The American Rescue Plan is set to boost global growth

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Global economic prospects have improved markedly in recent months, helped by the gradual deployment of effective vaccines against Covid-19, announcements of additional policy support in several countries, and signs that economies are coping better with measures to supress the virus. This is reflected in the stronger recovery shown in the new OECD Interim Economic Outlook, with global GDP growth now projected to be 5½ per cent in 2021 and 4% in 2022.

Strong and timely fiscal support since the onset of the pandemic has played a vital role in supporting incomes and preserving jobs and businesses. This should be maintained whilst economies are still fragile and growth remains hampered by containment measures and incomplete vaccination deployment. As economies reopen, new discretionary fiscal measures can also be an effective means of helping to close the large shortfalls of output and jobs from their normal, pre-pandemic levels.

The substantial fiscal support being provided in the United

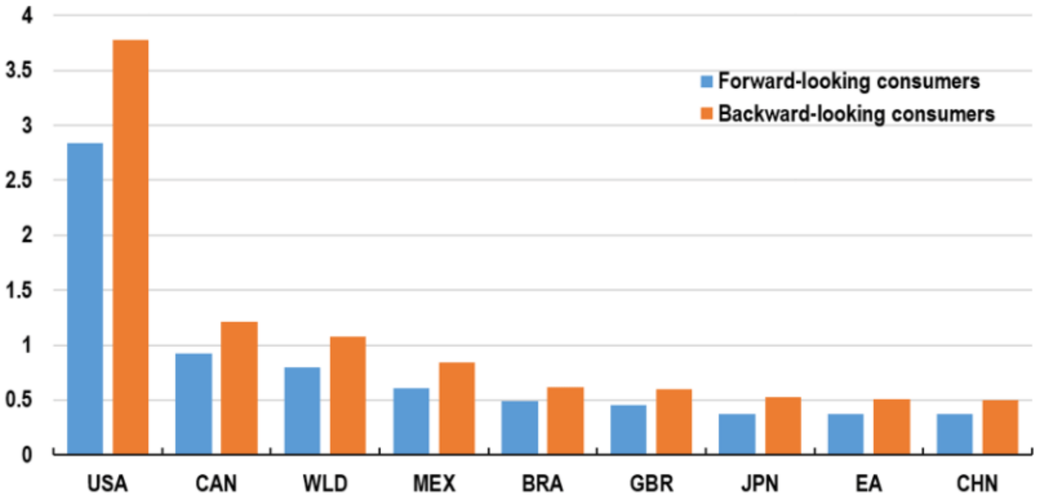
States this year is an important factor behind the improved global outlook. Already, the package of measures enacted in December 2020, worth USD 900 billion (4% of GDP), has boosted household incomes and, to a smaller extent, consumer spending at the start of 2021. The new American Rescue Plan of USD 1.9 trillion (8½ per cent of baseline GDP) provides a considerably larger additional stimulus that should raise aggregate demand substantially in the United States, with welcome spillovers for activity around the world. There is likely to be a clear immediate boost from stimulus payments to households, which represent around one-fifth of the overall package of measures. Other measures in the Plan are only partly pandemic-related and will take effect over the next year or so. Futher details on the content of the American Rescue Plan will be provided in a future blogpost.

Illustrative simulations on the NiGEM global macroeconomic model suggest that the measures in the American Rescue Plan could raise US output by around 3-4 per cent on average in the first full year of the package (from 2021Q2 to 2022Q1). This is broadly equivalent to the spare capacity estimated to exist in the US economy in the December 2020 OECD Economic Outlook.

The US upturn also helps to stimulate demand in all other economies. Output is raised by between ½-1 percentage point in Canada and Mexico, both close trading partners of the United States, and between ¼-½ percentage point in the euro area, Japan and China (see Figure). Overall, global GDP is boosted by around 1% during this period.

The American Rescue Plan will have a strong economic impact

% difference in GDP from baseline on average over first four quarters



Source: OECD calculations using the NiGEM macroeconomic model

In these simulations, stronger US domestic demand improves near-term job prospects, with US employment rising by between $2\frac{1}{4}$-3 million by the end of 2021 and the unemployment rate declining by between $1\frac{1}{4}$-2 percentage points. The demand upturn also boosts import growth and widens the US current account deficit by around $\frac{3}{4}$ per cent of GDP on average in the first four quarters of the shock, despite higher US exports due to stronger foreign demand. US price inflation picks up temporarily, by around $\frac{3}{4}$ percentage point per annum on average in the first two years of the shock, but not to a rate that would necessarily require any immediate policy tightening by the Federal Reserve given the new US monetary policy framework. The overall budgetary cost in the near term is lower than the size of the stimulus, with higher nominal activity offsetting around one-quarter of the cost of the discretionary stimulus measures. Even so, the US general government debt-to-GDP ratio is raised by 6 percentage points by 2023.

These simulations show the impact of an illustrative mix of higher transfers to households, stronger final government consumption and tax reductions introduced over 2021Q2-2022Q2. The near-term impact of the US fiscal package will be relatively large if consumers are “backward-looking” and more sensitive to current income developments and the impact of higher government transfer payments. In contrast, “forward-looking” consumers, more focused on the lifetime income path of incomes and the potential budgetary offset from higher tax payments in the future, may spend less of the stimulus, resulting in smaller spillovers to other countries.

In either case, there are substantial near-term gains to output and the risks of lasting damage from a slow recovery have been reduced considerably. Further ahead, the direct impact of the Plan on output and inflation may be modest, reflecting the temporary nature of the fiscal stimulus, although there could be a lasting boost to the size of the labour force from attracting back previously discouraged workers. Growth prospects would also be improved if innovation and investment were raised permanently (relative to baseline). A faster recovery from the pandemic and additional policy measures to help foster investment would raise the chances of such an outcome.

See also The need for speed: Putting the World Economy on the Fast Track out of the COVID-19 crisis

Reference:

OECD (2021), *OECD Economic Outlook, Interim Report March 2021*, OECD Publishing, Paris, https://doi.org/10.1787/34bfd999-en.