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Rise in labor earnings inequality during pandemic reversed by stimulus, unemployment checks

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Job losses during the pandemic were substantially worse among workers in low-paying jobs, leading to a dramatic increase in wage inequality during the early months of the COVID-19 recession, says new research co-written by a University of Illinois, Urbana-Champaign labor economist.

The effect would have been even more pronounced if the federal government hadn't stepped in with fiscal stimulus through the CARES Act and enhanced unemployment benefits, according to a new working paper from Eliza Forsythe, a professor of labor and employment relations and of economics at Illinois.

While other recessions have led to increases in inequality, Forsythe said the effects of the COVID-19 recession have been different thus far in being driven mainly by job losses rather than slowed wage increases.

"Those who remained employed didn't experience any atypical earnings changes," Forsythe said. "The lowest paid among us, however, really bore the brunt of it. They were much more likely to lose work during the pandemic."

Using data from the Current Population Survey, the primary source of U.S. labor force statistics, Forsythe and co-author Guido Matias Cortes of York University show that the COVID-19 pandemic led to a loss of aggregate real labor earnings of more than $250 billion between March-July 2020 compared with workers' earnings the previous year.

"The decline in aggregate earnings was entirely driven by declines in employment, particularly among the lowest-paid workers," Forsythe said.

Individuals from the bottom third of the wage distribution scale received almost half of all federal dollars from unemployment insurance payments, reversing the increase in wage inequality, according to the paper.

The $600 in additional weekly unemployment insurance provided by the federal government was intended to provide the median full-time earner a 100% replacement rate when combined with standard state unemployment insurance replacement rates of about 40%.

"Between standard unemployment insurance and the enhanced weekly unemployment benefits, payments were designed to, on average, bring workers' income replacement rates up to 100%," Forsythe said. "But since the bulk of job losses skewed toward low-wage workers, it ended up paying them more than what they originally earned. Basically, the government gave them a raise, and it's likely one reason why poverty rates actually fell during the pandemic."

The policy overshot its mark for two reasons, Forsythe said.

"First, the median weekly pay in 2019 was only $765, because many workers don't work full time," she said. "This would push the median replacement rate to 118%. But since the pandemic job loss was concentrated among low-earning individuals with median weekly paychecks of only $519, that means a median job loser had a projected replacement rate of 156% of their pre-pandemic earnings."

One of the criticisms of the federal monetary response was that the government was paying people more money not to work than they would earn if they were employed. But directing those additional stimulus dollars to low-income individuals who typically live paycheck-to-paycheck served as a crucial additional economic stimulus for consumer demand during the early months of the COVID-19 recession, Forsythe said.

"Those are the people who are likely to spend every dollar, so giving them that extra money very likely rescued the economy from a more severe recession," she said. "It's been an extremely successful policy from the perspective of increasing incomes at the bottom of the income scale. During a recession, we want people to spend money. So we need to get money in the hands of the people that are actually going to spend it, because that's what's going to keep us from tipping into an even worse recession and can help us get into the recovery. On the public policy side, we want to help people who have lost their jobs so they don't also lose their houses or get evicted because they can't make their rent. But we also want to stimulate aggregate demand in the economy. People who have lost their jobs face a big income shock, and by replacing the money they lost, we're keeping the economic contraction from spiraling out of control."

But since the enhanced unemployment benefits expired July 31, we're back to unemployment insurance replacing only 35%-40% of wages, Forsythe said.

"That is tough for the unemployed, tough for the economy and completely preventable with policy," she said. "Pretty much all economists think it's crazy not to extend those benefits, because we know that giving people money works in terms of an anti-poverty measure and stimulating the economy."

A working paper of this research was released by the IZA Institute of Labor Economics.

More information: Impacts of the COVID-19 pandemic and the CARES Act on earnings and inequality: ftp.iza.org/dp13643.pdf

Provided by University of Illinois at Urbana-Champaign

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