**FISCAL POLICY AND THE ECONOMY, 2020 THROUGH 2022**  
**By** *Kadija Yilla and Louise Sheiner*

The fiscal policy response to the pandemic had a large impact on GDP growth in the third quarter, boosting it 5.4 percentage points at an annual rate, but the boost from fiscal policy was smaller than in the second quarter, according to the latest reading of the Hutchins Center Fiscal Impact Measure (FIM). The FIM translates changes in taxes and spending at federal, state, and local levels into changes in aggregate demand, illustrating the effect of fiscal policy on real GDP growth. This is the second highest level of the FIM since 1973, the earliest year for which we have data. The only higher reading occurred in the second quarter of this year, when fiscal policy pushed up GDP growth by 14 percentage points. GDP increased at an annual rate of 33.1 percent in the third quarter, according to the latest government estimate.

Taxes, subsidies, and transfer programs account for the largest component of the increase in the FIM over the past two quarters. This category captures the boosts to consumption from the CARES Act’s payments to households and expanded unemployment benefits, as well as from the automatic stabilizers—the reduction in taxes and increases in unemployment and SNAP benefits that occur automatically when an economy falls into recession. Government-financed purchases by both federal and state and local governments, on the other hand, were a restraint—holding down GDP growth by -0.7 and -0.5 percentage point, respectively. The decline in federal purchases follows a sharp rise in the second quarter, and reflects the decline in payments for PPP processing services. State and local expenditures have been declining steadily since the beginning of the pandemic, in response to tight budget conditions and perhaps also the different staffing needs of virtual public schooling.

Without any additional stimulus, we project that fiscal policy will become a drag on economic growth in coming quarters. Under our assumptions about the timing of spending from fiscal stimulus, the effect of last spring’s legislation will be mostly gone by the second quarter of 2021. As a result, in our projection, fiscal policy becomes sharply negative. While additional legislation to support the economy is possible, we don’t know what form it will take, and thus have not included it in our forecast.

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. 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 (MPCs)—for instance, how much households spend versus how much they save from the $1,200 per 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 a bit, both for the payments to households and the expanded unemployment benefits, but, because of social distancing, we also have assumed the spending occurs over a longer time period.

Estimating the impact of the PPP on GDP is particularly difficult, as it requires knowing what share of those grants went to businesses that would have otherwise laid off employees—in which case the PPP funding operates much like unemployment insurance—and what share should be viewed like standard business tax cuts that have only small near-term effects on business spending. Recent evidence suggests that [these loans did boost employment, although only for a small minority of the firms that received them](https://economics.mit.edu/files/20094). As a result, we’ve assumed that additional spending as a result of the PPP grants is likely to be relatively small and slow. State and local governments are also cutting their purchases, suggesting spending of the grants provided to them in the CARES Act will also be very gradual.

Before the onset of the COVID-19 pandemic, federal, state, and local fiscal policies were providing a modest boost to GDP growth.

*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/)*.*