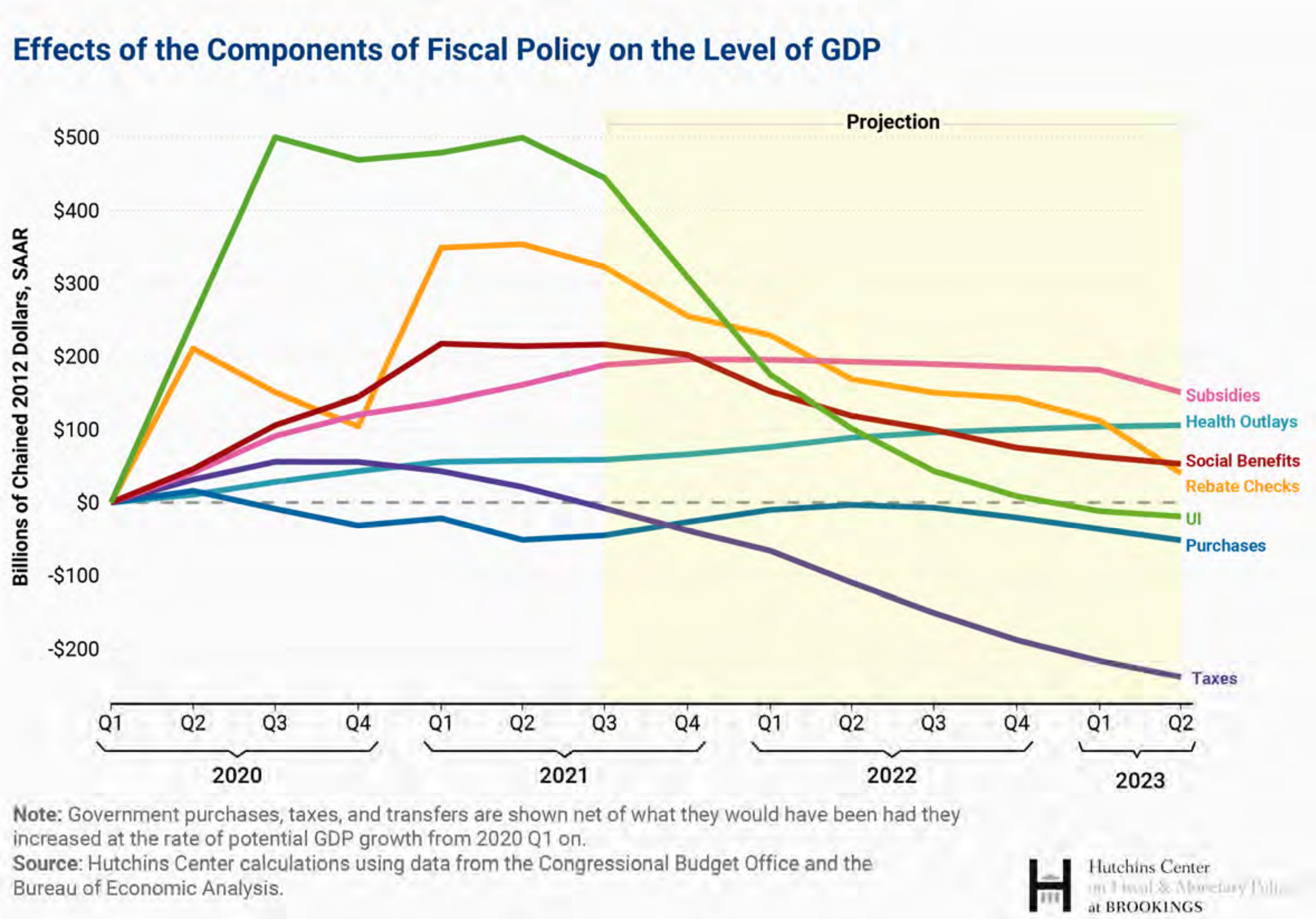
# Lessons from US Fiscal Policy since the Pandemic

Kaneta Sato
Embassy of Japan in the US
August 2, 2023

# Economic Effects of Fiscal Policy under the COVID-19 Pandemic

- The effect of fiscal policy on demand shortfalls has been significant. In particular, unemployment benefits and direct benefits to households boosted GDP and contributed to the V-shaped recovery of the US economy.

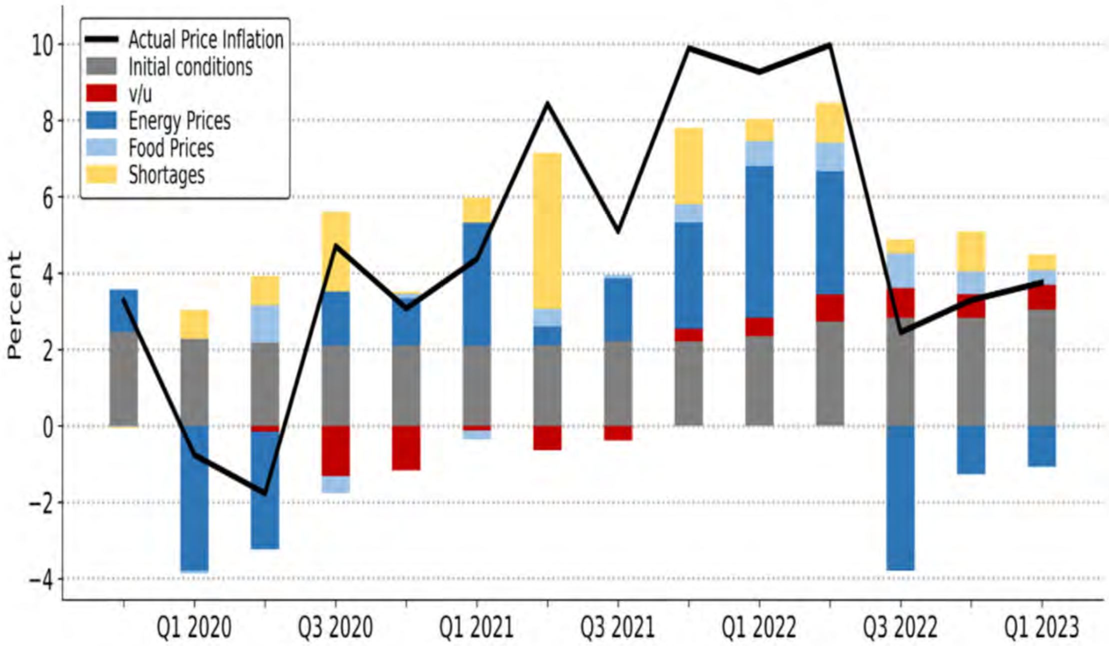



Source: Louise Sheiner, Sophia Campbell, Manuel Alcalá Kovalski, Eric Milstein, "How pandemic-era fiscal policy affects the level of GDP", Brookings, October 19, 2021

# Impact of US Fiscal Policy on Inflation

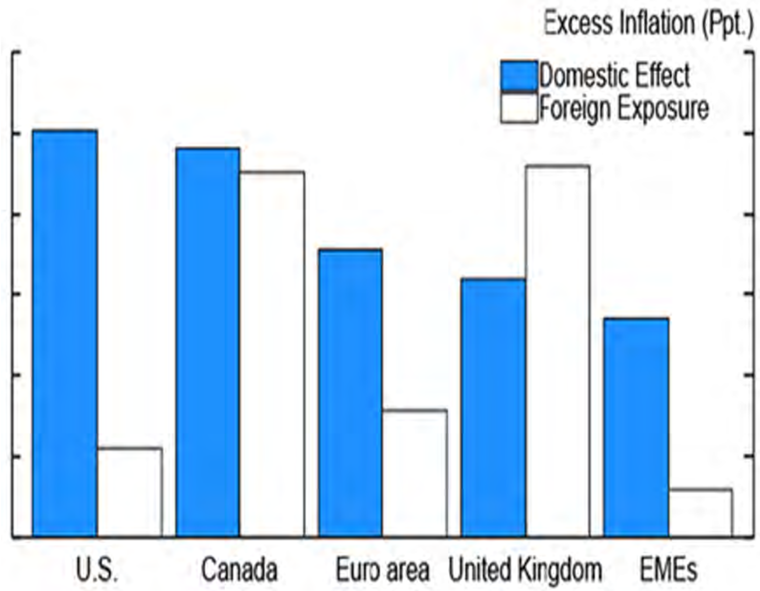
- The expansion of demand (especially for goods) due to fiscal policy has led to an imbalance between supply and demand, which is one of the factors contributing to soaring inflation.
- The evaluation of fiscal policy will depend on how smoothly the return of inflation to 2% will be.

**The Sources of Price Inflation, 2020Q1 to 2023Q1**




Source: Ben Bernanke and Olivier Blanchard, "What Caused the U.S. Pandemic-Era Inflation?" Hutchins Center working Paper, June 2023

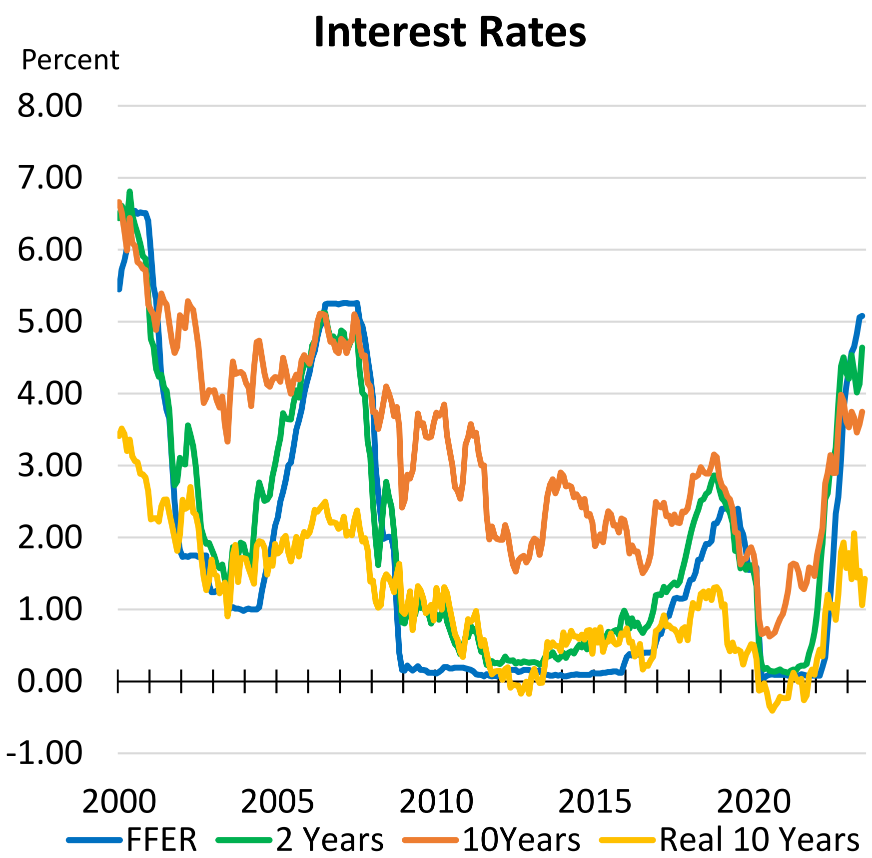
**Impact of Fiscal Stimulus on Inflation**



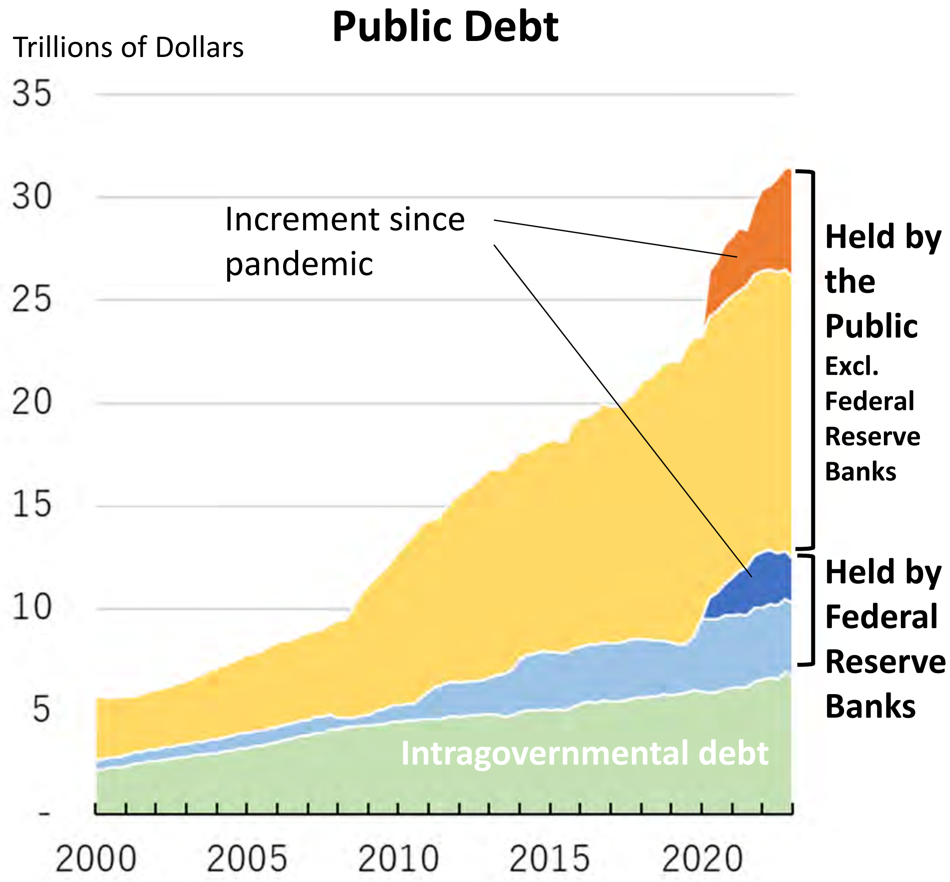

Source: François de Soyres, Ana Maria Santacreu and Henry Young, "Fiscal policy and excess inflation during Covid-19: a cross-country view" FEDS Notes, July 15, 2022

# Trends in Interest Rates and Public Debt since the Pandemic

- Interest rates began to rise as a result of a series of rate hikes to control inflation. Even though less than the short term interest rate, the long term interest rate (both nominal and real) has increased above the pre-pandemic level.
- Public debt has increased by about $8 trillion since the pandemic, most of which has been absorbed by the market.



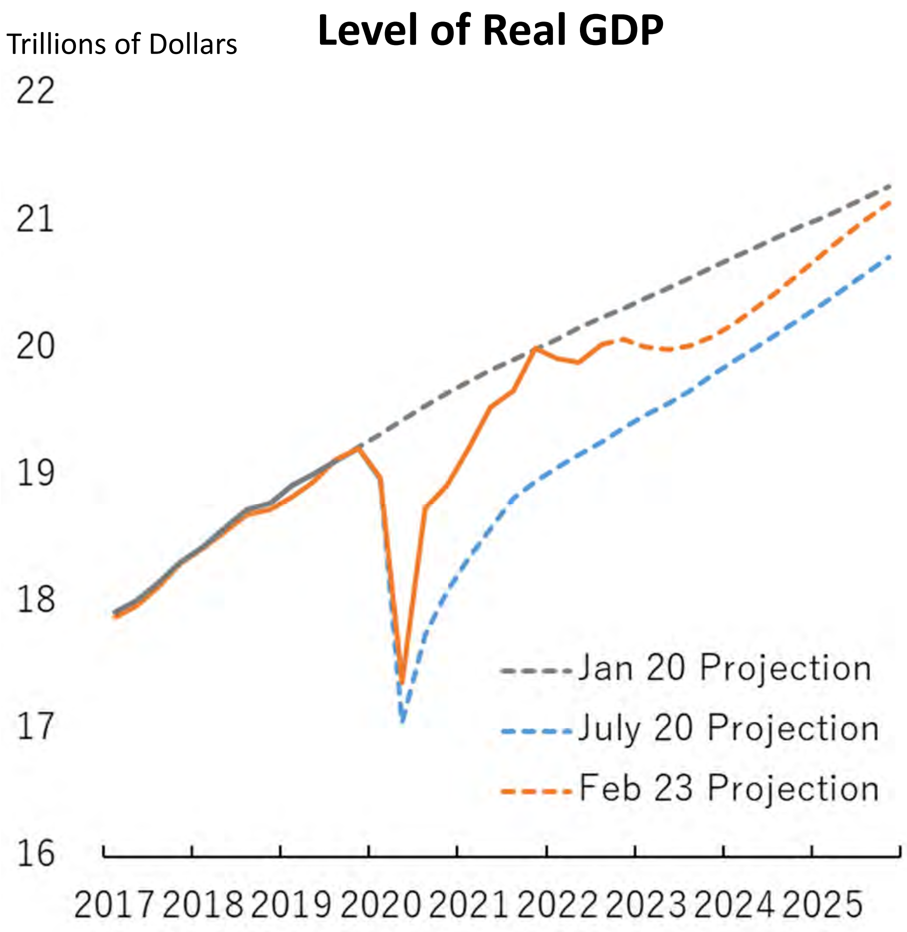

Source: Board of Governors of the Federal Reserve System and (Federal Reserve Bank of Cleveland (retrieved from FRED)

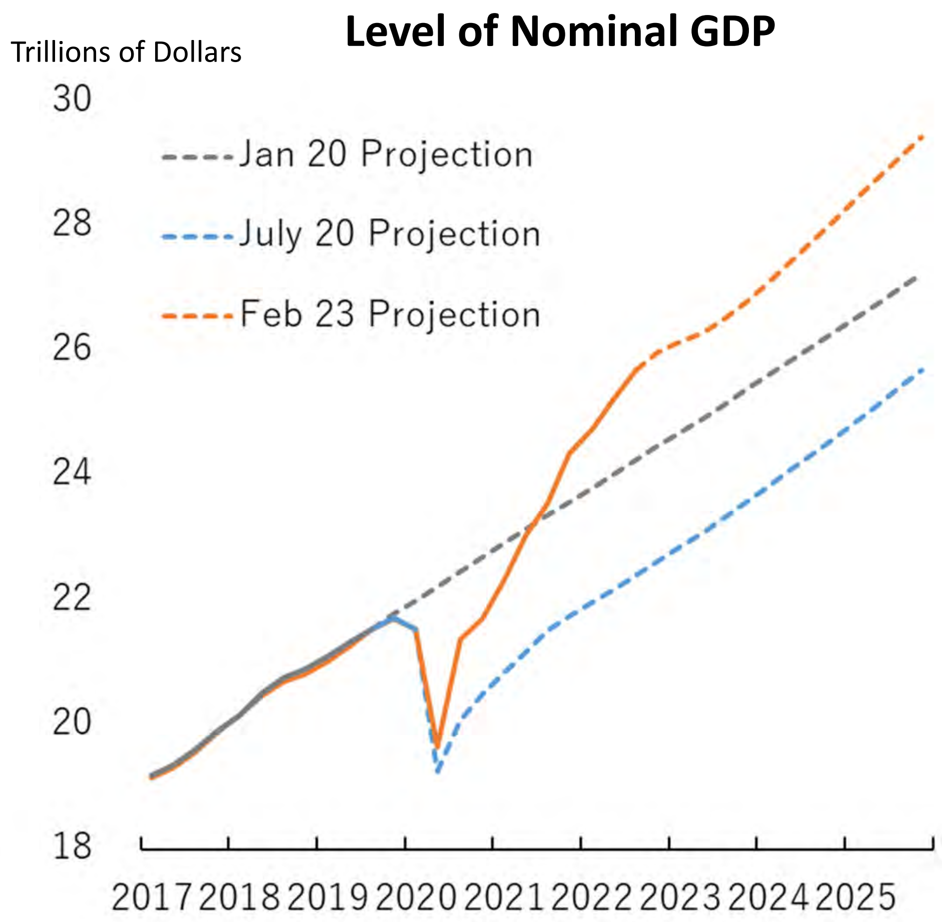



Source: Department of the Treasury (retrieved from FRED)

# Economic Recovery and Inflation Compared to Previous Projections

- Real GDP returned to the pre-pandemic trend earlier, compared to the economic projection made just after the pandemic.
- Nominal GDP increased above the pre-pandemic level, with the additional impact of inflation

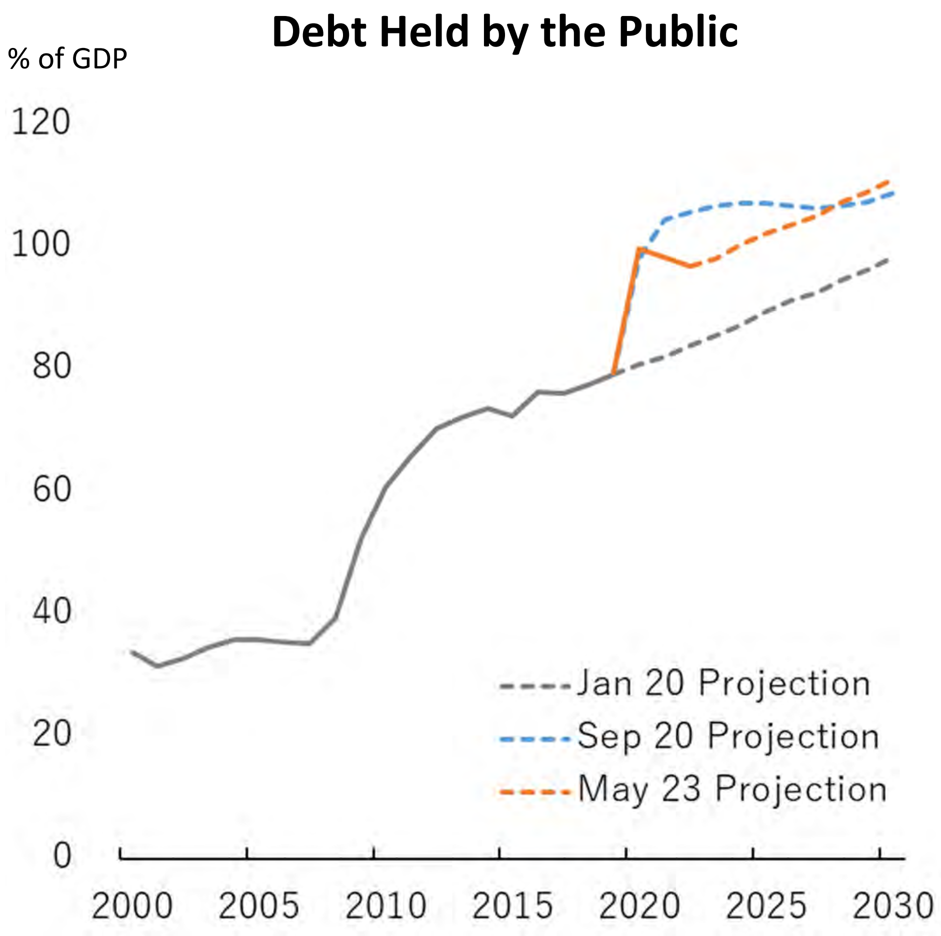


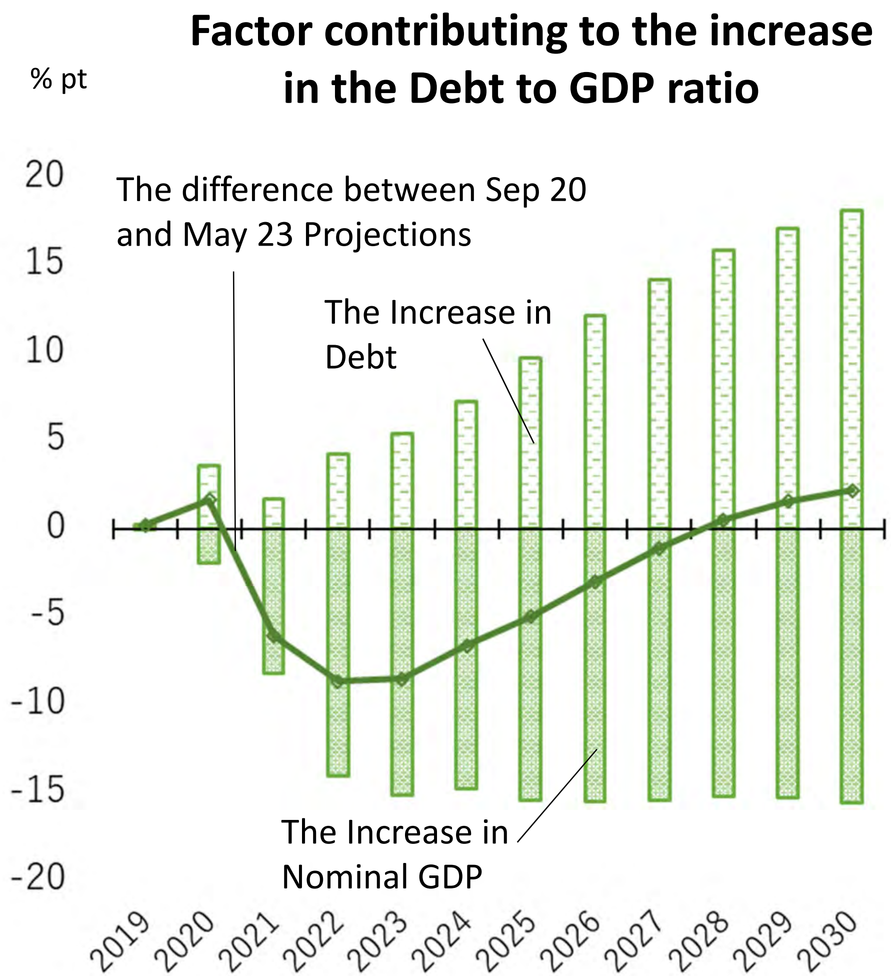




Source: Congressional Budget Office, 10-Year Economic Projections

# Public Debt with the Change of Economic Conditions

- The economy's early recovery has initially reduced the debt-to-GDP ratio compared to the Sep. 2020 projection, but the pace of debt's increase is expected to accelerate in the future.

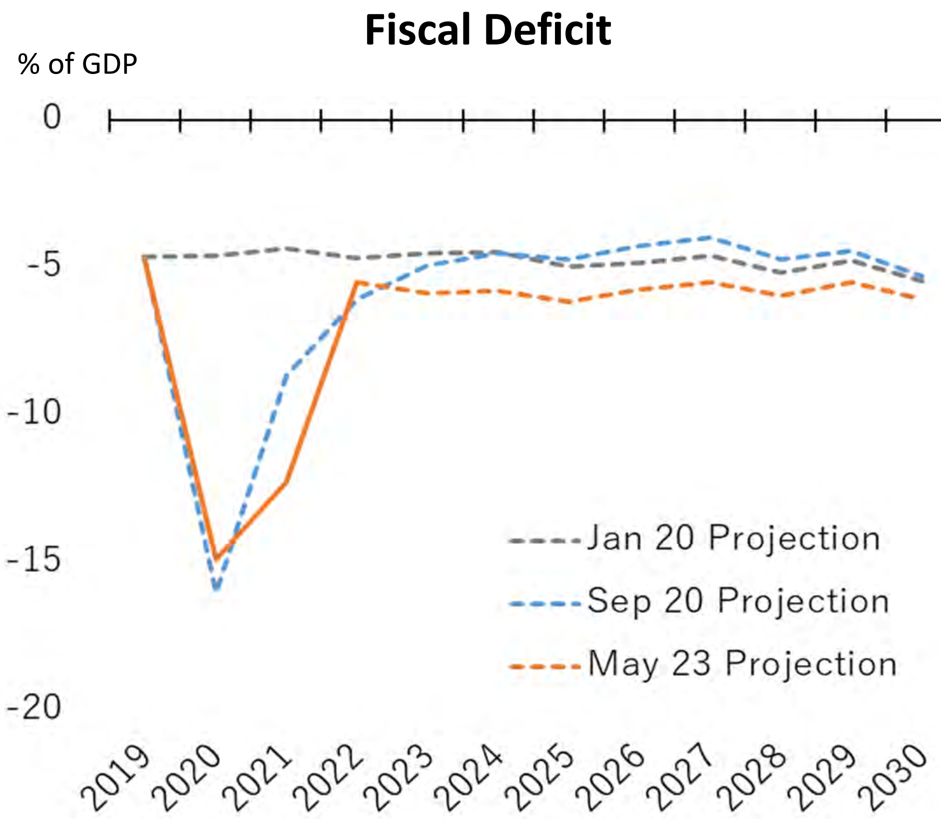


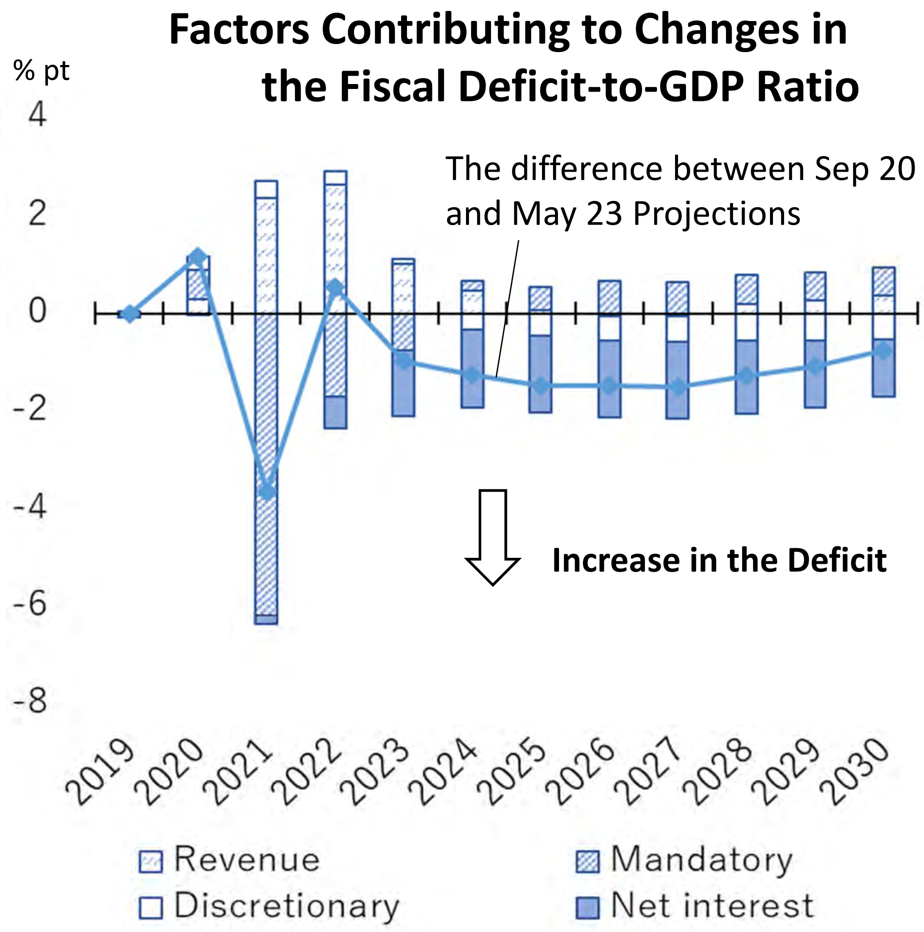




Source: Congressional Budget Office, 10-Year Budget Projections

# Factors Exacerbating the Budget Deficit

- The additional fiscal stimulus in 2021 added to the deficit, and the net interest expense increased on a constant basis.
- Discretionary expenses also increased, albeit on a smaller scale.



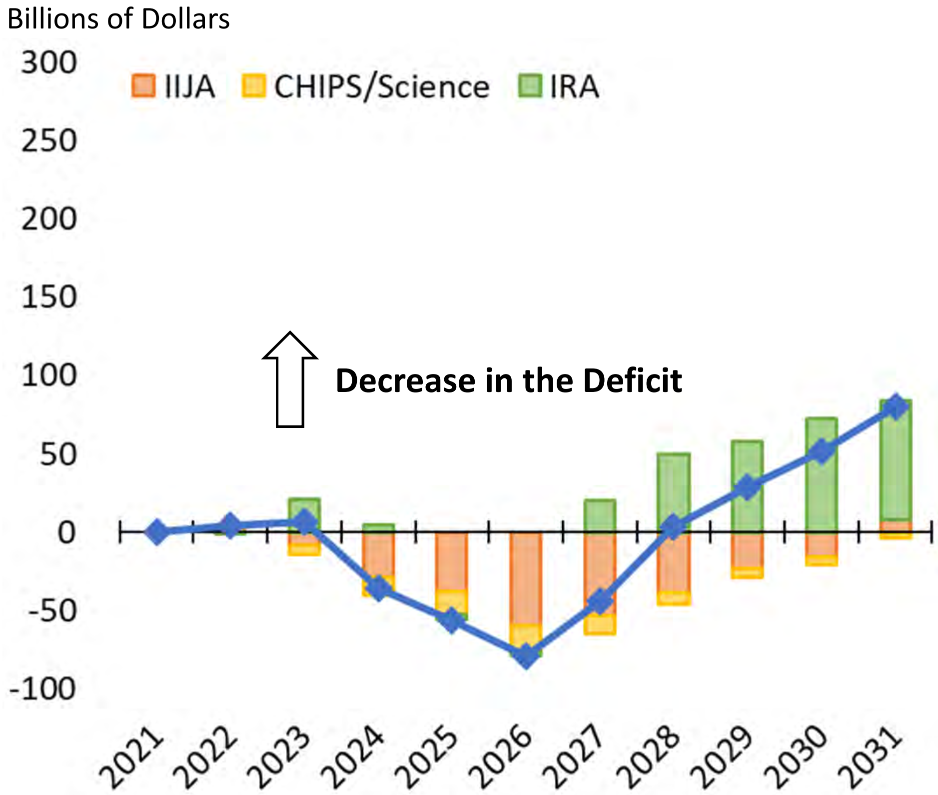



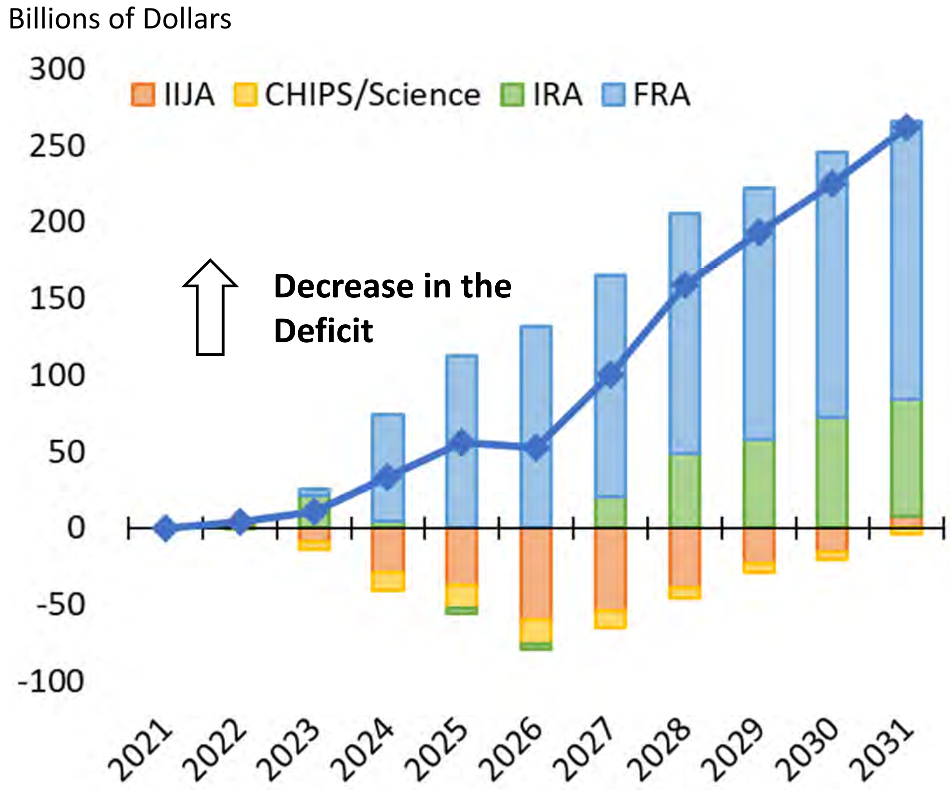

Source: Congressional Budget Office, 10-Year Budget Projections

# Post-Pandemic Fiscal Policy

- Policymakers move to focus on policies to expand supply capacity.
- Initially raising financial resources through borrowing, the Inflation Reduction Act aims for fiscal neutrality by raising revenues.
- The Fiscal Responsibility Act, passed after the debt ceiling negotiations, capping discretionary spending in FY24 and FY25, will save money in subsequent years

**Impact of each Legislation on the fiscal deficit**

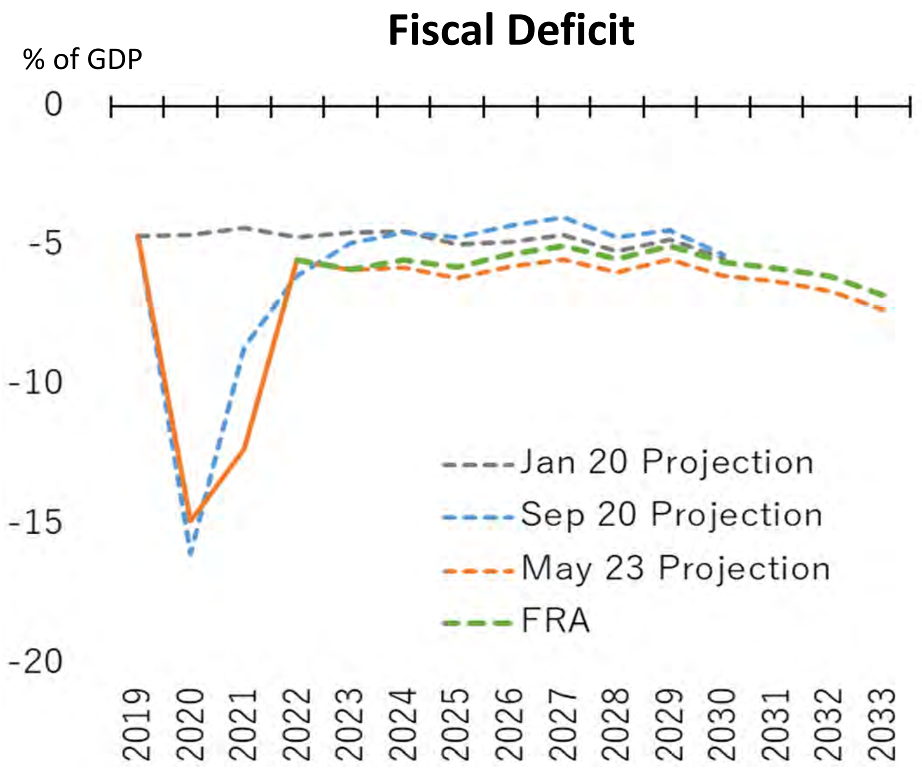


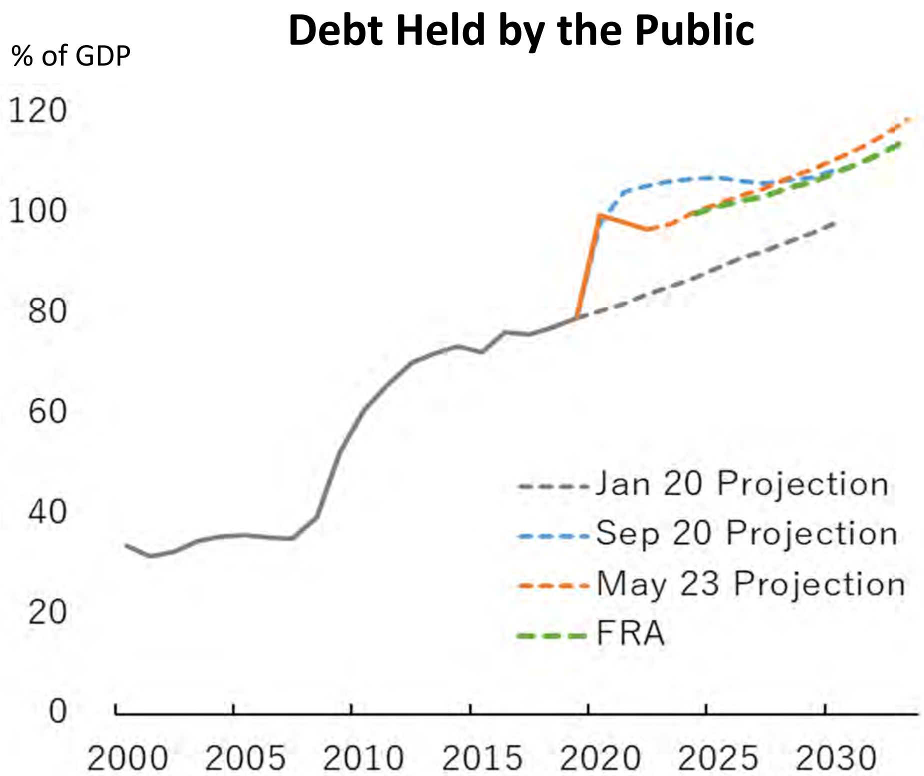




Source: Congressional Budget Office, The cost estimate of each legislation made by the CBO.

# Impact of the Fiscal Responsibility Act on the Fiscal Situation

- The Fiscal Responsibility Act reduces the budget deficit by $1.5 trillion over 10 years. This will result in an improvement in the path of fiscal deficits and debt-to-GDP ratios, but will not lead to a major change in trends.




Source: Congressional Budget Office, 10-Year Budget Projections and "How the Fiscal Responsibility Act of 2023 affects CBO's Projections of Federal Debt", June 9, 2023

# Policy options for Fiscal Consolidation

- CBO presents several policy options for fiscal consolidation. While politically difficult, it is essential to tackle taxation or mandatory spending in order to achieve a significant reduction in the budget deficit.

**Projected Savings from Options for Reducing the Deficit**

Billions of Dollars

| Option | Title | Savings, 2023–2032[a] |
|---|---|---|
| 1 | Establish Caps on Federal Spending for Medicaid | 501 to 871 |
| 2 | Limit State Taxes on Health Care Providers | 41 to 526 |
| 3 | Reduce Federal Medicaid Matching Rates | 68 to 667 |
| 4 | Increase the Premiums Paid for Medicare Part B | 57 to 448 |
| 5 | Reduce Medicare Advantage Benchmarks | 392 |
| 6 | Reduce Tax Subsidies for Employment-Based Health Insurance | 500 to 893 |
| 7 | Reduce Social Security Benefits for High Earners | 40 to 184 |
| 8 | Set Social Security Benefits to a Flat Amount | 270 to 593 |
| 9 | Increase the Maximum Taxable Earnings That Are Subject to Social Security Payroll Taxes | 670 to 1,204 |
| 10 | Reduce Spending on Other Mandatory Programs | 580 |
| 11 | Reduce the Department of Defense’s Annual Budget | 995 |
| 12 | Reduce Nondefense Discretionary Spending | 332 |
| 13 | Increase Individual Income Tax Rates | 502 to 1,329 |
| 14 | Eliminate or Limit Itemized Deductions | 541 to 2,507 |
| 15 | Impose a New Payroll Tax | 1,136 to 2,253 |
| 16 | Impose a Tax on Consumption | 1,950 to 3,050 |
| 17 | Impose a Tax on Emissions of Greenhouse Gases | 571 to 865 |

Data sources: Congressional Budget Office; staff of the Joint Committee on Taxation. See www.cbo.gov/publication/58164#data.

a. For options affecting primarily mandatory spending or revenues, savings sometimes would derive from changes in both. When that is the case, the savings shown include effects on both mandatory spending and revenues.

Source: Congressional Budget Office, “Option for Reducing the Deficit, 2023 to 2032 Volume I: Larger Reductions”, December 2022