The Aftermath of the Pandemic Recession

The Role of Economic Development Policy

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I want to discuss some economic challenges we face because of this "pandemic recession," and how economic development policy can help.

Here are four types of economic challenges we face:

(1) The current pandemic recession has exacerbated many economic inequalities: regional inequality, income inequality, inequalities between big and small business, and inequalities across different racial groups.
(2) The current pandemic has accelerated the trend toward remote work.
(3) The current pandemic has revealed deficiencies in our current economic capacity to provide health-care services, including health-care-related manufacturing goods.
(4) The current pandemic is eroding the fiscal capacity of state and local governments.

Let's begin with regional inequality. The current crisis has led to major increases in regional inequality. For example, in June of 2019, the five lowest unemployment states had an average unemployment rate of 2.5 percent, while the five highest unemployment states had an average unemployment rate of 5.3 percent, a gap of a little under 3 percentage points. In June of 2020, the five lowest unemployment states had an average unemployment rate of 6.5 percent, and the five highest unemployment rate states had an average unemployment rate of 15.7 percent, a gap of over 9 percentage points.

https://www.bls.gov/web/laus/laumstch.htm

This regionally divergent recession is of concern because more severe local recessions lead to persistent regional disadvantages. Research by my colleague Brad Hershbein and his coauthor Bryan Stuart finds that metro areas that experience more severe recessions tend to do worse even 10 years later than otherwise comparable metro areas. If a metro area loses 5 percent more employment than an otherwise comparable metro area during a recession, its level of employment 10 years later will still be 6 percent lower than it otherwise would have been, and its employment-to-population ratio—its employment rate—will still be 2 percentage points lower.

https://research.upjohn.org/up_workingpapers/325/

These persistent regional disadvantages occur in part because local job losses lead to a loss of job skills by local unemployed workers, increases in substance abuse and crime, increases in family problems, and declines in the quality of local public services. These local changes brought on by a locally severe recession will undermine the local economy's long-run competitiveness.

Therefore, the current pandemic will worsen the already large disparities in job availability across state and local areas in the United States. This accentuates the importance of using local economic development policies to help distressed areas. We know from prior research that if we can boost an area's employment by 10 percent, this will boost its employment-to-population ratio (its employment rate) by 2 percent in the long run, on average. In more distressed local labor markets, with lower prior employment rates, job growth has even greater effects on long-run employment rates: in distressed local labor markets, a 10 percent increase in local jobs will boost local employment rates by over 3 percent, one-half larger than the 2 percent boost in the average local labor market. https://research.upjohn.org/up_workingpapers/308/ Both state and federal governments should do much more to target distressed local labor markets for greater economic development assistance. Doing so will not only help these distressed areas but will also help bolster overall state and national employment rates by moving more jobs to where the unemployed are.

The pandemic recession has also had more negative effects on low-wage workers. From February through the end of May, employment of workers in the lowest quintile of wages declined by 30 percent, while employment of workers in the highest quintile of wages declined by only 5 percent. https://www.brookings.edu/wp-content/uploads/2020/06/Cajner-et-al-Conference-Draft.pdf Surveys of households and businesses suggest that 20 to 40 percent of these job losses are permanent. https://www.brookings.edu/bpea-articles/covid-19-is-also-a-reallocation-shock/

This accentuates the importance of targeting more job growth toward low-wage workers, which can be done if economic developers link their job-creation programs with the local workforce, and if workforce developers link their training programs with local employers. More jobs will go to more disadvantaged local residents if economic-development assistance packages include customized job-training programs, in which community colleges help train a firm's workers. Such customized training programs help broaden the pool of who gets the jobs from economic development programs. We can also consider economic development job-creation subsidies that explicitly are tied to hiring the long-term unemployed, such as a program used by Minnesota in the 1980s called MEED program, an acronym for Minnesota Employment and Economic Development program. MEED provided job-creation subsidies to employers for hiring the long-term unemployed.
https://research.upjohn.org/cgi/viewcontent.cgi?article=1079&context=empl_research

We also need to increase support for workforce development programs and community college programs that provide free or heavily subsidized skills training that is tied to jobs in demand in the local economy. Some useful models include Tennessee Reconnect, which provides free community college education leading to an associate's degree or certificate for any adult in Tennessee (https://www.nytimes.com/2020/05/14/opinion/free-college-adults-covid.html). Another good model is Project Quest in San Antonio, which provides free community college job training and supports for in-demand jobs, which in San Antonio have recently been in the health-care sector. Based on a randomized control trial, Project Quest leads to annual earnings gains of more than $5,000. https://economicmobilitycorp.org/wp-content/uploads/2020/06/Nine_Year_Education_Gains.pdf

The current pandemic recession also will hurt small businesses more than large businesses. The initial effects of the recession clearly fell harder on small business than on large business. From February to April, employment in businesses with more than 500 employees declined by 15 percent, whereas employment in businesses with fewer than 50 employees declined by 25 percent. By May, both groups were experiencing similar declines of around 15 percent. But among the small-business group, a higher percentage of the declines in employment stemmed from permanent closures. This suggests that this pandemic recession threatens to reduce the relative strength of the U.S. small business sector. https://www.brookings.edu/wp-content/uploads/2020/06/Cajner-et-al-Conference-Draft.pdf

These disproportionate effects of the pandemic on small businesses heighten the need for economic development policymakers to target the local small-business sector for greater assistance. Small businesses can be helped by various programs that provide high-quality business advice, such as Small Business Development Centers and manufacturing extension programs. State and local areas should consider trying to allocate some funding to expand such business advice services to small business. The research suggests that business advice programs are relatively cheap per job they create or save—the estimated cost per job created is between $15,000 and $35,000.
https://research.upjohn.org/cgi/viewcontent.cgi?article=1326&context=up_workingpapers These business advice programs may need to be coupled with business financing programs that will help increase the flow of capital to small businesses.

The problems for low-wage workers and for small business are even greater for Blacks than for whites. Even after controlling for age, education, and family structure, Blacks, compared to otherwise similar whites, were 5 percentage points more likely to lose their jobs between March and April—and among those whites and Blacks who lost jobs between March and April, Blacks were 8 percentage points less likely to be rehired in May. https://www.brookings.edu/wp-content/uploads/2020/06/Bartik-et-al-conference-draft.pdf There also were more severe drops in business ownership among Blacks and other racial and ethnic minority groups. Between February and June, the number of white business owners in the U.S. declined by 5 percent, versus a decline in the number of business owners of other groups as follows: Blacks, 19 percent decline; Latinx, 10 percent decline; Asian, 10 percent decline; immigrants, 18 percent decline. https://people.ucsc.edu/~rfairlie/current/

These losses heighten the importance of special efforts both to increase employment among Blacks and to increase business ownership among Blacks. For example, a recent west Michigan program called HireReach has been working with some employers in the Grand Rapids area to encourage hiring based more on objective data than on subjective information, in an attempt to reduce unconscious biases as well as lead to better hiring decisions. The research so far suggests that HireReach doubles minority hires—and also reduces first-year turnover by 23 percent. https://research.upjohn.org/cgi/viewcontent.cgi?article=1246&context=reports

The pandemic is also likely to accelerate the trend toward remote work. For example, it is estimated that 40 percent of all jobs can be done from home, yet right now, only 10 percent of all jobs include a work-from-home component for even part of the work week, and only 3 percent of all jobs are full-time work from home. https://bfi.uchicago.edu/wp-content/uploads/BFI_White-Paper_Dingel_Neiman_3.2020.pdf But based on surveys of employers, these percentages will roughly triple after the pandemic: 27 percent of all jobs will include a part-time work-from-home component, and 10 percent of all jobs will be full-time work from home. https://www.frbatlanta.org/blogs/macroblog/2020/05/28/firms-expect-working-from-home-to-triple

What policy response is needed for this increased trend toward remote work? Well, clearly there is uneven access to high-quality broadband, both by region and by economic class. There will need to be major investments to increase broadband access in rural communities. And if having high-quality broadband is increasingly necessary for many jobs, we will need to explore measures to establish reasonably high-quality broadband access as a public utility, and make it available at subsidized rates to all economic classes.

The pandemic is also likely to increase interest in further development of greater capacity of health systems, including capacity for producing health-related manufactured goods, such as masks and testing equipment. I think there is likely to be a push for increased U.S. funding of health-related research, and of biotech industries, including biotech-related manufacturing.

A key issue is whether this high-tech investment will only go to a few of the existing high-tech centers or be more broadly spread. Most high-tech growth has been focused on a few coastal metro areas. https://philadelphiafed.org/-/media/covid/research-for-equity-in-recovery/place-based-strategies.pdf?la=en This concentration comes at a significant cost in lost jobs for much of the United States. It also causes escalating housing prices and congestion problems in some of the coastal high-tech centers, such as San Francisco and Silicon Valley.

There are some good proposals to reverse these trends. For example, Jonathan Gruber and Simon Johnson of MIT, in their 2019 book "Jump-Starting America," propose increasing federal funding in health-care research and other research areas by $100 billion per year—and to target a large percentage of this research to 20 to 30 different research hubs around the nation, outside of the traditional coastal hubs. These 20 or 30 research hubs would be selected in a competition from among eligible metro areas, those which have sufficient technical personnel to be viable tech hubs. They identify 102 metro areas as potential tech hubs, from all regions of the country, including areas such as: the Lehigh Valley in Pennsylvania; Grand Rapids, Michigan; Kansas City, Missouri; Louisville, Kentucky; Tuscaloosa, Alabama; and Spokane, Washington. https://www.jump-startingamerica.com/policy-summary.

State and local economic developers can help diversify high-tech growth geographically by supporting high-tech businesses, and by using manufacturing extension services and industry cluster programs to help manufacturers move into markets for health-care products, as has been done for example in Grand Rapids. https://www.rightplace.org/for-local-business/manufacturing-training https://www.rightplace.org/industry-sectors/smart-manufacturing/medical-device-manufacturing

Another challenge caused by the pandemic consists of the fiscal crises besetting state and local governments. Using CBO's latest budget forecast as of July 2, https://www.cbo.gov/publication/56442#:~:text=CBO%20projects%20that%20from%202020,projected%20to%20average%206.1%20percent. along with estimates of how state and local tax revenue and needs for more spending respond to local unemployment, https://www.upjohn.org/research-highlights/proposal-timely-responsive-federal-aid-state-and-local-governments-during-pandemic-recession my predictions are that the state and local budget problem will be about 15 percent of state and local budgets for 2020 and 2021, and will only slowly decline to a 5 percent problem by 2024 and 2025. About 90 percent of this budget problem is due to declining tax revenues from a slower economy; the other 10 percent is due to extra public spending that is necessitated by higher unemployment. In dollar terms, the total state and local budget problem between now and 2025 amounts to about $1.4 trillion. I think it unlikely that federal aid will fully make up that gap, so state and local governments will need to take actions to cut spending and raise revenue.

In this situation, economic development policy can help by proposing ways of raising state and local tax revenue that will *not* harm business investment and job creation. This can be done by having taxes and incentives favor new capital over old capital, and export-base businesses over non-export-base businesses. States and localities can do tax reforms that raise rates or close some tax loopholes, but offset these reforms for new capital investment in export-base industries. These offsets may be accomplished either with increases in discretionary business incentives for export-base businesses, or through increases in investment tax credits and job creation tax credits for export-base businesses that are written into the tax code.

Additionally, I think economic development policymakers should explore developing a national compact that would prevent further escalation of discretionary incentives, which disproportionately go to large firms. Currently, state and local incentives for businesses cost communities around $45 billion per year. In terms of state and local budgets, this is less than 3 percent of total state and local tax revenue. Thus far, the overall fiscal impact of incentives is of modest size. But some discretionary incentive offers, such as Wisconsin's bid for Foxconn, or some of the Amazon inducements, have been about 10 times as great, whether per job or as a percent of investment. If all incentives similarly escalated to 10 times their current levels, they would significantly impinge on state and local budgets.

One model for preventing further escalation of U.S. incentives is what the European Union (EU) does to cap incentive size. Discretionary economic development incentives are legal in the EU. But in most of the EU, for large projects, discretionary incentives are limited to 3.4 percent of the investment amount, or 3.4 percent of the first two years of payroll, whichever is larger. In more economically distressed regions, the limit is five times this amount—either 17 percent of the investment amount or 17 percent of the first two years of payroll. So this would rule out some of the largest U.S. bids. For example, Foxconn was a $10 billion investment, and under EU rules, Wisconsin could have bid $340 million if southeast Wisconsin *was not* deemed distressed, and up to $1.7 billion if southeast Wisconsin *was* deemed distressed. But Wisconsin's bid of $3.0 billion would not have been permissible anywhere in the EU. Now, I think we can debate the limits—maybe we don't want to have the federal government set incentive limits as low as the EU standard, or maybe we don't want to have the federal government be charged with determining what areas are distressed or nondistressed. But I do think it might be prudent to have some national limits on discretionary incentives, although not on entitlement incentives, which are written into the tax code and are automatic. In my view, to cap discretionary incentives in a politically sustainable way would require federal legislation, which is highly unlikely to pass unless a sizable majority of states got behind it.

Let me conclude by simply listing some of the policy initiatives I have suggested today. In the aftermath of the pandemic recession, here are some changes in economic development policy that will help us have a more robust and equitable economic recovery:

(1) More targeting of distressed regions, whose number will be growing because of the recession
(2) More programs to make jobs more accessible to lower-wage workers, who are being adversely affected by recent economic trends
(3) More programs to help small businesses rebound from the pandemic
(4) More effective help for Black workers and Black-owned businesses
(5) Greater investments in broadband access for all regions and economic classes
(6) Diversification of high-tech beyond the coastal cities
(7) Promoting advanced manufacturing industries that produce health-care-related products;
(8) Designing business tax policies and incentives that will raise state revenue, while encouraging investment in base industries.

Economic development policy alone cannot ensure a more robust and equitable recovery. But economic development policy can play an important supportive role in broadening the recovery from this recession to include more regions, more businesses, and more economic classes and racial groups.