

## RESEARCH SUMMARY

# A Fiscal Accounting of COVID Inflation

---

US inflation surged in 2021 and remains higher than the Federal Reserve’s target rate. To explain the rise, economic analysts have cited a range of factors. But in “A Fiscal Accounting of COVID Inflation,” Joe Anderson and Eric M. Leeper focus on a single cause: a large increase in federal COVID-related spending financed by new government borrowing, with little to no discussion of how ultimately to pay for the spending.

### **BLAMING THE USUAL SUSPECTS**

Between 2019Q4 and 2023Q2, federal COVID-related spending totaled \$5 trillion. Government communications about the new spending focused on its emergency nature, which emphasized that this spending was different: It would not be offset by higher taxes or cuts in other spending. And when inflation began its upward march in 2021, commentators seeking to identify culprits lined up the usual suspects:

- overheated markets
- supply-chain disruptions
- shifts in consumer demand from services to goods
- food and energy price rises
- excessive corporate profits
- price gouging (a perennial favorite)

Many of these candidates affected the evolution of this inflation. But none caused it.

According to views put forth by Federal Reserve policymakers, prominent macroeconomists, and economic journalists, a country’s central bank can always handle inflation on its own. This way of thinking ignores the effects of fiscal policy. To fully understand cause and effect, we must examine the intricate interplay of fiscal and monetary policies in shaping this inflation episode.

### **UNDERSTANDING FISCAL POLICY’S ROLE IN INFLATION**

To make their case, Anderson and Leeper draw on the fiscal theory of the price level, which

1. offers a perspective on COVID inflation that differs starkly from the conventional view,
2. springs from the uncontentious premise that government debt derives its value in large part from how people expect the debt will be repaid, and
3. underscores the need to bring both monetary and fiscal policy into any examination of inflation.

## KEY TAKEAWAY

COVID-related spending led to increased consumer expenditures, a swift recovery, and ensuing inflation. If the COVID spending bills had included legislation that adjusts taxes or other spending to pay for COVID relief, then we would not have seen such a substantial rise in inflation.

The problem is not one the Fed can fix on its own. If fiscal policy continues to refrain from raising revenues or reducing spending and the Fed continues to combat above-target inflation with ever-increasing interest rates, there is little reason to expect inflation will return to pre-pandemic levels.