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Fiscal Stimulus in the COVID-19 Era: Legacy of the American Rescue Plan

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Abstract

This paper examined the effectiveness of fiscal stimulus measures enacted by the United States federal government on the recovery from the COVID-19 recession, with a focus on the American Rescue Plan Act of 2021. Despite substantial existing analysis, a gap remains regarding the long-term effectiveness of the American Rescue Plan in achieving its goal of an equitable economic recovery. To address this, the study evaluated the American Rescue Plan's short-term and long-term impact on low-income households nationwide through a synthesized dataset of poverty, inflation, interest rates, and inflation inequality. The findings revealed that although the American Rescue Plan alleviated short-term burdens, it also had long-term consequences, including high inflation and elevated interest rates, that make it increasingly difficult for low-income families to accumulate wealth. Given the ongoing debates over the appropriate magnitude and timing of federal economic intervention, this paper points to the potential for well-meaning fiscal stimulus policies to exacerbate economic inequality in the United States and amplify the burdens of poverty.

Keywords: Fiscal stimulus, American Rescue Plan Act of 2021, Economic recovery, Inflation, Low-income households

1. Introduction

As the COVID-19 pandemic swept across the globe in the early months of 2020, it disrupted economies worldwide and triggered many countries to enter a recession. By February 2020, the United States had experienced a sharp and severe economic downturn. Various industries collapsed due to government lockdowns and public fear of getting infected by the rapidly spreading virus. In response, the federal government adopted multiple stimulus packages to revive the economy. President Joe Biden's administration passed the sixth and final stimulus package, the American Rescue Plan Act of 2021 (ARP). The ARP was and still is highly controversial. It was incredibly valuable in temporarily achieving a more equitable recovery from the pandemic. However, these gains are tempered by its inflationary impact, which disproportionately affects low-income families. Overall, this paper showed that the negative impacts on poverty in the medium- to long-term overshadow the short-term benefits of the ARP.

2. Methodology

This paper used primary source data on several key statistics. These include: the national unemployment rate from the Bureau of Labor Statistics; poverty rate from Columbia University's Center on Poverty and Social Policy; federal funds rate from the Federal Reserve Bank of St. Louis; Consumer Price Index, which measures inflation, from the U.S. Bureau of Labor Statistics; and 10-year Treasury yield from the Federal Reserve Bank of St. Louis. The data were graphed to evaluate trends between inflation, interest rate, and bond yield.

Additionally, this paper used inflation projections from various economic models. There were limitations in finding models that singled out the effect of the ARP versus a cumulative effect from the stimulus packages. Given their close timing, it is difficult to precisely quantify a percentage increase in inflation from the ARP.

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3. Overview of Stimulus Packages

3.1 Purpose of Stimulus Packages

Stimulus packages are discretionary fiscal policies designed to reduce the severity of a recession by boosting aggregate demand, theoretically putting the economy back at long-run equilibrium. These packages consist of a variety of government actions that increase government spending and cut taxes. This includes industry bailouts, which are targeted at individual companies or industries; tax incentives, which reduce the final amount of taxes people owe; stimulus checks, which are payments given directly to individuals; and supplemental unemployment insurance benefits (Curry, 2022).

Generally, stimulus packages aim to achieve two policy objectives. The first is to offer immediate aid, given the severe human cost of an economic crisis. Recessions are associated with spikes in unemployment, which can result in a loss of lifetime earnings, physical and mental health repercussions, worker discouragement, and more. Therefore, it is crucial for stimulus packages to include programs that directly increase a household's disposable income, such as by creating and preserving jobs in specific sectors of the economy. Second, as the name suggests, stimulus packages aim to stimulate and stabilize the economy. This helps keep recessions as short and as shallow as possible, since long-term damage can persist across generations by reducing educational achievement, investment, the creation of small businesses, and more (*Economic Scarring*, 2009).

However, these outcomes of stimulus packages are not guaranteed. Economics is often considered to be somewhere between an art and a science. Therefore, there is no exact formula behind a stimulus package. Although these packages are designed with specific goals in mind, they are also incredibly nuanced and complex. It is impossible to predict all the different variables that can affect the result of a stimulus package. For instance, stimulus packages are only one of the many tools that can be used to influence the economy. The central bank of the United States, the Federal Reserve (commonly referred to as the Fed), often conducts monetary policy as well. The Federal Reserve's objectives are to control inflation and keep employment high (Mathai, n.d.). Monetary policy is almost always combined with fiscal policy, which adds to the uncertainties surrounding the potential effects of a stimulus package.

3.2 Historical Use of Fiscal Stimulus in the United States

Prior to COVID-19, there was a relatively short history surrounding the strategic use of fiscal stimulus in the United States. The most well-known examples of these policies lifting the American economy were during two of the most severe recessions, the Great Depression and the Great Recession.

The key precedent of using the fiscal power of the federal government to regulate and stimulate the nation's economy was born during the Great Depression. During the worst economic crisis in American history, President Franklin D. Roosevelt launched a series of programs collectively known as the New Deal. Though not labeled as stimulus packages at the time, the New Deal included many temporary programs that aimed to revive a sense of hope in ordinary Americans and improve their well-being through immediate relief. For example, the Civil Works Administration and the Civilian Conservation Corps provided jobs for the unemployed, and the Federal Emergency Relief Administration provided aid to state and local governments (New Deal, n.d.). The Roosevelt administration spent $41.7 billion on the New Deal, which adjusts to about $793 billion in today's dollars (Dupor, 2021). To this day, the impact of the New Deal persists and has set the groundwork for contemporary fiscal policies.

Another important example of government intervention in the economy was by President Barack Obama during the Great Recession. The Great Recession began in December 2007 when the U.S. housing bubble burst due to a failure of government policies to regulate the financial industry. In response, Obama adopted the American Recovery and Reinvestment Act of 2009. This stimulus package aimed to preserve and create millions of jobs by targeting public infrastructure, healthcare, education, and tax relief ("American Recovery," n.d.). Although the Great Recession officially ended in June 2009, the economy did not return to pre-recession conditions until several years later due to fiscal efforts ending too soon (Bivens, 2016).

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3.3 Stimulus Packages During COVID-19

The COVID-19 pandemic led to the most widespread use of stimulus packages. The virus was first detected in the U.S. in January 2020. By February, it had sparked the worst global economic crisis since the Great Depression and was far deeper than the Great Recession (*Chart Book*, 2024). Demand for goods and services plummeted as people increasingly stayed inside, both voluntarily and due to governmental mandates. Many Americans lost their jobs, and government restrictions decreased the supply of goods and services that could be produced. Even after supply increased due to changes in public health restrictions, demand remained low (*Policy Basics*, 2020).

To alleviate the burden of the pandemic, the Trump and Biden administrations adopted six stimulus packages between March 2020 and 2021. This succession of packages allowed the government to adapt its response as the circumstances surrounding the pandemic evolved. Many of the stimulus packages funded similar objectives, including the research, development, and distribution of COVID-19 vaccines and testing, the Supplemental Nutrition Assistance Program (SNAP), small business relief through loans and the Paycheck Protection Program (PPP), additional unemployment insurance benefits, direct payments, rent assistance, and education.

The first five packages were all adopted in 2020 by the Trump administration. The third package, the Coronavirus Aid, Relief, and Economic Security (CARES) Act, was the largest and totaled $2.1 trillion. It consisted of a one-time direct payment (which were known as Economic Impact Payments) of $1200 per adult and $500 per child (LaBrecque, 2020). The fifth package, the Consolidated Appropriations Act, was adopted in late December 2020 and totaled $900 billion. It included a direct payment of $600 per person to individuals making less than $75,000 per year. The sixth and final package was the American Rescue Plan Act of 2021 adopted under the Biden administration, which totaled $1.9 trillion. President Biden signed the ARP into law on March 11, 2021, about three months after the Consolidated Appropriations Act.

The key aspects of the ARP are summarized below (American Rescue, 2021):

- Economic Impact Payments of $1,400 per person, including children, for individuals making up to $75,000 and married couples making up to $150,000: totaled $413.6 billion
- Funding to state and local governments: totaled $350 billion
- Additional unemployment insurance benefits, including a supplement of $300 per week: totaled $242.4 billion
- Education: totaled $170.5 billion
- Increased Child Tax Credit from $2000 to $3000 per child and $3600 for children under 6: totaled $88.49 billion
- Childcare: totaled $43.09 billion
- 15% increase to Supplemental Nutrition Assistance Program (SNAP) benefits

4. Results

4.1 Short-Term Impacts of the ARP

The ARP was highly beneficial to short-term recovery. In the early months of the pandemic, the unemployment rate shot up to as high as 14.7% (*Unemployment Rate*, 2020). By March 2021, it had fallen to 6.1%. Then, the ARP created 12 million jobs, reducing unemployment to 3.6% in 2022 (*The American*, 2023).

Before the ARP passed, six to ten million children had not eaten enough in the last seven days because their families were unable to afford enough food. Before the pandemic, this number was one million children (Johnson & Jackson, 2021). A study from Columbia University's Center on Poverty & Social Policy projected that the ARP would result in 5.5 million fewer children in poverty (Parolin et al., n.d.). The ARP successfully cut child poverty almost in half to 5.2%, its lowest rate in U.S. history (*The American*, 2023). Four main components of the ARP reduced the poverty rate: unemployment insurance benefits, SNAP benefits, Economic Impact Payments, and the child tax credit. Of these four, the Economic Impact Payments had the most significant effect. The Urban Institute estimated that, by itself, direct payments cut poverty from 13.7% to 10.2%. The four policies combined cut poverty from 13.7% to 8.7% (Wheaton et al., n.d.). During the pandemic, the Census Bureau's Household Pulse Survey asked various questions to

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gauge material hardship and mental health. In the survey periods immediately following the delivery of Economic Impact Payments, food insufficiency and financial instability fell sharply (Cooney & Shaefer, n.d.). Adverse mental health symptoms fell and didn't increase.

The ARP also addressed the devastating impact of COVID-19 on education, particularly for students of color. It tackled this learning loss by providing $123 billion in funding for 16,000 school districts across the nation (Johnson & Jackson, 2021).

4.2 Medium to Long-Term Impacts of the ARP

The longer-term effects of the ARP on low-income households are less clear. Shortly after recipients spent their Economic Impact Payments, food insufficiency, financial instability, and housing hardship all increased (Cooney & Shaefer, n.d.). Then, when the expanded child tax credit expired at the end of 2021, the child poverty rate increased from 12.1% in December 2021 to 17% in January 2022 and 16.7% in February, meaning 3.4 million more children lived in poverty. This includes an increase of 28% (600,000) Black children and 40% (1.25 million) Latino children.

In February 2021, the Congressional Budget Office had estimated that the economy was approximately $700 billion below potential through 2023, given an already stronger than expected recovery (*How Much*, 2021). The ARP was approximately three times larger than this amount, leading to concern over inflationary pressures. An analysis from the Brookings Institution projected that the ARP would boost output by $1.5 trillion, enough to close nearly 225 percent of the gap (Edelberg & Sheiner, 2021). The prices of goods and services reflected these worries that many had raised. In May 2022, prices had increased by 8.6% compared to one year prior (Bureau of Labor Statistics, n.d.).

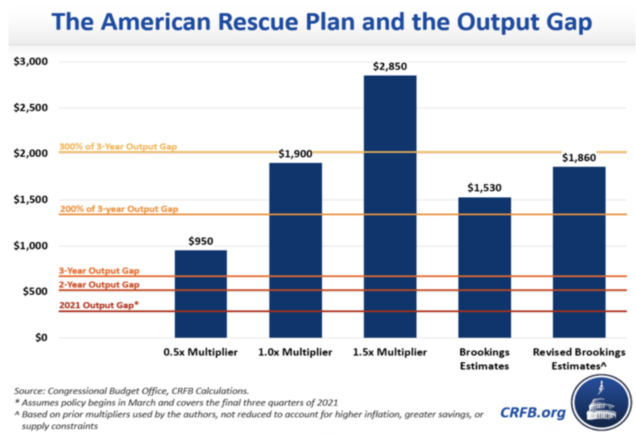

Figure 1. Comparison between the output gap in the economy before the ARP passed and projected economic growth from the ARP (*How Much*, 2021).

The Federal Reserve Bank of San Francisco estimated that fiscal stimulus contributed to three percentage points of inflation by the end of 2021 (Jordà et al., n.d.). Their study compared U.S. core inflation with the average inflation in nine Organization for Economic Cooperation and Development (OECD) nations (Canada, Denmark, Finland, France, Germany, Netherlands, Norway, Sweden, and the United Kingdom). Core inflation excludes food and energy prices, which tend to fluctuate more. Historically, inflation rates in the U.S. and the OECD nations have remained similar. However, in 2021, the U.S. core CPI increased from below 2% to above 4%. In contrast, the average OECD core CPI increased from 1% to 2.5%. Compared to the OECD countries, the U.S. also pumped more money into the economy through its stimulus packages. Similarly, another study from the Federal Reserve Bank of St. Louis found that fiscal stimulus contributed to 2.6 percentage points of inflation (de Soyres et al., n.d.).

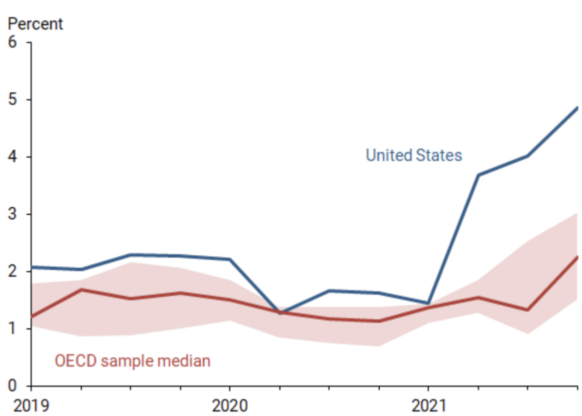

Figure 2. Comparison between core inflation in the United States vs. in OECD countries (Jordà et al., n.d.).

Although inflation poses an issue for most households in the U.S., it is particularly worrisome for low-income households, who are the hardest hit. According to the Household Pulse Survey, families

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with incomes between $25,000 and $35,000 were 19.3% more likely to be very stressed by inflation than those with incomes between $75,000 and $100,000.

In January 2023, food costs had increased by 10.6%, gasoline by 10.1%, rent by 7.9%, and health services by 4.4% (Jayashankar & Murphy, n.d.). Meanwhile, households with incomes below $20,000 only saw their income increase by about one-third of their cost of living (*Did Wages*, n.d.). Although these individuals had the fastest growth in earnings per hour, they experienced this growth starting from a much lower wage. As a result, their purchasing power remained limited. Low-income families already spend most of their income on necessities like food, gas, and rent, which have higher-than-average inflation rates. Often, these families cannot find cheaper substitutes when they are already buying the least expensive items, which results in fewer ways to reduce spending.

These rising prices triggered the Federal Reserve's attempts to fight inflation through monetary policy. Although the Federal Reserve often works in tandem with the federal government to regulate the economy, it has independent authority. By raising the federal funds rate, a short-term interest rate, they aimed to return inflation to its target of 2%. Starting in March 2022, the federal funds rate was raised from 0-0.25% to 5.25-5.5% over nearly two years. Figure 3 shifts the inflation rate back 6 months, 12 months, 18 months, and 24 months to show this delayed reaction by the Federal Reserve. The strongest correlation between inflation and the federal funds rate occurs after lagging inflation rates by approximately 16 months.

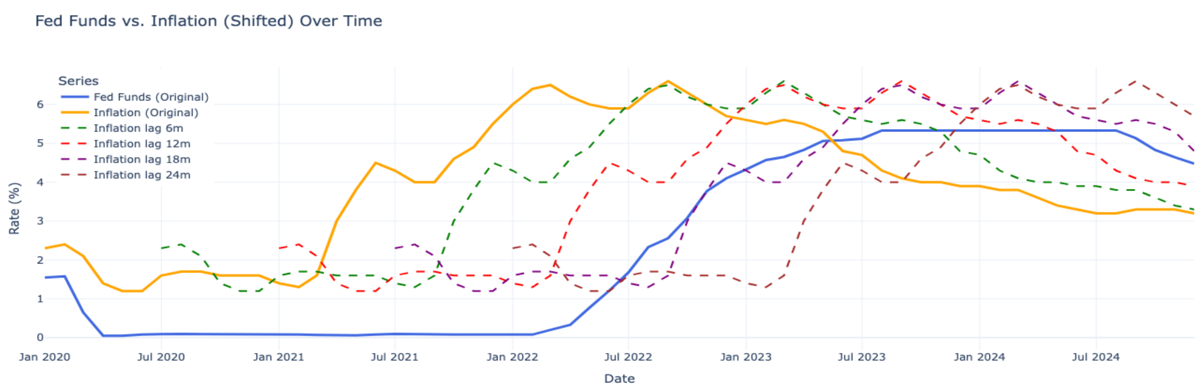

Figure 3. Graph of lagged inflation rate and the federal funds rate.

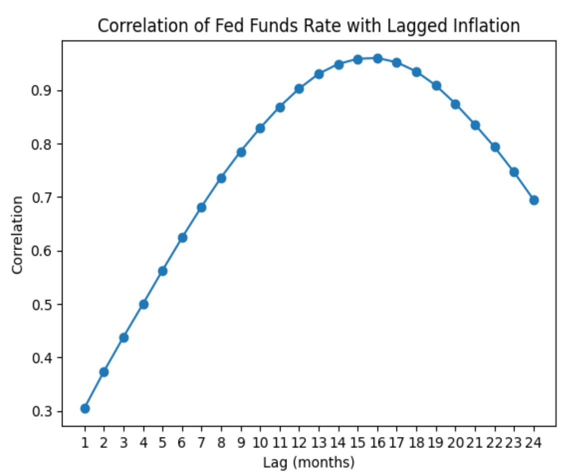

Figure 4. Correlation between lagged inflation and federal funds rate.

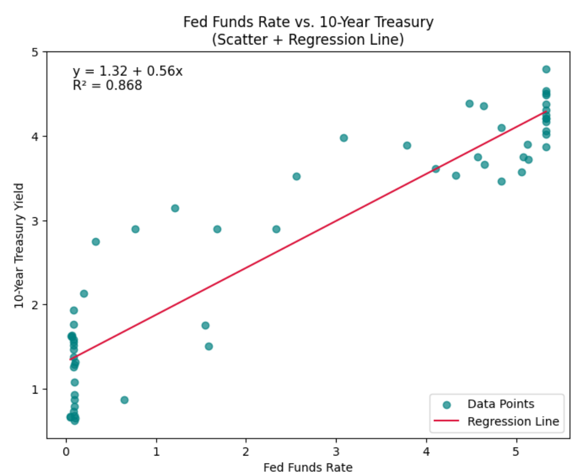

Figure 5. Linear regression of federal funds rate vs. 10-year treasury yield.

Increases to the federal funds rate often result in a rise in other interest rates, particularly short-term interest rates, which directly impact Americans (Hopper, 2022). Figure 5 shows the relationship between the federal funds rate and the 10-year Treasury yield, which serves as a benchmark for mortgage rates. Although mortgage rates are long-term interest rates, changes to the federal funds rate can affect market expectations and therefore the 10-year Treasury yield, though it is less directly impacted compared to other interest rates.

5. Discussion

5.1 Analysis of Short-Term Effects

In the short term, the massive influx of money from the ARP positively impacted Americans immediately. One of the package's most remarkable goals was to foster an equitable recovery from the pandemic by prioritizing relief to lower-income families. More than two-thirds of the ARP's direct payments and tax credits were targeted toward families making less than $90,000 (*American Rescue*, n.d.). There were significant drops in Black and Hispanic unemployment, both of which were higher than the drop in White unemployment.

COVID-19 had forced some states with budget restraints to cut back on their education funding. On average, students lost nine months of education, but students of color lost an entire year (Johnson & Jackson, 2021). The ARP targeted money toward schools with greater numbers of low-income students. In addition to this federal aid, states were not allowed to cut school funding in their budgets, especially in districts with many children living in poverty. Access to education, along with healthcare and nutrition, is one of the best ways to escape poverty and break its cycle. Education during early childhood is more likely to close the gap between children in poverty and children in higher-income families (De Schutter et al., n.d.). Furthermore, the ARP provided funding for more affordable and accessible childcare, which increased employment opportunities for mothers and, consequently, the chance that a family could earn more income. In turn, the additional income can be invested in more educational opportunities.

However, these short-term impacts were unsustainable, despite the Biden administration's hope of creating permanent change. A stimulus package, after all, is only meant to be a temporary measure to revive the economy.

5.2 Analysis of the Longer-Term Consequences of Inflation

Despite the positive short-term impacts of the ARP, the medium- and long-term effects are generally adverse. Although a stimulus package isn't meant to have a positive long-term effect, it should not create long-term issues, the most significant of which is inflation.

In the medium term, many positive gains were reversed soon after government payments to households stopped, which was expected. Once government funding for many ARP programs ended, these households had less disposable income to spend on necessities. However, in the longer term, there has been widespread concern about the link between the ARP and inflation. Although deficit spending helped prevent a worse economic outlook, it has also contributed to rapid inflation. The ARP quickly increased demand for goods and services, but production and supply did not grow enough to meet this increase in demand.

The ARP was highly controversial among economists and lawmakers. At the time of its negotiation, prominent economists from both sides of the political aisle objected to the ARP's wide-ranging nature. For instance, Larry Summers, who served as the Secretary of the Treasury under President Clinton and the Director of the National Economic Council under President Obama, was an early and outspoken critic of its lasting inflationary pressures (Summers, 2021). Jason Furman, who was chairman of President Barack Obama's Council of Economic Advisers, remarked that the stimulus package was "too big for the moment" (Uhlfelder, 2022). The ARP ultimately received no votes from Republican legislators.

The issue with the ARP can be summarized as having pumped too much money into a partially recovered economy too quickly in several unnecessary ways. The $1.9 trillion plan came after the federal government had already spent $3.51 trillion on fiscal stimulus under the Trump administration. These six packages collectively poured $5.41 trillion into the economy within the span of a year.

The ARP notably provided the last and largest round of direct payments among all the COVID-19 stimulus packages. The breadth of these stimulus checks, which more than 85% of households received, may have been influenced by political motivations (*American Rescue*, n.d.). Respondents to a survey by the Federal Reserve Bank of New York said that they expected to save about 40% of their stimulus check from the ARP (Thorbecke, 2021).

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Although these stimulus checks did reach lower-income families, they were not sufficiently targeted to benefit those who were most in need. Furthermore, the ARP provided $350 billion in funding to state and local governments, which is more than double the $150 billion that the CARES Act had provided, despite state and local tax revenue falling less than expected (*How Does*, 2021). Although some governments used their funds in beneficial ways for their communities, such as for public health, other government programs have misused excess funds. For example, Alabama allocated almost one-fifth of its funding towards constructing two new mega-prisons (Pereira, n.d.).

For the purposes of this paper, the most significant issue with inflation is its unequal effects. A study from Columbia University found that between 2004 and 2018, inflation inequality drove 3.2 million more people into poverty (Wimer et al., n.d.). This is because low-income families face a higher inflation rate than higher-income families. However, official poverty rates in the U.S. use the Consumer Price Index to measure inflation, which assumes that the whole population experiences the same inflation rate, thereby underestimating the poverty rate. People who are driven into poverty by the unequal effects of inflation are not officially considered to be under the poverty threshold. Thus, they do not qualify for aid from anti-poverty programs, which further exacerbates their struggles.

The rise in the federal funds rate due to recent inflation has increased the cost of borrowing money, impacting everything from credit card rates and purchasing a car to student loans and the money to start a new business. As low-income families face higher prices but also higher interest rates on their credit cards, paying off accumulated debt becomes increasingly difficult (Gertler & Karadi, 2015). For many households, access to affordable credit is crucial for managing costs that exceed their monthly income. These families struggle to meet basic needs while repaying their debt, which negatively affects their physical and mental health (Harper et al., 2024). Moreover, rising interest rates on student loans puts low-income Americans at a greater disadvantage in educational outcomes. Yet, access to education is a key way to break the cycle of poverty.

Furthermore, higher 10-year Treasury yield rates, and consequently higher mortgage rates, makes it difficult for low-income families to borrow money to purchase a house. A one percentage point increase in mortgage rates lowers the number of home purchase loans going to low-income families by one percentage point (Ringo, n.d.). The effect is even more pronounced for first-time home buyers. This presents an issue because homeownership is a crucial way to build wealth and escape poverty. Studies have shown that although homeownership is risky, particularly for low-income individuals, it leads to the accumulation of wealth in the long term (Goodman & Mayer, 2018).

By worsening inflation, the ARP indirectly generated a response by the Federal Reserve that compounded into a negative effect. Despite the numerous positive short-term effects of the ARP, its direct and indirect long-term consequences can still be felt by low-income Americans today.

5.3 Alternative and Conflicting Perspectives

It is important to note that economists have differing perspectives on the ARP's inflationary impact and its necessity for economic recovery. Due to the close timing of the six COVID-19 stimulus packages, it is difficult to distinguish between their individual impacts. Inflation likely resulted from the rapid succession of such a large sixth stimulus package following five others. For instance, the CARES Act was larger than the ARP but had been adopted a year earlier, in March 2020, when the U.S. was still in a recession. The size of the CARES Act met the economic conditions at the time, yet when the ARP was adopted, its size no longer matched the circumstances. Future research should aim to quantify the ARP's inflationary impact, such as by comparing the U.S. inflation rate to that of other countries that closed but did not overshoot their output gap in 2021.

Additionally, economists have a wide range of conflicting perspectives on how much the ARP actually fueled inflation. Another study from the Federal Reserve Bank of San Francisco found that the ARP led to a .3 percentage point increase in inflation in 2021 and a .2 percentage point increase in 2022 (Barnichon et al., n.d.). Stimulus packages were only one of the several causes of inflation. Inflation has been a global issue due to factors such as Russia's invasion of Ukraine and China's COVID-19 lockdowns, which increased energy prices and led to supply chain disruptions. At the same time, the expansionary fiscal measures of the federal government can be characterized as another shock to the U.S. economy.

Alternatively, other policymakers and economists have argued that, despite the inflationary risks of the ARP, it

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was crucial to further economic recovery. Janet Yellen, who served as President Biden's Treasury Secretary, believed that the ARP was necessary to save millions of jobs and alleviate hardships (*Remarks by Secretary*, 2025). Nevertheless, she recently acknowledged that it may have contributed "a little bit" to inflation (Breuninger, 2025). Similarly, the Economic Policy Institute praised the ARP's efforts to support the unemployed and reduce poverty (Lee, 2021).

6. Conclusion

Although efforts to foster a more equitable recovery from the pandemic are praiseworthy, the ARP struggled to strengthen the financial position of the most vulnerable in American society. Short-term relief to low-income households was invaluable. Specific aspects of the package, such as well-targeted direct payments, were necessary to reduce hardship. However, the ARP also helped fuel inflation and the Federal Reserve's subsequent need to increase interest rates.

Historically, big stimulus packages in the U.S. have all been subjected to political backlash, and the ARP is no exception. Despite biting criticism of the ARP in some circles, its true long-term positive and negative economic effects will remain uncertain until more time passes. The ARP underscores the impossibility of designing a perfect piece of fiscal stimulus, especially during an unprecedented economic crisis. There were many uncertainties and conflicting opinions before the ARP was adopted, and critics can speculate that it would have benefitted from a less generous construction, but no one knows exactly how that scenario would have played out.

Looking ahead, the COVID-19 pandemic will not be the last time the U.S. faces an economic crisis. Future fiscal stimulus efforts can build upon both the strengths and shortcomings of the COVID-19 stimulus packages. The Biden administration had hoped to avoid the insufficient response during the Obama administration by adopting a more expansive stimulus package but instead may have relied too heavily on fiscal stimulus. Going forward, it is important for lawmakers to further emphasize a careful consideration of diverse perspectives from economists and public policy experts. This approach can lead to more targeted assistance, which helps ensure that future fiscal stimulus designs minimize unintended consequences and are adapted to evolving economic conditions with greater precision.

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