Louis Johnston

Current pandemic recession differs from typical recession, needs different policy response

June 12, 2020

Watch and listen to the June 12, 2020, Civic Caucus Zoom interview of Louis Johnston, Professor of Economics at the College of Saint Benedict/Saint John's University. Connect to the Zoom recording here.

Note: Like so many other organizations, the Civic Caucus has changed its way of doing business as a result of COVID-19. Instead of our traditional in-person interviews, we've joined the world of Zoom meetings. We've conducted five Zoom interviews. Our latest, the June 12, 2020, interview of Louis Johnston, Professor of Economics at the College of Saint Benedict/Saint John's University, addresses the issue of understanding and responding to the current pandemic recession.

During the interview, Johnston refers to several helpful flow charts and graphs, which are linked here.

Biography

Louis Johnston is Professor of Economics at the College of Saint Benedict and Saint John's University, where he has taught since 1997. He earned his B.S. at the University of Minnesota (1983), and his M.A. (1987) and Ph.D. (1990) at the University of California, Berkeley (all in Economics).

Johnston writes a column on economics and the economy for MinnPost and is a guest on Minnesota Public Radio, WCCO Radio, and Twin Cities Public Television. He has been interviewed and quoted by the *St. Cloud Times*, Minneapolis *StarTribune*, St. Paul *Pioneer Press*, *Bloomberg News*, *Los Angeles Times*, the *Washington Post*, *Marketplace*, CNN, Minnesota News Network and other media.

Summary of discussion

Louis Johnston, Professor of Economics at the College of Saint Benedict/Saint John's University, draws a distinction between a typical recession and the current pandemic recession. He says that the usual response to a typical recession-the Federal Reserve lowering interest rates-will not work in the current recession. He calls instead for the use of fiscal policy-taxes, spending and borrowing against the future-to respond to the pandemic recession.

Johnston refers to a two-line graph-running from 1981 to May 2020: one line showing the labor force as a percentage of population and the second line showing people employed for pay as a percentage of population. (The gap between the two lines is the percentage of the population looking for paid work.)

He notes a decline in employment during and after the 2008-2009 recession. Then he points to May 2020 on the graph, which shows a straight-line drop in both employment as a percentage of population and the labor force as a percentage of population. He wonders whether this is a temporary phenomenon or something that will have long-lasting effects.

Johnston says a typical recession involves a shock to the economy, which leads to a fall in spending by households and businesses, which leads to a decrease in employment. There is a feedback effect of the decrease in employment, which leads to further cuts in spending by households and businesses. He says the policy response to a typical recession is the Federal Reserve reducing interest rates. This leads to an increase in spending by households and businesses, which leads to an increase in employment.

In contrast, the current pandemic recession started with a shock to the economy-shutting everything down to reduce the spread of COVID-19, he says. That has led to a decrease in employment, which has led to a fall in spending by households and businesses. The fall in spending feeds back to a further decrease in employment.

Using the typical recession policy response of the Fed reducing interest rates *might* lead to an increase in spending by households and businesses, he says. But if the economy is not open or is open only 50 percent, the potential increase in spending will not materialize and there will be a further decrease in employment.

Johnston says the current dilemma for policymakers is that they're trying to fit everything into a typical recession, not the pandemic recession. "People are not thinking enough about the fact that when you come out of your shelter after an earthquake, things aren't the same," Johnston says. "Bridges have collapsed, buildings have collapsed, highways are impassable, etc. In the same way, we can't simply reboot after COVID-19. Will people who've left the labor force come back?"

Johnston says economists have ignored fiscal policy, while putting the emphasis on actions by the Fed. Fiscal policy involves using taxes and spending to affect the economy. "What if we can break the link between the decrease in employment and the decrease in spending?" he asks.

Fiscal policy, Johnston says, can include several actions: (1) direct support for businesses; (2) direct support for households; and (3) direct support for state and local governments. He argues that we should be borrowing from the future to do these things by using perpetual bonds with no expiration date, or consols. The bondholders would receive perpetual interest payments, but no principal payments. "We're never going to pay off the debt," he says. "We're just going to service it."

Johnston notes that since 1870, the U.S. economy has averaged two percent growth in terms of income per person. That means income doubles in 35 to 50 years. He argues that we should borrow from the future increase in income by issuing perpetual bonds as a way to recover. We could make an investment in broadband, he says, to assure that every child in the country has high-speed internet. And he argues that we need a Manhattan Project for developing testing regimes and vaccines for COVID-19, modeled after the World War II Manhattan Project tasked with developing an atomic bomb.

He says economists don't think enough about the political will needed to make changes. They act as if they can implement a policy, foragetting about the need for Congress and the president to have the will to make changes, he says. Economists, he says, have walked away from their role in public policy.

Johnston says the Employment Act of 1946 enshrined economic growth as our goal for the economy. He says now we need a new employment act that takes climate change into account.

Again, go to this link to view and listen to a Zoom recording of the Louis Johnston interview.