of effects on the employment and income trajectories of low-skilled workers," *Journal of Public Economics*, vol. 170, February 2019.
[18] Arindrajit Dube, "Impacts of minimum wages: review of the international evidence," Independent Report to Her Majesty's Treasury, 2019. David Neumark and Peter Shirley, "Myth or Measurement: What Does the New Minimum Wage Research Say about Minimum Wages and Job Loss in the United States?" *NBER Working Paper Series*, no. 28388, January 2021.
[19] Jeffrey Clemens and Michael R. Strain, "The Short-Run Employment Effects of Recent Minimum Wage Changes: Evidence from the American Community Survey," *Contemporary Economic Policy*, vol. 36, no. 4, 2018.

As a policy to help the working poor, the minimum wage is very inefficient—the vast majority of its benefits accrue to middle-class households and households above the poverty line. The reason for this is simple: many low-wage workers do not live in low-income households.

So a $15 per hour federal minimum wage represents a trade-off: Is the cost of eliminating hundreds of thousands of employment opportunities for the least-skilled, least-experienced, most-vulnerable workers in society worth the benefit of increasing the incomes of middle-class households? In my view, a $15 minimum wage clearly does not pass the cost-benefit test.

President Biden has the right goal in mind. When announcing this proposal, he said: "No one working 40 hours a week should live below the poverty line."[20] But the minimum wage is the wrong tool to achieve this goal. Instead, Congress should increase the earned income tax credit (EITC) to ensure that no one who works full-time and heads a household lives in poverty.

THE GOOD COMPONENTS OF THE AMERICAN RESCUE PLAN

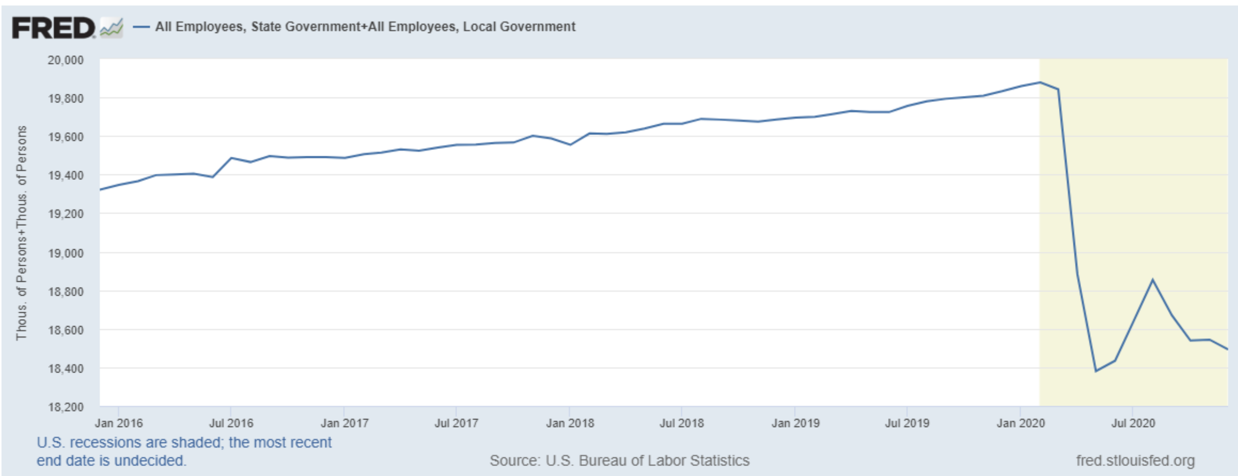
Congress should significantly expand the nation's ability to distribute the Covid-19 vaccines and to test people for Covid-19. I am not a public health expert and cannot offer expert advice on the funding level needed for these activities. But the economic benefits from ending the pandemic earlier would surely outweigh the costs of rapid vaccine distribution and better testing.

Closed schools are a national emergency, inflicting significant near-term damage on children's social, psychological, and educational development, and making it very difficult for many parents to work and generate income. In addition, closed schools will lower the lifetime incomes of many children, particularly children in low-income households. Congress has already

[20] "Biden Urges More Than Doubling Minimum Wage to $15 an Hour," *Bloomberg*, January 14, 2021.

appropriated a sizable amount of funding to support schools. But if additional funding is needed to reopen schools to in-person instruction immediately, then that is a good use of government funds.

Making the child tax credit fully refundable — so that low-income households with little or no tax liability receive the same benefit from the credit as middle-class households do — is long overdue and should be made permanent law. The President's proposal to temporary increase the generosity of the credit is reasonable.



Congress's fiscal policy response to the Pandemic Recession has been admirable. The most glaring and damaging omission has been grants to state and local governments. These governments are generally prohibited from running deficits, so when tax revenue plunged last spring at the onset of the pandemic, they had little choice but to cut back on providing essential services and laying off workers. Employment by state and local governments is down 1.4 million jobs relative to February 2020, including a loss of over 600,000 education-sector jobs.

Without federal grants, states and localities will have to maintain reduced employment levels, holding back the national economic recovery by keeping unemployment elevated and reducing consumer spending.

Congress should determine the size of each state's grant according to a formula such that the amount of each grant is directly linked to pandemic-related revenue losses. Congress should not reward states for misusing rainy-day funds and should not bail out state pension funds.

States and localities will likely experience revenue shortfalls of around $130 billion from the onset of the pandemic through June 2021, when the current fiscal year ends.[21] They have already been appropriated a sizable amount by Congress in previous economic relief bills. But much of that funding is dedicated for specific spending programs (for example, for the Medicaid program) and their spending needs have increased. States and localities need more flexibility. The American Rescue Plan requests $350 billion in aid for these governments, which is more than is necessary. Around $100 billion would be appropriate to the need.

[21] Jeffrey Clemens and Stan Veuger, "State and local government budgets are in better shape than expected," *AEI Ideas*, February 2, 2021. Jeffrey Clemens, Benedic N. Ippolito, and Stan Veuger, "US fiscal federalism during the COVID-19 pandemic," *AEI Economics Working Paper Series*, no. 2020-16, December 2020.