

Why sending money to the neediest can boost the US economy

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In response to the shock of the COVID-19 pandemic, Congress pumped trillions of dollars into the economy in the form of stimulus checks,

expanded unemployment benefits, and targeted spending to bolster specific industries such as airlines. The massive package apparently staved off a long, deep recession. But which elements were the most effective in the complicated, intertwined modern American economy?

Some research, involving pre-pandemic data, suggests that stimulus directed to households is most effective—when it's targeted to people who need it most.

In a recent working paper, Asst. Prof. Christina Patterson of the University of Chicago's Booth School of Business found that—to get the maximum bang for the buck in spurring the economy—lawmakers should give the money to the people who will spend the most of it rather than sock it away in savings, as many Americans did with COVID-19 relief checks. Technically, these are the groups with the highest marginal propensity to consume, or MPC.

"Our estimates suggest that government transfers of \$1,000 to each employed worker would increase GDP by 69 cents per dollar spent, whereas transfers of \$2,000 to each worker with above-median MPC would increase GDP by 96 cents per dollar spent," Patterson wrote with co-authors Joel P. Flynn and John Sturm, Ph.D. students at MIT.

A labor economist who focuses on how inequality across workers and firms can affect the economy's response to shocks, Patterson worked with Flynn and Sturm to build a model taking into account economic linkages through supply chains, regional trade, and the dramatic differences in household spending tendencies.

"Policy makers must consider the cascades of expenditure they set off, as expenditures in one industry and region reach not only its workers but also others in its [supply chain](#), those at firms where workers spend their marginal income, and so on," they wrote.

They fed the model with 2012 data covering the 50 U.S. states plus the District of Columbia, 55 industry and business sectors and 80 demographic groups. They then assessed how each industry, region and demographic group responded to a \$1 change in income. Virtually all of the differences boiled down to where households ranked on the MPC continuum, they found.

So what groups had the highest MPC scores? Those who were the most vulnerable to economic catastrophes, the researchers find: people who were younger than 35, didn't have college educations, made less than \$35,000 a year or were Black. Relatively poor Arkansas, Mississippi and South Dakota had the highest MPCs among states, the researchers found. Connecticut, the District of Columbia and New Jersey had the lowest.

"We show that concentrating transfers among the highest MPC households can increase the effect of the policy on GDP by up to 130 percent," the researchers wrote. "Governments should understand the opportunity costs associated with untargeted fiscal spending. ... [Such] policies responding to the Great Recession and COVID-19 may have left substantial gains on the table—on the order of several hundred billions of dollars."

More information: Fiscal Policy in a Networked Economy.
economics.mit.edu/files/21594

Provided by University of Chicago

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