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WEEKLY ECONOMIC COMMENTARY

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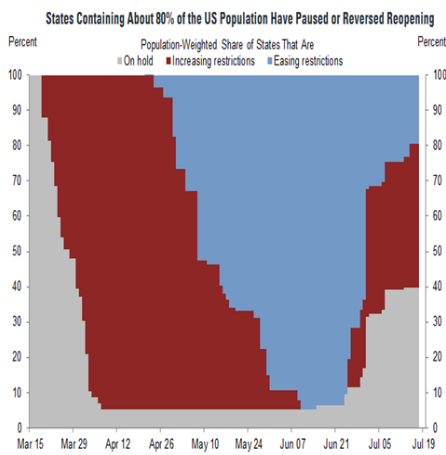
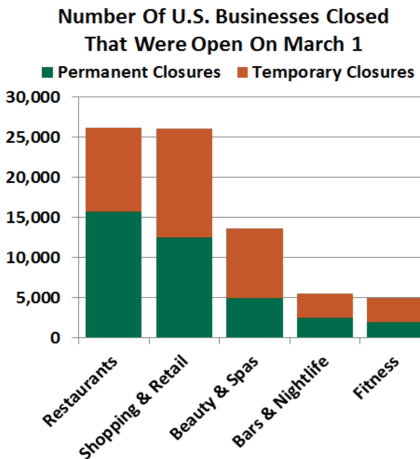
Our family took its regular summer sojourn to Northern Wisconsin last week. COVID-19 made this year’s trip a little different: we ventured out less, masked when we did, and ate at our rental unit instead of dining out. Fortunately, some of the simpler pleasures were the same as always: reading books outdoors, enjoying cherry pie, and watching some of the best sunsets anywhere. After five months of limited movement, it was nice to get away.

I try to avoid the news during these annual intervals, to clear my mind. I always hope that some of the world’s problems will get solved while I am off, allowing a gentle re-entry to work. But this year provided no such respite. Upon my return, I learned that the U.S. Congress departed for its summer leave without extending key pandemic-related aid programs. Negotiations continue, but each week that goes by without a deal raises risks for the U.S. economy.





Sources: Goldman Sachs, Yelp

COVID-19 has proven hardy and stealthy. Its long contagion period and its ability to produce asymptomatic carriers have proven difficult for public health officials to deal with. In some places, the public has grown weary of the restrictions that remain the best way to slow the spread. Several countries have endured significant second waves after seemingly having the outbreak under control.

The United States is chief among them. New cases peaked at about 32,000 daily in early April, then began a slow decline. But as restrictions were removed in late May and early June, new cases began to accelerate rapidly, reaching a new peak of 65,000 daily in late

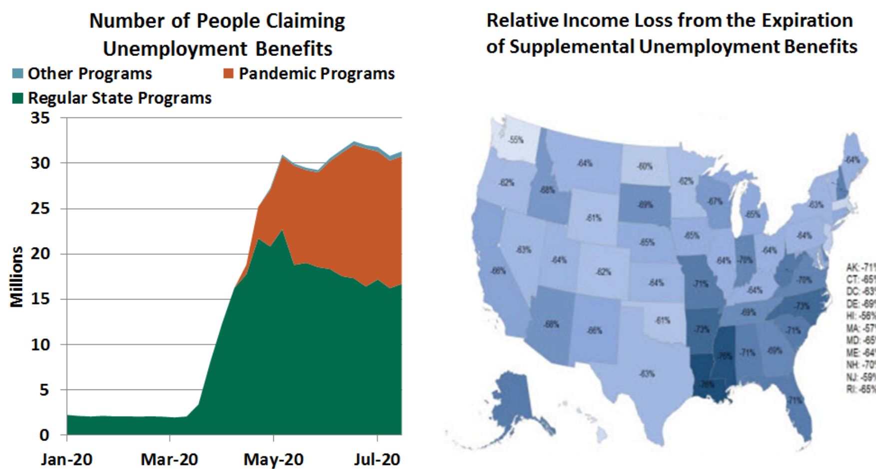
July. Reopening plans have been paused or reversed in many states, leaving businesses shuttered and tens of millions still out of work.

The U.S. Congress has passed four separate bills to address the economic damage done by the pandemic. Spending and lending programs totaling more than $3 trillion, equivalent to more than 15% of gross domestic product (GDP), has been enacted. The CARES Act, a broad-ranging bill passed in late March, was the centerpiece of the effort.

Initial rounds of stimulus assumed that the pandemic would recede by midsummer.

The feeling at that time was that the pandemic would run out of steam with the arrival of warmer weather, leading legislators to give key provisions of the Act summer expiration dates. This step also helped contain the cost of the effort, which required enormous amounts of financing.

It took some time to disperse funds from the CARES Act, but its provisions have sustained demand across the economy. One-time stipends were sent to households in the spring, and an additional $600 per week was made available to the unemployed. (The Act also extended jobless benefits to the self-employed for the first time.) Many small businesses received loans whose balances will be forgiven if workers are kept on payrolls. Congress allocated $150 billion to help state and local governments compensate for significant losses of sales tax revenue.



Sources: WSJ, Oxford Economics

The spending power generated by the CARES Act helped initiate a recovery late in the second quarter. It limited unemployment, foreclosures and evictions.

Nonetheless, Congress has been reluctant to extend this support. There are some good reasons for hesitation:

- The national debt is growing rapidly, which should always give pause.
- Some businesses currently receiving support were struggling before the pandemic and may not have the right model to survive after it ends. Preventing failure at all costs prevents healthy and natural economic churn.
- Some CARES Act programs were designed with speed in mind, and money may not have been distributed as carefully as it should have been.
- Aid would ideally be targeted specifically at damage caused by COVID-19, and not used to cover the consequences of poor decisions made prior to the pandemic.

Perhaps the biggest concern surrounding another round of aid is fear that supplemental unemployment benefits have provided a disincentive to work. For some occupations, support payments exceeded wages, leading some employees to purposely remain on the sidelines. But these situations are very much in the minority. A vast number of businesses remain closed, or are operating well below full capacity. And the uncertainty surrounding the duration of supplemental jobless benefits might be an incentive to go back to work. Analysis at the state level shows little correlation between the generosity of benefits and levels of unemployment.

Closed businesses, not jobless benefits, are keeping people out of work.

Some legislators might also note that the economy is recovering, which would limit the need for additional stimulus. But both employment and GDP remain well below their pre-pandemic levels, and high frequency indicators suggest that the recovery may be losing momentum. Layoffs at state and local governments, small businesses and airlines loom large on the horizon. Adding a loss of spending power to the mix will make further progress much more difficult to achieve.

Last week, the White House attempted to compensate for Congressional inaction with a series of memoranda aiming to sustain unemployment benefits and forestall evictions. But procedural hurdles will limit their effectiveness. Authority for appropriations is vested in Congress, which won't return from recess until after Labor Day. And when it does, election year politics will continue to complicate fiscal deliberations.

With the CARES Act, Congress attempted to build a bridge to economic recovery. With the waters below still choppy, the span needs to be lengthened. But reaching a deal to extend support is increasingly looking like a bridge too far.

Broken Commitment

The United States-Mexico-Canada Agreement (USMCA) came into force on July 1, 2020. It largely maintained the status quo set by the North American Free Trade Agreement (NAFTA), but also offered hope of ending trade quarrels within North America. Those hopes were fleeting.

Merely a month after enactment of the USMCA, the U.S. administration revived old tensions by reinstating 10% tariffs on unwrought aluminum from Canada. Unsurprisingly, Canada retaliated by announcing "dollar-for-dollar" duties on $2.7 billion in U.S. imports.

The U.S. measures violate the spirit of any free trade agreement (FTA), but not the legal terms of the USMCA. The USMCA did not end Section 232 tariffs on steel and aluminum. The argument that U.S. metal producers merited national security protection was settled in a separate deal last year. The U.S., which purchases 75% of total Canadian exports, kept the right to re-impose duties on Canadian aluminum in case of a "surge meaningfully beyond historic volumes of trade over a period of time." Canada retained the right to "retaliate only in the affected sectors."

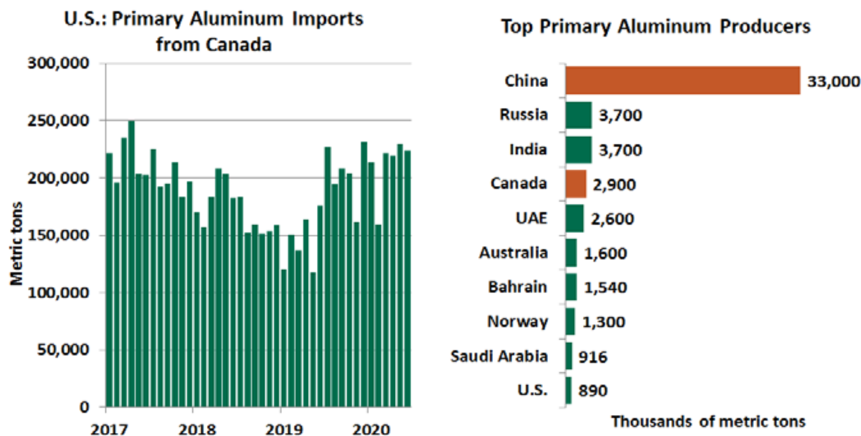
While the U.S. runs a large trade deficit overall, its trading relationship with Canada is largely balanced. Yet Canada's steel and aluminum industries have been a persistent target of the U.S. administration. While overall imports of this metal from Canada are not substantially above historical levels, data shows a shift in the types of aluminum imported into the U.S. Imports from Canada of unwrought aluminum have increased this year, offset by declines in alloyed imports amid faltering demand. This does not make a strong enough economic case for tariffs, but nevertheless has raised the ire of the White House ahead of the elections.

Now is not the time for new trade battles. Economies and businesses are already struggling amid the pandemic. In challenging times like these, tariffs are the last thing Canadian and American businesses (and consumers) need, as they lead to higher costs. American smelters lack the

capacity to fulfill all domestic demand and account for only 3% of U.S. aluminum jobs. About half of America's aluminum used in its auto, construction and beverage industries comes from Canada. The move could prompt U.S. industries to turn to other countries for supplies.

China is far and away the world's largest producer and exporter of aluminum. Targeted measures including anti-dumping and countervailing duty cases have reduced imports of Chinese aluminum in recent years, but China's enduring and growing overcapacity in its state-subsidized aluminum industry is distorting the global aluminum market. Its high export volume has led to anti-dumping probes from countries including Australia, India and the European Union.

The future of the USMCA deal is not at immediate risk.



Sources: Census Bureau, CBC, Statista

North America stands to benefit from countries and firms moving or diversifying their supply chains away from China. But regional frictions like these will likely discourage manufacturers' reshoring plans, as they cause disruptions in supply chains and increase the cost of doing business. Eliminating tariffs through FTAs could save billions of dollars. Switzerland serves as an ideal case study. According to a study by the Switzerland State Secretariat for Economic Affairs, Swiss importers and consumers saved about $2.7 billion in customs duties in 2018 thanks to FTAs. In contrast, American beverage industries alone have paid more than half a billion dollars in tariffs since 2018, according to the trade association of beer producers and importers.

While governments across the world continue their pursuit of a COVID-19 vaccine, we hope they might also collaborate in looking for a cure against the anti-trade virus. This type of virus may not cause fatalities among humans, but it can be lethal for their long-term economic prospects.

Answering the Bell

Ryan offers thoughts on the debate surrounding school re-opening.

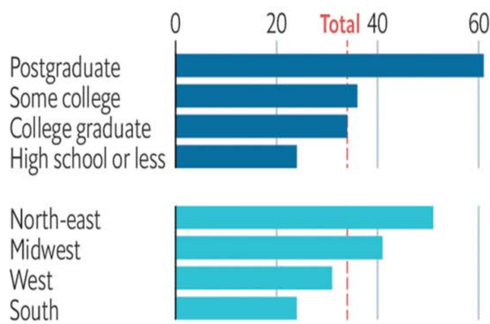
Parents in my community eagerly awaited word of how our local schools would reopen. When the email arrived, it didn't offer simple instructions; instead, it directed us to an hour-long video explaining all aspects of primary education for the year ahead. The complexity of the message is driven by the complicated tradeoffs facing parents, teachers and administrators, which will have consequences that extend beyond the classroom.

Students are starting the year at a disadvantage. School closures in early COVID-19 lockdowns led to distance learning that had varying degrees of success. Pupils and teachers alike were unfamiliar with e-learning technology. Teaching new concepts remotely is a challenge, especially for younger students. And many students, especially in lower-income areas, lack the resources at

home to participate in e-learning. A year of ineffective education can compound into a lifelong impairment in students' capabilities and earning potential.

Working parents are eager for a reprieve from childcare. The distraction has been widespread: For example, more than 15% of U.S. households contain children ages 6-17. Though schools are adding to their distance learning resources, parents must still tend to their children more than they would during normal school days. Parents working from home were sidetracked; parents who cannot work remotely needed to reduce hours or quit to stay with their children. A Brookings Institution study estimated a four-week school shutdown would cost the U.S. economy 0.3% of annual GDP.

Economic recovery will be enhanced if children are able to return to school safely.



Sources: YouGov, Economist, Sasaki Associates

Any school reopening will have to be tentative. Schools in Germany and Israel faced selective shutdowns after local COVID-19 cases were found, a story likely to recur as schools reopen worldwide. Many schools lack any spare space to support social distancing. While younger children appear to be at low risk, contagion among teachers, adolescents and their families is a legitimate concern.

Our school district offered an option for fully remote learning, but we decided to send our children back to their classrooms at the end of the month. Backup plans are ready in case the schools need to close. Schools have spent the summer planning for new approaches to learning. And parents have spent the summer steeling ourselves for even more time with the kids ahead.

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