Remarks on the Fiscal Response to the COVID-19 Pandemic[1]

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My remarks are focused on the fiscal response, meaning the federal spending, some $6 trillion, driven by pandemic relief legislation.

Regarding the totality of the federal fiscal response, I'll lead with two broad observations.

First, there is a key sense in which the March 2020 relief bills (namely the Families First Coronavirus Response Act and the Cares Act) were impressive. Faced with daunting time constraints, Congress cobbled together programs to address a wide range of needs to which the unfolding pandemic might give rise. This included direct payments to most households, elevated, expanded, and extended support for the unemployed, support for businesses and industries, and support for state and local governments. The Federal Reserve simultaneously extended several emergency lending facilities.

While the scale and scope of the initial relief packages were impressive, key programs nonetheless had substantial flaws. Evaluations of the Paycheck Protection Program, for example, have estimated high costs per job saved. But again, given the time pressure Congress faced, the March 2020 relief bills may have been as well designed as we can hope for an ad hoc fiscal response to a crisis of the pandemic's magnitude.

This brings me to my second broad observation, which is that later relief legislation was disappointing in its failure to either a) react to key changes in conditions on the ground or b) to improve on the earlier relief bills' weaknesses.

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[1] For source material, in particular regarding state and local government finances, please see: Clemens and Veuger (2020a;b) for early analyses of the pandemic's potential effects on state and local tax revenues; Clemens and Veuger (2021) for an analysis of how federal aid to state and local governments was distributed; Clemens (2022) on the resilience of state and local budgets; and Clemens, Hoxie, and Veuger (2022) on the macroeconomic effects of federal aid to state and local governments during the pandemic. These papers, in turn, contain references to a wide range of research on both the fiscal effects of the pandemic and the effects of the ensuing fiscal response.

Some examples:

- First, the design of pandemic unemployment assistance was never substantively improved and the end of enhanced benefits was never tied to either the state of the pandemic or the state of the labor market.

- Second, the third round of stimulus checks, meaning the American Rescue Plan Act's $1,400 per eligible taxpayer, was no better targeted towards households in need or households that had suffered specifically from the pandemic than were the April 2020 stimulus checks.

- Third, assistance to state and local governments failed to reflect the condition of their budgets. By March 2021, it was apparent that the revenues of state and local governments had remained on surprisingly sound footing during the pandemic. In spite of this, the American Rescue Plan would account for $500 out of $900 billion in total federal aid to state governments, local governments, and school districts.

- Fourth, funding for vaccines, tests, and therapeutics remained, in my view, bizarrely underemphasized.

These design flaws were far easier to comprehend in March 2020 than in March 2021. To me, the totality of the US fiscal experience suggests a need for greater pre-pandemic preparedness. The ad hoc nature of the Congressional response looms large in that response's shortcomings.

For the rest of my remarks, I'll make several points regarding the pivotal position of state and local governments, which have been the focus of my pandemic-related research.

First, why do state and local governments take center stage during crises? The reason is two-fold. State and local governments are central to the delivery of public services; in addition to education, public safety, and the management of the safety net, this includes pandemic-related services like the administration and delivery of testing and vaccination programs. At the same time, the operating budgets of state and local governments are often constrained by balanced budget requirements. So when tax revenues are threatened by crisis, maintaining existing services while also expanding public health services can require an injection of federal dollars.

With that backdrop in mind, what was the outlook for state and local governments at the pandemic's outset? Initial forecasts varied considerably, but were generally dire. The $900 billion Congress delivered was always at the high end. But estimates from the pandemic's initial months, including my own, foresaw budget shortfalls reaching into the hundreds of billions.

So what actually happened to the revenues of state and local governments? Remarkably, data from the National Association of State Budget Officers revealed the following: for fiscal years 2020 and 2021, states' own-source revenues actually exceeded pre-pandemic forecasts by 2.2 percent. (And to be clear, these are pre-pandemic forecasts; not forecasts from the period of peak uncertainty). Put differently, there was a small windfall rather than a massive shortfall.

This raises the question: How did early estimates get things so wrong? There are two major factors.

A first factor is that early projections did not account for the trillions of dollars the federal government would ultimately send to businesses and households. As the pandemic progressed, incomes actually rose relative to trend and income tax revenues proved to be robust.

Second, the pandemic's effects on the income, sales, and property tax bases differed in key ways from the effects of typical recessions:

- First, job losses were concentrated in relatively low-paying industries. Progressive income taxes thus felt less bite than during a typical recession.
- Second, the stock market boomed.
- A third factor involves the finer details of state and local sales tax bases. Specifically, goods are taxed more extensively than services. Because the pandemic led consumers to shift away from services and towards goods, the typical sales tax base expanded.
- Fourth, the pandemic increased demand for housing. Residential property values have risen and property tax bases have, like the income and sales tax bases, proven robust.

What can we learn from this experience?

I see a strong case for greater pre-crisis fiscal preparedness.

What do I have in mind?

For dealing with revenue shortfalls, preparedness could come through a revenue stabilization program, by which I mean a formula-driven, automatic stabilizer for state and local government revenues. The benefits of such a program would be threefold: it would reduce the uncertainties faced by state and local officials, it would reduce the odds that ad hoc assistance will wildly over- or under-shoot, and it would reduce the strains on Congress's bandwidth as it acts in the heat of a crisis.

For other dimensions of pandemic response, preparedness might involve a strengthening or broadening of mechanisms like the Disaster Relief Fund or other such funds.

The details of such measures are non-trivial, but enhancing our fiscal preparedness strikes me as being one of the most valuable steps we can take to improve policy responses in the face of future pandemics.

I'll look forward to discussing these issues in more detail if they come up later in the panel.

References

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