***Editor’s Note:*** *We have reinstated the near-term forecast of the FIM, incorporating recent legislation and the automatic effects of the recession on taxes and spending. While additional legislation to combat the recession is likely, we don’t know what form it will take and have not included it in the FIM forecast.*

**FISCAL POLICY AND THE ECONOMY IN 2020 AND 2021**  
**By** *Kadija Yilla and Louise Sheiner*

The fiscal policy response to the pandemic will greatly affect the contour of GDP over the next few years. The Hutchins Center Fiscal Impact Measure (FIM) is intended to translate changes in taxes and spending at federal, state, and local levels into changes in aggregate demand.

In the first quarter of 2020, fiscal policy boosted GDP growth ¼ percentage point above its longer run potential. Tax and spending policies will contribute significantly to growth over the next four quarters. As a result, the FIM will hit its highest level since 1973, the earliest year for which we have data, in the second quarter—boosting GDP growth by 9 percentage points at an annual rate. Policy will continue to support the economy in coming quarters, although by decreasing amounts (barring further action from Congress). But as the effects of the CARES Act and other legislation wane, the effects reverse; fiscal policy becomes a negative factor for GDP growth. In the second quarter of 2021, for example, the fiscal policy will decrease GDP growth by 5 percentage points below its potential.

Taxes and transfer programs are the largest component of the projected increase in the FIM. This category captures much of the recent legislation—the recovery checks, the increase in unemployment benefits, and the forgivable loans under the Paycheck Protection Program (PPP), as well as the reductions in taxes and increased spending on Medicaid, unemployment, and SNAP that occur automatically in a recession. Federally financed purchases, mainly grants to state and local governments and state and local hospitals and community health centers, also boost the economy in coming quarters. Purchases financed by state and local governments, on the other hand, are a restraining factor, as the need to balance budgets in the face of declining tax revenues forces state and local government to make big cuts in spending.

While the overall trajectory of the FIM is clear—a near-term boost to the economy that abates quickly, followed by several quarters of restraint—the exact magnitude and timing of the effects are not. We will update the FIM as more information becomes available. For the current projection, we’ve made several assumptions: about the timing of the outlays from the recent legislation, for example, and, importantly, about the behavioral responses to it. The impact of taxes and government transfers on the pace of GDP growth depends on the marginal propensities to consume (MPC)—for instance, how much households spend versus how much they save from the $1,200/person payment that the CARES Act provided to most households. During the pandemic, the MPCs could be smaller or larger than in normal times. The effects of lockdowns and social distancing could reduce consumption; the progressivity of the increased federal spending—particularly the $600 per week increase in unemployment benefits—could produce larger effects on consumption. Data available thus far suggest the spending response has been robust, and we have boosted our standard MPCs both for the rebate checks and the expanded unemployment benefits a bit.

Estimating the impact of the Paycheck Protection Program (PPP) on GDP is particularly difficult, as it is too soon to know what share of those grants went to businesses that would have otherwise laid employees off—in which case the PPP funding operates much like unemployment insurance—and what share should be viewed more like standard business tax cuts that have only small near-term effects on business spending.  Evidence about who got these loans suggest they were not particularly well targeted. Areas of the country and industries hardest hit by the virus were not more likely to get the PPP loans, and initial data comparing layoffs between eligible and noneligible firms suggests little difference. As a result, we’ve assumed that additional spending as a result of the PPP grants is likely to be relatively small and slow. (Specifically, we’ve assumed a weighted average MPC that is ¼ the MPC we assume for UI, and ¾ the MPC we assume for corporate tax cuts.)

Finally, the FIM may not capture all the effects of recently enacted legislation on the economy. The FIM is intended to capture the effects of fiscal policy on aggregate demand. Thus, we don’t include the benefits of the up to $450 billion in emergency lending authority for the Federal Reserve to lend, nor do we include the potential benefits of PPP in keeping businesses from going bankrupt. We consider whether the dollar amounts of the PPP loans are spent but not the longer-term benefits of keeping businesses from folding.

*For more on the FIM, see our* [*methodology »*](https://www.brookings.edu/research/the-hutchins-centers-fiscal-impact-measure/)*. You can also read our* [*Guide to the FIM »*](https://www.brookings.edu/2019/07/26/a-guide-to-the-hutchins-center-fiscal-impact-measure/%20/)*.*