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Putting the Size of the Needed COVID-19 Fiscal Response in Perspective

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The severe and unprecedented size of the health, human, and economic crisis caused by COVID-19 should determine the size of the legislative response — not arbitrary dollar comparisons to stimulus in prior recessions, the level of debt, or the debt ratio. The United States has the fiscal space to take the action needed to address the health care needs, economic damage, and personal hardships from the COVID-19 crisis.

The costs of doing too little include lost wages, lost jobs, and lost work experience. The people most vulnerable to the adverse effects of recessions are those who already faced barriers to economic opportunity — including low-income workers and workers of color. The harm to these workers, together with the impact of business closures and lost investment, can damage the economy's future productivity. Doing too little to lessen these costs will slow the recovery and will likely cause the economic damage to be both greater and longer lasting.

The longer-run cost of an aggressive fiscal response is low; the United States has the fiscal space to act, as leading mainstream economists, including former Federal Reserve Chair Janet Yellen and former International Monetary Fund (IMF) Chief Economist Olivier Blanchard have pointed out. Harvard economist Gregory Mankiw, who served as a chairman of President George W. Bush's Council of Economic Advisers, has said, "There are times to worry about the growing government debt. This is not one of them." Similarly, Treasury Secretary Steven Mnuchin has noted that while the Administration is monitoring concerns about debt, "This is a war, and we need to win this war and we need to spend what it takes to win the war."[1]

A mistaken and premature turn toward fiscal austerity impeded the recovery from the Great Recession, and policymakers must avoid making the same mistake now. Reopening the economy has failed as a strategy to bolster household and state finances, and this strategy cannot justify a federal

[1] Richard Rubin, "Mnuchin Says 'We Need to Spend What It Takes' to Overcome Coronavirus Crisis," *Washington Post*, April 22, 2020, https://www.wsj.com/articles/mnuchin-says-we-need-to-spend-what-it-takes-to-overcome-coronavirus-crisis-11587565557?mod=searchresults&page=1&pos=1.

retreat on robust fiscal help for families and states.[2] Contrary to some earlier theories, there's no evidence that a certain ratio of debt to gross domestic product (GDP) precipitates a debt crisis. While the debt ratio can't grow forever without harming the nation, it can and *should* grow in an economic downturn to minimize human suffering and the threat to longer-term growth from a deep and protracted recession. Moreover, robust fiscal stimulus that boosts aggregate demand substantially will speed up the recovery and may thereby lessen the rise in the debt-to-GDP ratio over time, recent research finds. Thus, fighting the recession effectively is not likely to make the long-run fiscal challenge notably worse than doing too little now — and may actually be beneficial in that regard.

Fiscal Policy Response Now Should Match the Extraordinary and Unprecedented Need

The extraordinary scale of the COVID-19 economic crisis is already clear:

- **The pace at which the economy is declining indicates that this recession will be deeper than the Great Recession of 2007-09.** The Congressional Budget Office (CBO) projects a fall in GDP in the crisis that would produce a gap between actual economic output and CBO's January projection of potential GDP of 7.1 percent in 2020 and 5.3 percent in 2021, CBPP analysis finds.[3] That cumulative gap of 12.5 percentage points is substantially larger than the 7.5 percentage-point gap in 2008-2009, the first two years of the Great Recession. And the peak projected output gap of 11.6 percent in the second quarter of this year is nearly twice the peak quarterly Great Recession gap of 6.0 percent. CBO projects a more rapid initial rebound than occurred in the Great Recession, but there is considerable uncertainty about the economy's recovery path. (See Figure 1.)

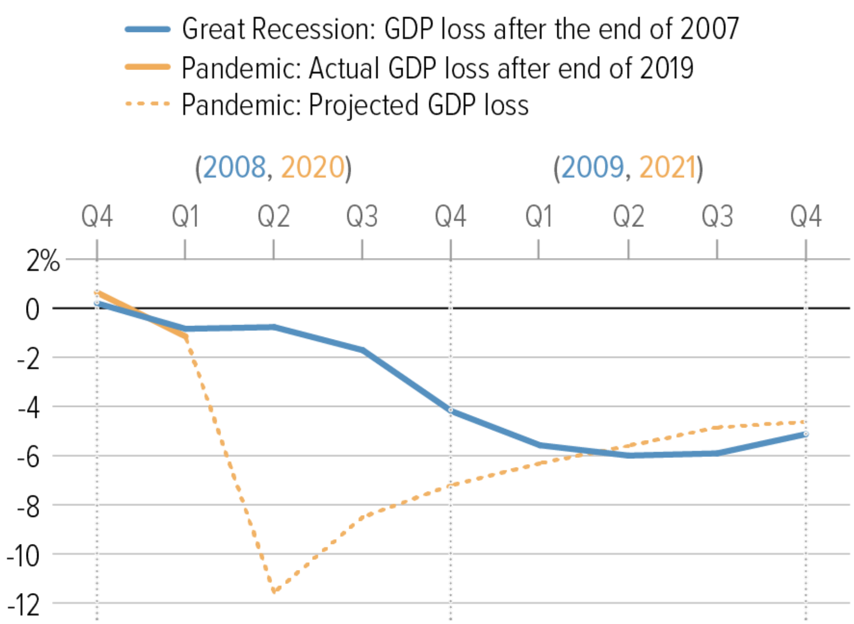
[2] Chye-Ching Huang and Chuck Marr, "Failed Reopenings Highlight Urgent Need to Build on Federal Fiscal Support for Households and States," Center on Budget and Policy Priorities, July 9, 2020, https://www.cbpp.org/research/federal-budget/failed-reopenings-highlight-urgent-need-to-build-on-federal-fiscal-support.

[3] CBPP analysis of Congressional Budget Office data. See "An Update to the Economic Outlook: 2020 to 2030," Congressional Budget Office, July 2, 2020, https://www.cbo.gov/publication/56442 and "The Budget and Economic Outlook: 2020 to 2030," Congressional Budget Office, January 28, 2020, https://www.cbo.gov/publication/56020.

FIGURE 1

Projected GDP Losses Due to COVID-19 Far Larger Than Losses in Great Recession

Percentage difference between potential and actual GDP



Note: GDP = Gross Domestic Product

Source: CBPP analysis of Congressional Budget Office data and Bureau of Economic Analysis data

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In addition, there are numerous other indications of extraordinary need. For example:

- **49 million people have applied for unemployment insurance since claims began to surge in March, including 1.4 million people in the week ending July 18 the nation has never seen anything close to that pace of job losses.**[4] By contrast, the number of people with a job fell by 8.3 million between the December 2007 start of the Great Recession and December 2009, when employment hit bottom.[5] CBO projects that the unemployment rate will average 10.6 percent over 2020 and still be at 7.6 percent by the end of 2021, even taking into account the significant relief that lawmakers have already enacted. *That would be the highest*

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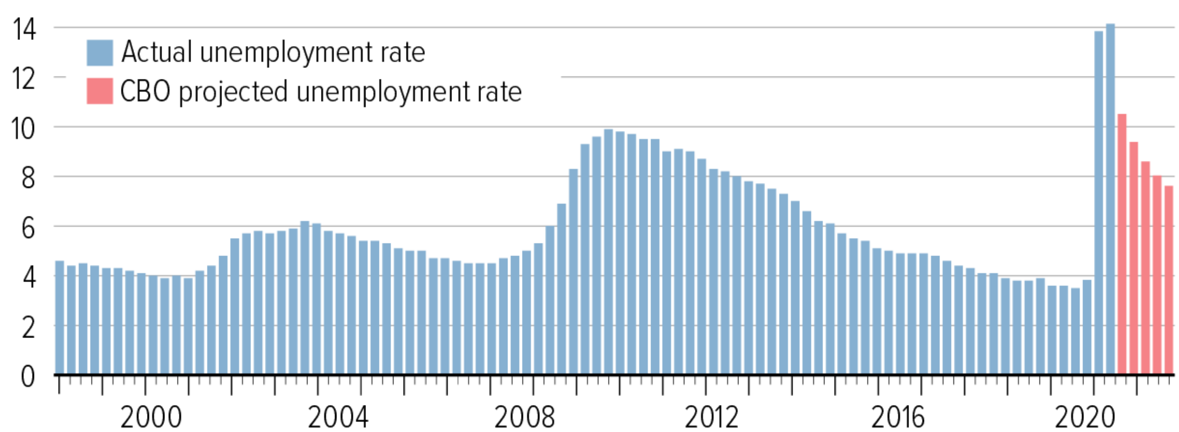
[4] These initial claims data do not account for the millions of initial claims filed for the Pandemic Unemployment Assistance program, a new program that provides jobless benefits to certain workers ineligible for regular state unemployment benefits. Before the several-million-per-week surge in initial claims for unemployment insurance that began in the week ending March 21, average weekly claims never exceed 700,000 in any four-week period in data back to 1967; in the 52 weeks before the surge, claims averaged 217,000 a week. Department of Labor, Employment and Training Administration data, https://oui.doleta.gov/unemploy/claims.asp.

[5] "Chart Book: The Legacy of the Great Recession," Center on Budget and Policy Priorities, June 6, 2019, https://www.cbpp.org/research/economy/chart-book-the-legacy-of-the-great-recession.

annual unemployment rate since the 1930s. And CBO projects that the unemployment rate could peak at 14.1 percent, significantly higher than the 10 percent peak in the Great Recession.[6] (See Figure 2.)

FIGURE 2

Unemployment Has Skyrocketed Due to COVID-19



Source: Actual: Bureau of Labor Statistics; Projected: Congressional Budget Office (CBO).

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- **States are on the brink of budget shortfalls that could be the largest on record — totaling $555 billion.**[7] States will face the greatest challenges addressing shortfalls in fiscal year 2021, which started on July 1 in most states. State budget shortfalls are expected to total $290 billion in fiscal year 2021. Over the state fiscal years 2020-2022, states face cumulative shortfalls of $555 billion (see Figure 3), against which they can readily apply only about $100 billion in federal fiscal relief provided to date and $75 billion in state reserves, leaving an unaddressed gap of nearly $400 billion.

  These estimates are for *state* budget shortfalls only; they do not reflect the additional shortfalls that local governments, territories, and tribes face. They also do not reflect the substantial new costs to states of addressing the pandemic. Nearly all states are prohibited from running deficits in their operating budgets, so without more federal help, they will be forced to make sharp cuts that will deepen and prolong the recession.

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[6] Congressional Budget Office, July 2, 2020, *op. cit.*

[7] Elizabeth McNichol and Michael Leachman, "States Continue to Face Large Shortfalls Due to COVID-19 Effects," CBPP, updated July 7, 2020, https://www.cbpp.org/research/state-budget-and-tax/states-continue-to-face-large-shortfalls-due-to-covid-19-effects.

FIGURE 3

COVID-19 State Budget Shortfalls Could Be Largest on Record

Total state budget shortfall in each fiscal year, in billions of 2020 dollars

* Estimated based on CBPP calculations

Source: Pre 2014: CBPP survey; 2020 and following: CBPP calculations

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- **The combination of a health crisis and recession means that maintaining states' ability to meet growing Medicaid costs without deep cuts in other services is vital.**[8] Millions of people are losing employer-provided health coverage and having their incomes shrink during the pandemic.

The Cost of Doing Too Little, Too Late Is High and Likely Unprecedented in Post-World War II Era

The harm from an inadequate response to the pandemic and the sharp economic contraction could be far more serious than in other recessions the country has faced in recent decades.

- **The harm from the COVID-19 recession may be more heavily concentrated on the people with the fewest resources than was the case in other recessions, intensifying the need to act to avoid deep and lasting hardship.** Immediate health impacts, including

[8] Judith Solomon, Jennifer Wagner, and Aviva Aron-Dine, "Medicaid Protections in Families First Act Critical to Protecting Health Coverage," Center on Budget and Policy Priorities, April 17, 2020, https://www.cbpp.org/research/health/medicaid-protections-in-families-first-act-critical-to-protecting-health-coverage.

deaths, look to be falling disproportionately on Black, Latino, and low-income Americans,[9] due in part to structural health inequities and residential location patterns, the emerging data indicate.[10] In addition, job losses to date appear to be more concentrated in low-paid service-sector jobs. As a result, this type of pandemic recession may have damaging effects that disproportionately affect low-income households to a greater degree than in previous downturns.[11] In addition to paying low wages, these low-wage service-sector jobs are disproportionately filled by Black, Latino, female, and immigrant workers.[12] That is also the case for workers who now remain at work on the front lines — at increased health risk — in jobs such as transportation, delivery, and growing, producing, and selling food and other basic supplies.

- **The fiscal response to the Great Recession, while substantial, was too small and ended too soon, mistakes important to keep in mind when comparing the size of the COVID-19 fiscal response to those in prior recessions**.[13] Although the substantial fiscal response to the Great Recession prevented an even more severe recession, it ended prematurely and was insufficient to promote a strong recovery. The protracted period of high unemployment and underemployment after the economy began growing again in June 2009 continued to cause hardship and impede long-term growth. In 2012, Christina Romer, then-Chair of the President's Council of Economic Advisers (CEA), acknowledged that the American Recovery and Reinvestment Act (ARRA) had been essential but was too small. Romer observed, "the fiscal stimulus will be viewed as an important step at a bleak moment in our history. Not the knockout punch the administration had hoped for, but a valuable effort that improved the lives of many."[14] This time, we should aim to deliver a knockout punch.
- **The scope for a conventional monetary policy response was lower heading into this recession and has already been tapped.** Interest rates heading into this crisis were already lower than they were in the two decades leading up to the Great Recession, and the Federal Reserve has essentially exhausted the room for cutting short-term interest rates to offset an

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[9] Craig Mauger and Christine MacDonald, "Michigan's COVID-19 cases, deaths hit blacks disproportionately," *Detroit News*, April 2, 2020, https://www.detroitnews.com/story/news/local/michigan/2020/04/02/michigans-covid-19-deaths-hit-417-cases-exceed-10-700/5113221002/.

[10] Samantha Artiga, Rachel Garfield, and Kendal Orgera, "Communities of Color at Higher Risk for Health and Economic Challenges due to COVID-19," Kaiser Family Foundation, April 7, 2020, https://www.kff.org/disparities-policy/issue-brief/communities-of-color-at-higher-risk-for-health-and-economic-challenges-due-to-covid-19/.

[11] Ana Danieli and Jane Olmstead-Rumsey, "Sector-Specific Shocks and the Expenditure Elasticity Channel During the COVID-19 Crisis," April 5 2020, https://drive.google.com/file/d/1VUx-Bhx02XdXsb7Oo4ZJTrqmoOgf2UIH/view. As Danieli and Olmstead-Rumsey set out in this paper, the intuition for why this may be the case has three parts. First, the immediate hit is to sectors that are disproportionately low wage; second, demand in those same sectors is very sensitive (elastic) to drops in overall income levels; and third, the workers directly affected, because they earn low incomes, are on average apt to spend a larger share of their income on the basics, so wage and job losses in these sectors translate relatively directly into reductions in spending in the broader economy.

[12] Pew Research Center, "Public views of the coronavirus's impact on the U.S.," March 26, 2020, https://www.people-press.org/2020/03/26/public-views-of-the-coronaviruss-impact-on-the-u-s/pp_2020-03-26_coronavirus-impact_1-04/.

[13] Chad Stone, "Fiscal Stimulus Needed to Fight Recessions: Lessons From the Great Recession," Center on Budget and Policy Priorities, April 16, 2020, https://www.cbpp.org/research/economy/fiscal-stimulus-needed-to-fight-recessions.

[14] Christina D. Romer, "The Fiscal Stimulus, Flawed but Valuable," *New York Times*, October 20, 2012, https://www.nytimes.com/2012/10/21/business/how-the-fiscal-stimulus-helped-and-could-have-done-more.html.

economic downturn and stimulate a recovery. While the Fed is using substantial unconventional measures to support economic activity and emergency measures to stabilize financial markets and ensure credit flows, strong fiscal measures are nevertheless essential to support economic activity and promote a strong recovery, and Federal Reserve Chair Jerome Powell has urged, "This is the time to use the great fiscal power of the United States to do what we can to support the economy and try to get through this with as little damage to the longer-run productive capacity of the economy as possible."[15]

- **The United States has relatively weak "automatic stabilizers," which means it must enact more discretionary fiscal relief/stimulus in a downturn.** Heading into this crisis, our automatic stabilizers — programs that cushion the effects of a slowing economy, such as unemployment insurance (UI), Medicaid, and SNAP — had significant holes in their coverage and modest benefit levels.[16] As a result, the United States must rely more heavily on new legislation providing discretionary fiscal relief.

Further, while some initial assessments of the pandemic's economic impact have focused on the disruption to supply chains,[17] such as the import of parts for manufacturing, such disruptions have rippled out into layoffs and deep declines in disposable income and demand for a broad range of goods and services. A strong fiscal response now can help people make ends meet and prevent consumption from falling even more deeply as the recession takes tighter hold. Getting resources to people facing financial hardship can help stop them from cutting back even more on necessities such as food, rent, utilities, and other essentials, or falling more deeply into financial crisis. Such relief should also put households in a better position to be able to spend on a broader range of goods and services when stay-at-home orders and social distancing guidelines are responsibly eased.[18]

U.S. Has Fiscal Space to Mount the Needed, Aggressive Fiscal Policy Response

[15] See Sylvan Lane, "Powell urges Congress to unleash 'great fiscal power' to defeat coronavirus, repair economy," *The Hill*, April 29, 2020, https://thehill.com/policy/finance/495320-powell-urges-congress-to-unleash-great-fiscal-power-to-defeat-coronavirus. See also "COVID-19 and the Economy," April, 9, 2020, https://www.federalreserve.gov/newsevents/speech/powell20200409a.htm, where Powell says, "I would stress that these are lending powers, not spending powers. The Fed is not authorized to grant money to particular beneficiaries. The Fed can only make secured loans to solvent entities with the expectation that the loans will be fully repaid. In the situation we face today, many borrowers will benefit from these programs, as will the overall economy. But there will also be entities of various kinds that need direct fiscal support rather than a loan they would struggle to repay."

[16] Vivien Lee and Louise Sheiner, "What are automatic stabilizers?" Brookings, July 2, 2019, https://www.brookings.edu/blog/up-front/2019/07/02/what-are-automatic-stabilizers/.

[17] "Global Credit Conditions: COVID-19's Darkening Shadow," S&P Global Ratings, March 3, 2020, https://www.standardandpoors.com/pt_LA/delegate/getPDF?articleId=2391629&type=COMMENTS&subType=.

[18] Gillian Brunet, "5 lessons from World War II for the coronavirus response," Vox, April 10, 2020, https://www.vox.com/2020/4/10/21214980/coronavirus-economy-jobs-ppe.

The mainstream economic view now is that debt worries should not inhibit the response to the recession and that the United States has sufficient fiscal space to do so (i.e., room to increase deficits and debt without debt holders losing confidence and provoking a debt crisis).[19]

- Former Federal Reserve Chair **Janet Yellen** stated earlier this year, "Even under current conditions, I think we can afford to … stimulate the economy if there's a downturn." She further added, "Chronic low interest rates create additional fiscal space."[20]
- Former CEA chair **Jason Furman** found that in the aftermath of the Great Recession, "the tide of expert opinion" among policy-oriented economists and international institutions such as the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development had shifted to the view that "fiscal stimulus is less constrained by fiscal space than previously appreciated."[21]
- The current CBO Director, **Phillip Swagel,** stated last year, "when there's a financial crisis and a recession … countries that respond with expansionary policy do better. And it looks like the United States has the fiscal space to do that. … Interest rates are low. The federal government is able to borrow. So [the debt situation] is not an immediate crisis. … It's a long-term challenge."[22]
- Similarly, former CBO Director **Douglas Elmendorf** wrote in the *Washington Post* last year, "Yes, we have a serious long-term debt problem, but no, that problem does not make anti-recessionary budget policy impossible or unwise." He noted, "Federal borrowing is thus less costly and creates less risk for the federal government than many of us predicted several years ago — and, according to economic analyses, does less harm to the economy even in the long run. … In sum, we have plenty of capacity in the federal budget to undertake vigorous countercyclical tax and spending policies when the next recession arrives. Given the economic and social costs of recessions, we should undertake such policies."[23]
- Former CEA Chair **Greg Mankiw** said in mid-March that, "There are times to worry about the growing government debt. This is not one of them."[24]

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[19] Heather Boushey *et al.*, "Commentary: Deficit and Debt Shouldn't Factor Into Coronavirus Recession Response," Center on Budget and Policy Priorities, March 19, 2020, https://www.cbpp.org/research/economy/commentary-deficit-and-debt-shouldnt-factor-into-coronavirus-recession-response.

[20] Heather Long, "Economists increasingly say it's acceptable for the U.S. to take on more debt — for the right reasons," *Washington Post*, January 14, 2020, https://www.washingtonpost.com/business/2020/01/14/economists-increasingly-say-its-ok-united-states-take-more-debt-right-reasons/.

[21] Jason Furman, "The New View of Fiscal Policy and Its Application," October 5, 2016, https://obamawhitehouse.archives.gov/sites/default/files/page/files/20161011_furman_suerf_fiscal_policy_cea.pdf.

[22] NPR, "CBO Predicts Budget Deficit Will Reach Nearly $1 Trillion This Year," August 22, 2019, https://www.npr.org/2019/08/22/753355117/cbo-predicts-budget-deficit-will-reach-nearly-1-trillion-this-year.

[23] Douglas Elmendorf, "Yes, we still have the fiscal capacity to deal with a recession," *Washington Post*, September 3, 2019, https://www.washingtonpost.com/opinions/yes-we-still-have-the-fiscal-capacity-to-deal-with-a-recession/2019/09/03/2f5081b4-c8f0-11e9-a4f3-c081a126de70_story.html.

[24] Greg Mankiw, "Thoughts on the Pandemic," Greg Mankiw's Blog, March 13, 2020, http://gregmankiw.blogspot.com/2020/03/thoughts-on-pandemic.html.

- In April, in response to a question about the impact of countries' "huge increase in deficits and debt," the IMF's Chief Economist, **Gina Gopinath**, said "[…]this crisis is a truly exogenous shock and it calls for countries to step up and do the needed spending that's required in the health sector, for firms, for people. So those deficits are called for. What would this look like going forward? A lot again depends on the interest rates at which countries are borrowing and the interest rates at which they would have to roll over."[25]
- Former IMF Chief Economist **Olivier Blanchard** noted in March that he had written before the COVID-19 crisis that "low safe interest rates implied not only that higher levels of debt were sustainable but also that the welfare cost of higher debt for future generations was small." Now Blanchard concludes that "safe interest rates are likely to be even lower in the future than they were expected to be before the COVID-19 crisis" and that governments should do "whatever it takes" — that is, "spending as much as needed to fight the virus and to avoid hunger and bankruptcies. Being ready and committed to spend more if demand does not pick up, but keeping options open. And, at least for advanced economies, not worrying about the resulting increase in debt."[26]
- Former CBO Director **Douglas Holtz-Eakin** said in late April, "I'm a fiscal hawk from way back, and all of my heebie-jeebies are going off when I see these numbers … but then I look at the scale of the problem, and I think, yeah, that's that. Gotta do it.… One way or another, you pay a price.… But if you take care of the budget at the expense of the economy, you're making a mistake."[27]

Even Trump Administration Secretary Treasury Mnuchin, responding to questions about Senate Majority Leader Mitch McConnell's citing debt as a "matter of genuine concern," noted that while the Administration is monitoring debt levels, "[T]he good news is, interest rates are very low, so the cost of carrying the debt to the American taxpayer is quite low. But I think we're all sensitive to that this is a war and we need to win this war and we need to spend what it takes to win the war."[28]

The United States has fiscal space to respond to the current crisis because:

- **Interest rates have been historically low in recent years — and are expected to remain so for years to come,** even as the debt has risen. Since 2001, the debt-to-GDP ratio has increased, but interest rates have fallen and are expected to remain quite low.[29] Indeed, due to

[25] Gita Gopinath, "Press Briefing: World Economic Outlook," International Monetary Fund, April 14, 2020, https://www.imf.org/en/News/Articles/2020/04/14/tr041420-transcript-of-april-2020-world-economic-outlook-press-briefing

[26] Olivier Blanchard, "'Whatever it takes.' Getting into the specifics of fiscal policy to fight COVID-19," Peterson Institute for International Economics, March 30, 2020, https://www.piie.com/blogs/realtime-economic-issues-watch/whatever-it-takes-getting-specifics-fiscal-policy-fight-covid.

[27] Victoria Guida and Marianne LeVine, "Economists urge Republicans to ignore the deficit," *Politico,* April 28, 2020, https://www.politico.com/news/2020/04/29/economists-urge-republicans-ignore-deficit-216491.

[28] Rubin, *op. cit.*

[29] Long-term real interest rates on government debt have fallen in recent decades. For example, real interest rates on ten-year government bonds averaged 0.8 percent in 2018, compared to 4.3 percent in 2000. Structural factors such as lower

both aggressive monetary policy from the Fed and weak global demand amid the current crisis, real interest rates are negative now and are expected to remain quite low for the foreseeable future.[30] This reduces the significance and potential adverse effects of government debt, because of the considerably lower cost of servicing it. Low interest rates also indicate that a growing debt is not overheating the economy or crowding out private-sector investment that could raise future productivity and incomes.

- **The Great Recession led to a better understanding of the high costs of recessions,** including the damage to economic capacity due to the harm to investment and workers' productivity.[31]
- **A mistaken and premature turn toward fiscal austerity in 2010-2011, when concerns about budget deficits and debt led policymakers to refrain from adopting further needed stimulus, impeded the recovery after the Great Recession.** Congressional opposition to continuing fiscal stimulus to promote a stronger recovery was fueled by the emergence of small-government Tea Party sentiments, since-discredited academic claims that levels of debt beyond a 90-percent-of-GDP threshold damaged growth, and a belief among some that cutting government spending in a recession would actually increase growth, despite the overwhelming evidence that cutting spending or raising taxes in a recession is contractionary.

Concerns About Deficits and Debt Should Not Impede Necessary Actions During Recessions, Especially During the Current Severe Downturn

When assessing how fiscal stimulus affect deficits and debt, lawmakers should consider that:[32]

- **The *dollar* amount of federal debt has little meaning by itself. Debt should be measured relative to the size of the nation's economy**, by looking at the ratio of debt to GDP (i.e., debt as a percentage of GDP) because it accounts for factors that heavily affect the nation's ability to handle debt, such as inflation, population growth, and productivity growth.
- **There is no evidence of any "magic number" for the debt-to-GDP ratio that would precipitate a debt crisis or damage growth.** As noted above, earlier academic research purporting to show that levels of debt beyond a 90-percent-of-GDP threshold produce significant economic damage has been soundly discredited. There is no evidence for any

investment demand, higher savings rates, and growing inequality have contributed to these lower rates. See Jason Furman and Lawrence H. Summers, "Who's Afraid of Budget Deficits?" *Foreign Affairs*, March/April 2019, https://www.foreignaffairs.com/articles/2019-01-27/whos-afraid-budget-deficits.

[30] Gertrude Chavez-Dreyfuss, "Yields on U.S. 10-year, 5-year TIPS turn negative as virus fears mount," Reuters, January 27, 2020, https://www.reuters.com/article/usa-bonds-tips/yields-on-u-s-10-year-5-year-tips-turn-negative-as-virus-fears-mount-idUSL1N29W1OA.

[31] See Mai Dao and Prakash Loungani, "The Human Cost of Recessions: Assessing It, Reducing It," International Monetary Fund, November 11, 2010, https://www.imf.org/en/Publications/IMF-Staff-Position-Notes/Issues/2016/12/31/The-Human-Cost-of-Recessions-Assessing-It-Reducing-It-24221 and Laurence Ball, "The Great Recession's long-term damage," Vox, July 1, 2014, https://voxeu.org/article/great-recession-s-long-term-damage.

[32] Richard Kogan and Paul Van de Water, "Rising Federal Debt Should Not Shortchange Response to COVID-19 Crisis," Center on Budget and Policy Priorities, May 21, 2020, https://www.cbpp.org/research/federal-budget/rising-federal-debt-should-not-shortchange-response-to-covid-19-crisis.

particular threshold, tipping point, or bright line between safe and unsafe levels of debt.[33] The debt-to-GDP ratio is likely to reach, and then exceed, 100 percent in the period ahead, but that threshold has no substantive policy significance.

- **The United States faces long-term fiscal challenges,[34] but deficit and debt concerns should go on the back burner in a recession.** The debt ratio can't grow forever without harming the nation, and the government already faced a long-term debt challenge before COVID-19 hit. But the debt ratio can and *should* grow in a downturn to minimize human suffering and the threat to longer-term growth from a deep and protracted recession.

- **Robust fiscal stimulus that boosts aggregate demand substantially in a low-interest-rate, high-unemployment economy will produce larger *immediate* budget deficits than lesser stimulus, but it will also speed the recovery and thus may ultimately slow the rise in the debt-to-GDP ratio**, recent research indicates. While well-designed fiscal stimulus will increase immediate budget deficits, it will put the economy on a higher recovery growth path, and the additional GDP will mean more revenues and less spending on safety net programs than if lawmakers had enacted less (or no) stimulus. Both of these factors will limit the growth in the debt ratio. With very low interest rates, the interest burden of the debt also grows more slowly than GDP. In some circumstances, the debt-to-GDP ratio may eventually be lower than it would be under less stimulative policies.

  Economists Alan Auerbach and Yuriy Gorodnichenko provide the following evidence in a recent study:[35]

  > For a sample of developed countries, we find that government spending shocks do not lead to persistent increases in debt-to-GDP ratios or costs of borrowing, especially during periods of economic weakness. Indeed, fiscal stimulus in a weak economy can improve fiscal sustainability along the metrics we study. Even in countries with high public debt, the penalty for activist discretionary fiscal policy appears to be small.

  Various other analyses reach similar results, including those that incorporate the effects of stimulus in helping to avoid the long-lasting erosion of labor force participation and productivity (hysteresis) that a deep, prolonged recession can cause, as Jason Furman recounts in his commentary on the Auerbach-Gorodnichenko analysis.[36]

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[33] Chad Stone, "From a Deficit to a Surplus and Back Again," *US News & World Report*, April 25, 2013, https://www.usnews.com/opinion/blogs/economic-intelligence/2013/04/25/debt-economic-growth-relationship; Chad Stone, "International Evidence Provides Poor Guide for U.S. Budget Policy," Center on Budget and Policy Priorities, March 21, 2011, https://www.cbpp.org/blog/international-evidence-provides-poor-guide-for-us-budget-policy; Andrea Pescatori, Damiano Sandri, and John Simon, "Debt and Growth: Is There a Magic Threshold?" International Monetary Fund, February 2014, https://www.imf.org/external/pubs/ft/wp/2014/wp1434.pdf.

[34] Richard Kogan, Paul N. Van de Water, and Kathleen Bryant, "Long-Term Budget Outlook Has Improved Substantially Since 2010 But Remains Challenging," Center on Budget and Policy Priorities, October 10, 2019, https://www.cbpp.org/research/federal-budget/long-term-budget-outlook-has-improved-substantially-since-2010-but-remains.

[35] Alan J. Auerbach and Yuriy Gorodnichenko, "Fiscal Stimulus and Fiscal Sustainability," Federal Reserve Bank of Kansas City, August 29, 2017, https://www.kansascityfed.org/~/media/files/publicat/sympos/2017/auerbach-gorodnichenko-paper.pdf?la=en.

[36] Jason Furman, "Commentary: Fiscal Stimulus and Fiscal Sustainability," Federal Reserve Bank of Kansas City, 2017, https://www.kansascityfed.org/~/media/files/publicat/sympos/2017/2017furman.pdf?la=en.

- **Thus, while fighting the recession with the resources needed will result in a large, one-time jump in the debt ratio, it may not substantially increase the long-run fiscal challenge.** A common key goal for long-run fiscal sustainability is to put the debt ratio on a stable path, which means not having debt rise ever upwards relative to the economy. Effective stimulus that shifts the *level* of debt upward need not make it more difficult to achieve a stable debt ratio; indeed, as explained above, effective stimulus may even *reduce* the long-run rise in the debt ratio and the cost of financing debt, compared with what they would be if lawmakers enacted considerably less stimulus. The latest research indicates that when interest rates are low relative to the economy's growth rate, the *level* of the debt poses little or no threat to sustainability (so long as the government pursues policies that meet national needs and have value), and hence the pre-crisis debt level may not be the appropriate target around which to stabilize.
- **Taking strong, effective steps to prevent a deep and protracted recession from taking hold should improve the country's health and well-being substantially in ways that GDP does not measure.** This could be especially true of steps that save human lives and make the nation more resilient to future pandemics and other shocks that would otherwise cause hardship. GDP measures only the economy's output of goods and services without reflecting other measures of well-being, like changes in health status or environmental quality.