State of the Economy and the Fiscal Response to Date

The text discusses the unemployment rate in the United States as of December 2020, which stood at 6.7%. This was down from earlier in the year but still higher than pre-pandemic levels. The service industry accounted for the largest number of unemployed workers, with the leisure and hospitality industry being hit particularly hard.

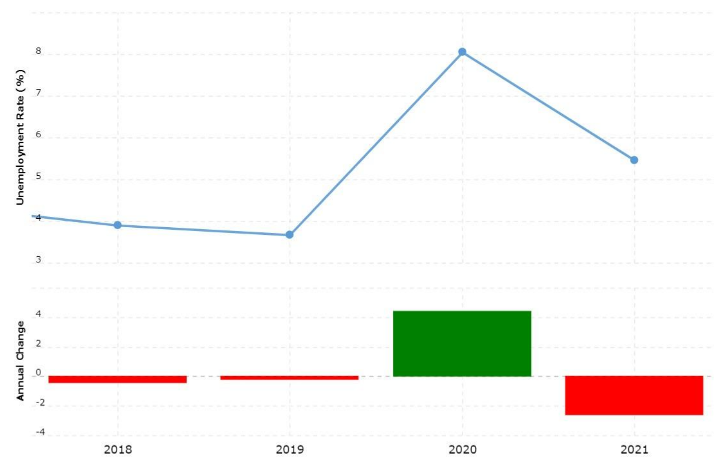
The federal government has enacted several laws in response to the pandemic to reduce the impact on unemployment, including the CARES Act, which provided fiscal policy initiatives and lending authorities to support small businesses and unemployed individuals. This included the Paycheck Protection Program (PPP), expanded and augmented unemployment benefits, and direct payments for individuals.

The Consolidated Appropriations Act, 2021 provided additional funding for coronavirus relief, including increases and extensions in unemployment benefits, an additional rebate for individuals, and more small business loans. There was also funding for transportation, banking, agriculture and nutrition, broadband internet access, and various other programs.

Unemployment Rates

According to the text, the unemployment rate for private, nonagricultural workers was 4.4% in March 2020, and then it started to rise sharply due to the COVID-19 pandemic. It reached its peak in April 2020, with a rate of 14.7%, which is significantly higher than any other period mentioned in the text. After that, the unemployment rate began to decline, and by December 2020, it was 6.7%. However, this is still higher than the rate in March 2020.

It's worth noting that the text mentions that these numbers may be an undercount and that the COVID-19 pandemic has had a significant impact on the economy, resulting in underemployment even as the unemployment rate declines.



Estimated Effect of Recently Enacted Policies

The article discusses the difficulty of estimating the current effects of fiscal policies due to the lags in data. However, studies using private data have examined the policies' consequences and the causes of the contraction. One study found that the economic collapse was largely due to the effect of reduced spending by high-income individuals on services requiring in-person interactions out of concerns about health risks. The reduction in turn caused revenue losses in businesses and job losses for workers. Another study found that direct payments increased spending by lower-income individuals, but that spending was not directed at the sectors most affected by the collapse in demand. The study suggests that Congress continue measures to mitigate the hardship experienced by lower-income workers through social insurance and also suggest place-based measures for low-income individuals in urban areas especially affected by the virus. The article also discusses the impact of PPP loans, which are found to be poorly targeted by some studies, while other studies found the program successful in achieving short-term goals of maintaining employee connections to firms and business survival. The article also discusses the impact of unemployment benefits, which sustained spending, and led to job creation.

Considerations for Policies Going Forward

The article discusses the need for continuing expanded unemployment benefits and potential traditional fiscal policy measures to stimulate demand, as the COVID-19 pandemic and related government restrictions continue to impact the economy. There are uncertainties regarding the timing of when social distancing measures can be relaxed and the extent to which consumer demand is dampened, which could affect the focus of fiscal policy measures. The optimal timing of a shift from relief-focused policies to traditional demand stimulus measures is unclear and may require both simultaneously. Policymakers should consider the efficiency of alternative types of stimulus in increasing demand and understand how fiscal policy in response to traditional economic downturns works, both theoretically and empirically.

How Fiscal Policy Works to Increase Demand

Review of Theoretical Effects of Fiscal Policy

The article discusses the use of fiscal policy, which began with John Maynard Keynes' work during the Great Depression. Fiscal policy involves government intervention in the economy through either an increase in spending or a decrease in taxes to boost demand and reduce unemployment. The effectiveness of fiscal policy is measured by a multiplier, which shows the impact of government spending on aggregate demand. The effectiveness of the multiplier depends on factors such as the share of spending that is saved or spent, interest rates, and assumptions about monetary policy. The article also notes that there is a consensus that spending increases are more effective than tax cuts, as all the initial spending increase is spent, while some of a tax cut is initially saved. However, some federal government spending is funneled through the states, which could result in some of it being saved.

Review of Empirical Effects of Fiscal Policy

The passage discusses various econometric studies that analyze the short-term effects of fiscal policy adjustments, such as increases or decreases in spending and/or taxes, on the economy. These studies use different models to estimate the size of the fiscal multipliers, which determine the effectiveness of fiscal stimulus. The multiplier is the amount of additional output produced for an additional dollar of spending or tax cuts, and it can range from 0.3 to 3.5 depending on various factors, including economic conditions, modeling and data assumptions, and fiscal policy details. The passage also notes that much of the recent interest in fiscal multipliers stems from the examination of the Great Recession and the subsequent shift towards austerity policies.

Review of Empirical Research on Austerity Measures During the Great Recession

During the Great Recession, studies examined the short-term effects of fiscal consolidation (spending reductions and/or tax increases) on government debt and the economy. These studies identified discretionary fiscal policy using either cyclically adjusted variables or a narrative approach. Alesina and Ardagna found that fiscal consolidation improved economic growth, with spending reductions being less likely to cause recessions than tax increases. However, successful fiscal consolidations occurred in economies at or near full employment, limiting the application of these findings to an economy in recession. An IMF study found that fiscal consolidation had a contractionary effect on output, with spending cuts being less contractionary than tax increases. Post-Great Recession studies found that fiscal consolidation in economies below full employment reduced economic growth. Traditional fiscal stimulus was found to increase output, while austerity measures reduced output.

Fiscal Policy Stimulus Alternatives and Multipliers

Relative Sizes of Multipliers

Research shows that direct federal spending and transfers to state and local governments and low-income individuals have the largest economic multipliers. Tax cuts for individuals tend to have smaller multipliers, and temporary tax cuts have smaller effects on spending compared to permanent ones. Tax cuts for high-income individuals have smaller multipliers than tax cuts for low- and middle-income taxpayers. Business tax cuts, particularly corporate rate cuts, have the lowest multipliers, as they have a relatively small effect on investment and demand. Investment subsidies such as expensing or bonus depreciation have larger multipliers than corporate rate cuts.

Other Concerns About the Effectiveness of Alternative Policies

The effectiveness of tax cuts as a stimulus measure has been studied extensively. Lump-sum payments were once considered less effective than tax cuts that are spread out over paychecks, but studies have suggested that their lump-sum nature is not a serious concern. The direct payments during the COVID-19 pandemic may have been less effective due to health concerns and restrictions, but studies suggest that they were mostly spent and may fund pent-up demand once restrictions ease. Temporary tax cuts, such as a sales tax holiday or a temporary investment subsidy, can be more effective than permanent ones under certain circumstances. Infrastructure spending is subject to lags, but it can increase long-term productivity and be appropriated now for planning time, with the actual spending delayed.

Long-Term Issues: Addressing the Federal Debt

The Debt Outlook and the Pandemic’s Effect

The United States was already experiencing an unsustainable growth in debt prior to the COVID-19 pandemic, with debt held by the public at the end of FY2019 at $16.8 trillion, 79% of GDP, and projected to rise to 98% by 2030. The pandemic's economic effects have further increased the debt, with the Congressional Budget Office projecting that federal debt will equal 98% of GDP by the end of 2020, and rise to 195% of GDP by 2050. This may eventually need to be addressed by a reduction in mandatory spending, an increase in revenues, or both.