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POLICY BRIEF

Why the Fed Moves Slowly on Inflation and Rates

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September 2025

The Federal Reserve (Fed) has been repeatedly attacked over the past several months over its decision to keep interest rates unchanged. According to critics, by keeping rates high, the Fed is slowing economic activity and incurring higher costs for the federal government. Lowering rates would therefore spur economic growth and reduce budget deficits. These attacks and the rationale used by the attackers are unnecessary and misguided. This brief begins by establishing the fiscal–monetary dynamics that began during 2020, describing how these dynamics resulted in 40-year high inflation, and offering an explanation for why it took the Fed a year to begin fighting inflation. It then turns to the present fiscal–monetary environment and provides justification for additional patience at the Fed. Despite contrasting objectives—tightening monetary policy during inflation and loosening monetary policy now—the obstacle for the Fed remains the same: unconstrained fiscal policy.

1. How We Got 40-Year High Inflation

The common scapegoat for the inflation that plagued the Biden administration was deficit spending, specifically the $1.9 trillion American Rescue Plan (ARP) of 2021.[1] While this is partly true—and the Biden administration certainly deserves blame for continuing deficit spending despite some very vocal warnings[2]—it is a far too simplistic explanation that omits two major facts: First, over half of the COVID-era deficit spending was enacted and implemented prior to ARP, and second, the Federal Reserve actively accommodated these policies.

From March 2020 through December 2020, the government enacted five rounds of COVID-19 stimulus spending, increasing 10-year deficits by almost $3.3 trillion.[3] Including the 2021 ARP brings the total deficit increase to $5.1 trillion. However, the timing of when this spending went into effect is highly relevant to a discussion on the inflationary effects of deficits. Unfortunately, I am unaware of any official post-COVID-19 estimates of when the outlays from each legislation occurred.

TABLE 1. Deficit increase by COVID legislation and year according to original Congressional Budget Office cost estimates

COVID legislation	Enacted	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2020-2031
Coronavirus Preparedness and Response Supplemental Appropriations Act	2020-03-06	1,041	4,160	1,700	381	196	61	23	6	2	0	0	N/A	7,570
Families First Coronavirus Response Act	2020-03-18	134,476	56,508	904	18	–25	–27	–13	–2	7	9	10	N/A	191,865
Coronavirus Aid, Relief, and Economic Security (CARES) Act	2020-03-27	1,606,000	448,000	–116,000	–156,000	2,000	–9,000	–11,000	–7,000	–5,000	9,000	–38,000	N/A	1,723,000
Paycheck Protection Program and Health Care Enhancement Act	2020-04-24	434,400	42,700	4,200	1,200	400	0	0	0	0	0	0	N/A	482,900
Consolidated Appropriations Act, 2021 Divisions M and N	2020-12-27	0	736,655	74,259	31,819	16,638	5,588	1,960	892	–42	–56	–41	N/A	867,672
American Rescue Plan (ARP) Act	2021-03-11	N/A	1,163,526	528,524	114,311	59,041	32,105	–6,080	–10,915	–3,928	–7,685	–13,301	–11,491	1,844,107
Total		2,175,917	2,451,549	493,587	–8,271	78,250	28,727	–15,110	–17,019	–8,961	1,268	–51,332	–11,491	5,117,114

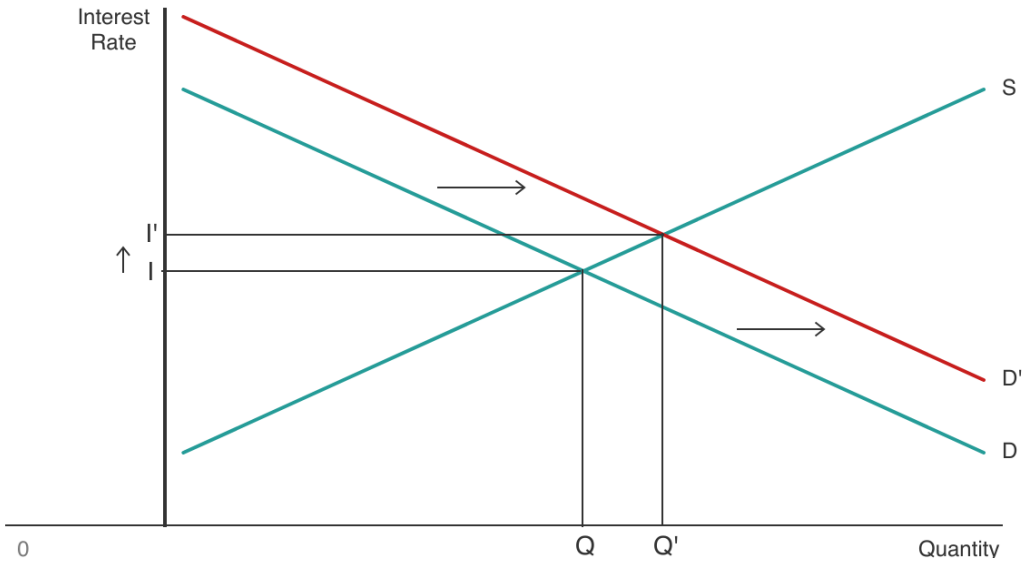
Sources: Congressional Budget Office, "CBO Estimate for H.R. 6074, the Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020" (Publication 56227, March 4, 2020); Phillip L. Swagel, letter to Nita M. Lowey "Re: Preliminary Estimate of the Effects of H.R. 6201, the Families First Coronavirus Response Act" (Publication 56316, Congressional Budget Office, April 2, 2020); Phillip L. Swagel, letter to Mike Enzi "Re: Preliminary Estimate of the Effects of H.R. 748, the CARES Act, Public Law 116-136, Revised" (Publication 56334, Congressional Budget Office, April 27, 2020); Congressional Budget Office, "CBO Estimate for H.R. 266, the Paycheck Protection Program and Health Care Enhancement Act, as Passed by the Senate on April 21, 2020" (Publication 56338, April 22, 2020); Congressional Budget Office, "Congressional Budget Office Estimate for Division N—Additional Coronavirus Response and Relief, H.R. 133, Consolidated Appropriations Act, 2021" (Publication 56961, January 14, 2021); Congressional Budget Office, "Discretionary Spending Under Division M, the Coronavirus Response and Relief Supplemental Appropriations Act, 2021" (Publication 56916, December 22, 2020); and Congressional Budget Office, "Estimated Budgetary Effects of H.R. 1319, American Rescue Act of 2021," (Publication 57056, March 10, 2021).

There are multiple methods for estimating those outlays, though. Perhaps the most straightforward is to use the original Congressional Budget Office (CBO) cost estimates for each legislation, as shown in table 1. Two alternative methods and their respective flaws are discussed in the appendix.

The COVID deficit increase was $2.2 trillion and $2.5 trillion in 2020 and 2021, respectively, with the vast majority of the $5.1 trillion in COVID spending projected to be spent by 2022. Of the combined $4.6 trillion spent in 2020 and 2021, $3.5 trillion (or 75 percent) came from pre-ARP legislation.[4] If conventional political reasoning is correct, our recent experience with inflation should have been attributed to the entirety of this spending—not just the 25 percent that immediately preceded inflation.

But larger deficits alone are not inflationary. In the traditional sense, a government funds a budget deficit in the same way as any other borrower does. It enters the market as a borrower or demander of loanable funds. These funds are supplied by investors across the economy who choose to save and lend these funds in exchange for a return—interest. When the government borrows, the demand for these loanable funds increases; this increase is represented by a rightward shift of the demand curve from D to D' in figure 1. The intersection of the new demand curve D' and the

FIGURE 1. Effects of increased government borrowing on loanable funds market



supply curve S results in an increase in the interest rate from I to I' and an increase in the quantity of loans from Q to Q'.

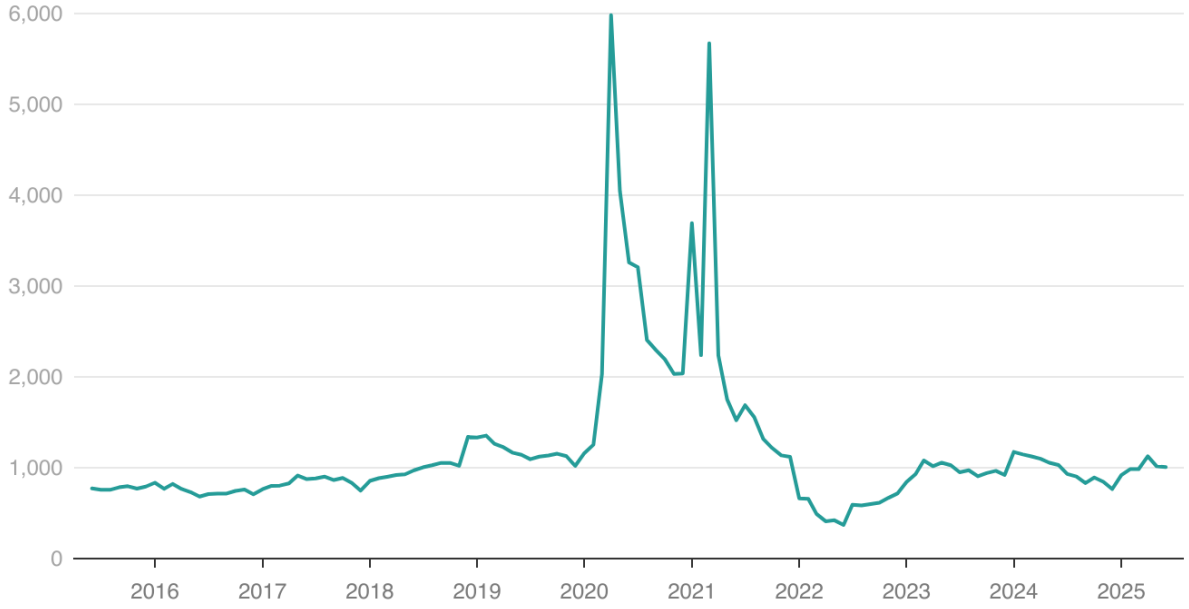
When funds are borrowed in this manner, government deficits have no effect on inflation.[5] To get a change in prices, whether inflation or deflation, the central bank must be involved.[6] Inflationary deficits occur when government debt is purchased by the central bank through money creation—exactly what the Fed did during the COVID-19 pandemic—or when the market expects *future* money creation to finance the government's debt.

ARP's role

One might ask, "But prices didn't start rising until *after* ARP—so isn't all the blame on the Biden administration justified?" According to the argument made by former US Secretary of the Treasury Larry Summers, ARP was too large relative to the output gap—the difference between the economy's potential and its actual output—thereby leading to higher inflation.[7] My colleague, Mercatus Center senior research fellow Veronique de Rugy, has recently written on this issue, pointing out that while, yes, ARP's size was almost triple the output gap, the fiscal stimulus prior to ARP also exceeded the projected output gap.[8] Hence, if the output gap was what drove inflation, then we should be looking at pre-ARP legislation as well.

An alternative explanation for the timing of inflation is that people were simply slow to spend the money they had been given. This effect can be seen with personal savings data represented in figure 2. From February 2020 to April 2020, personal savings increased by 377 percent from $1.2 trillion to $6.0 trillion. Most of those savings were spent in the subsequent months, falling

FIGURE 2. Personal savings, billions of dollars



Source: US Bureau of Economic Analysis via the Federal Reserve Economic Database (FRED).

to $2.0 trillion by December 2020 before passage of the almost $900 billion COVID package at the end of that month that caused savings to jump back to $3.7 trillion in January 2021. Savings then dipped down to $2.2 trillion in February 2021 before spiking again to $5.7 trillion after ARP.

While comparable spikes in savings occurred after the passage of the CARES Act in 2020 and ARP in 2021, there is a noticeable difference in how long it took for those savings to be spent. Of the $4.7 trillion increase in savings after CARES, $3.9 trillion, or 83 percent, was spent over eight months. However, the entire $3.4 trillion savings spike after ARP was exhausted in just one month. Furthermore, savings did not return to their pre-COVID level until October 2021 and did not reach their trough—one-third the pre-COVID level—until June 2022, when inflation peaked.

The major difference between these two periods was that the economy had largely been reopened by the time ARP had passed, and economic growth prospects had recovered. The uncertainty surrounding COVID, leading to high savings, had dissipated.

Those findings do not mean that only ARP was inflationary. The demand-driven effects of COVID stimulus were present prior to ARP and were strikingly similar to the post-ARP effects.

Consider personal consumption expenditures (PCE), shown in figure 3. In the five years preceding 2020, PCE grew on average by 0.35 percent per month. PCE then plummeted in March and April 2020 by 6.9 and 11.4 percent, respectively. The vertical axis on figure 3 was adjusted to remove this

FIGURE 3. Personal consumption expenditures, percent change

Source: US Bureau of Economic Analysis via the Federal Reserve Economic Database (FRED).

decline in PCE and to emphasize what followed. In May and June 2020, consumption rebounded sharply, growing by 8.3 and 6.0 percent, respectively. However, even after I exclude these months of high growth, PCE grew well above the pre-COVID trend, at a monthly rate of 0.82 percent up through February 2021, just before passage of ARP in March 2021, after which it spiked again at 4.9 percent.

If I exclude the exceptionally high month of March 2021, as I did those four months in 2020, PCE growth continued at a monthly rate of 0.82 percent both through the end of 2021 and through inflation's peak in June 2022—making PCE growth after ARP 2.3 times the pre-COVID trend but no different than the growth that followed earlier COVID stimulus.

So while inflation did not noticeably take hold until after ARP, this outcome appears to have had less to do with the uniqueness of ARP's size and more to do with the broader economic environment. In addition to consumers' being slower to spend, businesses also faced uncertainty both about future business conditions and about changes to aggregate demand during 2020, which clouded price signals despite substantial growth in consumer demand.

ARP did, however, break a clear norm of signaling the intent to repay new debt. This is what de Rugy calls "the old fiscal religion that holds that, while government may deficit-spend during recessions, the aftermath requires austerity."[9] This insight is especially pertinent given the Fed's role throughout COVID.

The Fed's involvement

In March 2020, the Fed announced that it would lower its target range for the federal funds rate (FFR) to 0–0.25 percent.[10] The Fed used two primary tools to achieve this goal: interest on reserves (IOR)[11] and quantitative easing (QE), a program of printing money to buy financial assets, thereby increasing the Fed's balance assets. The Fed declared its QE plans in the same announcement:

> *To support the smooth functioning of markets for Treasury securities* and agency mortgage-backed securities that are central to the flow of credit to households and businesses, over coming months *the Committee will increase its holdings of Treasury securities by at least $500 billion* and its holdings of agency mortgage-backed securities by at least $200 billion.[12]

The Fed greatly exceeded those targets. Beginning in early March 2020, the Fed more than doubled its balance sheet from $4.2 trillion to a peak of almost $9.0 trillion in April 2022, as shown in figure 4. Most of this increase came from purchases of US Treasury securities, the Fed's holdings of which grew from just under $2.5 trillion prior to COVID to a peak of $5.8 trillion.

Of course, those securities were not purchased directly from the Treasury at an auction; they were purchased in the secondary market. The effect is similar though: Liquidity is injected into the

FIGURE 4. Federal Reserve's balance sheet, millions of dollars

Source: Board of Governors of the Federal Reserve System via the Federal Reserve Economic Database (FRED).

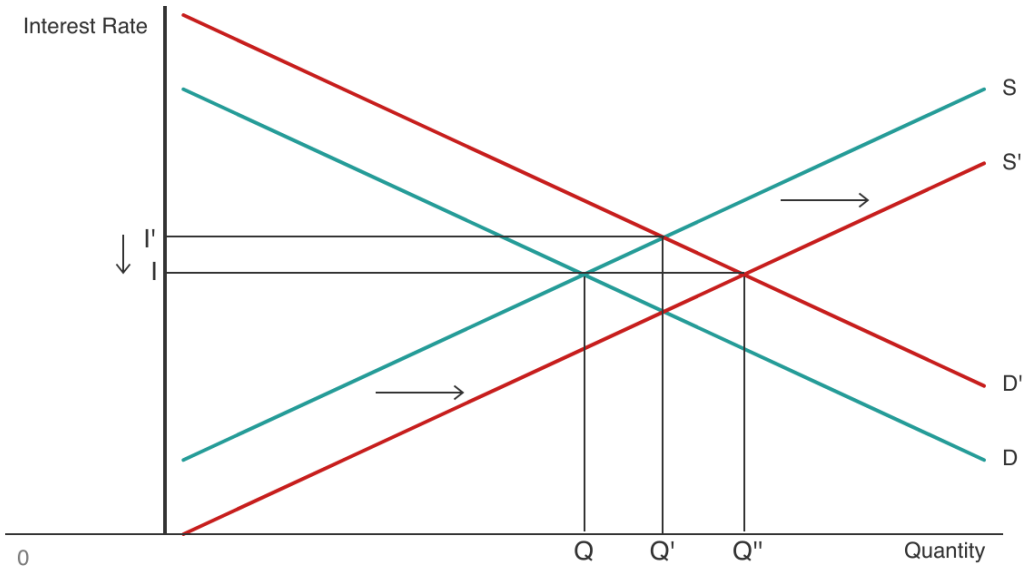
market, reducing the strain on financial institutions to absorb the new debt and leading to lower interest rates than would otherwise occur. Thus, the Fed indirectly monetized or printed about two-thirds of the federal government's $5.1 trillion in COVID spending.

Most of the remaining increase on the Fed's balance sheet came from purchases of mortgage-backed securities, which grew from about $1.4 trillion to $2.7 trillion. While these were not purchases of government debt, by purchasing other assets, the Fed further freed up market resources that could then be used by financial institutions to purchase lower-risk assets—namely, Treasury securities. In total, the Fed's actions accommodated 92 percent of the federal government's COVID response.

By printing money to expand its balance sheet, the Fed increased the supply of loanable funds, causing the supply curve to shift from S to S' in figure 5. This shift puts downward pressure on interest rates, counteracting the interest rate effect from government borrowing that was illustrated in figure 1.

The Fed's effectiveness at lowering interest rates hinged on inflation expectations remaining low, as they did through most of 2020. If investors anticipate higher inflation, they will require higher interest rates—implying that loose monetary policy will not always be as effective at lowering rates as it was in 2020. This situation will be discussed further in section 2.

FIGURE 5. Effects of increased government borrowing on loanable funds market combined with quantitative easing



Why the Fed was slow to raise rates

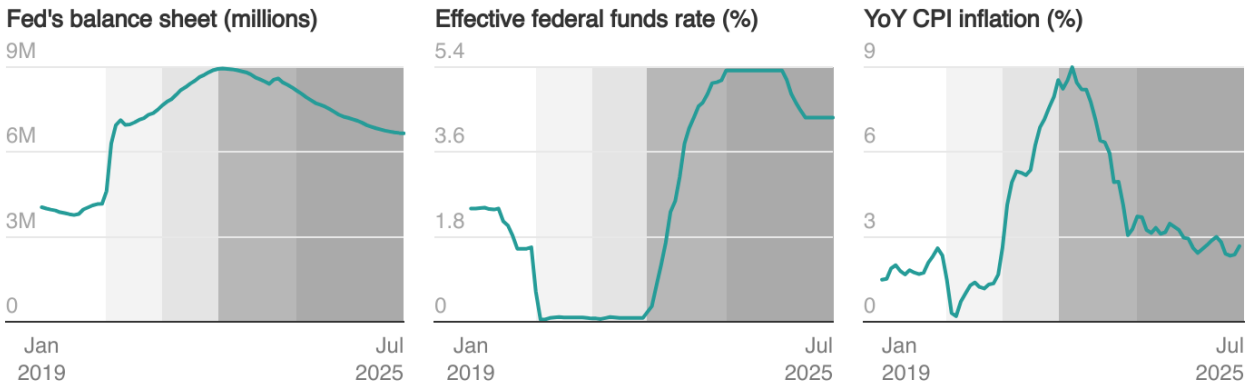
The Fed's successful interest rate cuts paid quick fiscal dividends. Despite adding trillions in new debt, the government's net interest costs declined from $375 billion in 2019 to $352 billion in 2021. Expressed as a share of the total federal budget, interest costs shrank from 8.4 to 5.2 percent over this period. This lower rate was not sustainable, though.

As inflation began to rise, it became clear that monetary policy would need to be tightened. However, the Fed was slow to act—waiting until annual inflation had reached almost 8 percent before tightening its monetary policy—a full year after the inflation spike had begun.

Figure 6 compares Fed policy to Consumer Price Index (CPI) inflation. The initial light shading beginning in early 2020 highlights the beginning of the Fed's balance sheet expansion and cut to the FFR. This loose monetary policy continued for an additional year after inflation began to rise (second shading). Once the Fed began tightening monetary policy, reflected in the reduction in the balance sheet and increase to the FFR, an almost immediate and substantial decline in inflation occurred (third shading). Once this tightening slowed, visualized as a flattening in the decline in the balance sheet and a pause to rate hikes before eventual rate cuts, progress on inflation also slowed (fourth shading).

Why the delay in raising rates and the apparently premature softening of monetary tightening? With a massive public debt, equal to $22 trillion when inflation began rising, even minor increases in interest rates have a substantial cost to the government. At the time, CBO estimated that if interest rates were just one percentage point higher than was projected over 10 years, interest costs would increase by about $2 trillion.[13] This problem was made worse by the fact that about

FIGURE 6. Effects of the Fed's monetary policy on year-on-year Consumer Price Index Inflation, January 2019–July 2025



Source: Board of Governors of the Federal Reserve System via the Federal Reserve Economic Database (FRED).
Note: From left to right, shadings indicate (1) loose monetary policy prior to the rise in inflation, (2) continued loose monetary policy after inflation accelerated, (3) monetary tightening and the deceleration of inflation, and (4) slowing of tightening and minimal progress on inflation.

one-third of US debt matures in one year or less, as de Rugy has reminded us for years—reiterating how quickly government debt can roll over into higher interest rates.[14]

Within this broader context, it would appear that the Fed kept rates low to avoid triggering a fiscal crisis. There are plenty of arguments against this conclusion, but each has serious flaws. One argument is that this conclusion is inconsistent with the Fed's explanation. For instance, Chair Jerome Powell openly stated that the Fed's policies weren't being dictated by fiscal policy. When asked about the possibility of feeling pressure to keep interest rates low because of the country's finances, Powell responded:

> I think that's . . . what people call fiscal dominance. And . . . I think we're just a very, very long way from that. I think . . . if we do our jobs well and support the economy and achieve maximum employment and stable prices . . . I don't think that that is something that . . . I would worry about, certainly not in the near term."[15]

Powell's statement should be taken with a grain of salt: If Fed policies were being dictated by our fiscal situation, you would hardly expect the Fed to admit it. As noted earlier though, the Fed was explicitly "support[ing] the smooth functioning of markets for Treasury securities."[16] Fed officials also expressed repeated support for COVID fiscal policies throughout 2020 and into 2021. During the same Q&A session, Powell stated that "the case for fiscal policy right now is . . . very strong. And I think that is widely understood."[17] Earlier that year, he stated that "additional fiscal support could be costly, but worth it."[18] Board of Governors member Lael Brainard in March 2021 described fiscal policies during COVID as "substantial," "necessary," and "strong and timely."[19]

There's also the argument that the Fed was slow to fight inflation because it believed inflation was transitory. This idea was defended mostly on the grounds that inflation had been caused by supply shocks such as port congestion and the war in Ukraine. De Rugy and Mercatus Center research fellow Jack Salmon have previously written about those claims, emphasizing that ports had returned to their pre-COVID shipping volumes *before* the acceleration of inflation while Russia's invasion of Ukraine came well *after*.[20]

Regardless of which explanation is correct, the Fed certainly behaved *as if* it were accommodating fiscal policy. And once tightening finally began, inflation started to decline—but not without fiscal consequences. After falling to $352 billion in 2021 and just 5.2 percent of the federal budget, net interest costs rose to $881 billion, or 13.1 percent, by 2024.

Those fiscal realities have direct implications for the path of the Fed's balance sheet. For the Fed to reduce its balance sheet and further take excess money out of the economy, those assets must be purchased by market investors—either directly or indirectly through deficit-financed Treasury purchases. However, new Treasury debt resulting from continued large budget deficits competes for investor resources. For the Fed to sell its Treasury holdings more quickly would require the

price of Treasury securities to decline, resulting in higher interest rates and an even worse fiscal situation.

In effect, current budget deficits crowd out the Fed's ability to sell its old government debt and fight inflation.

2. Why the Fed Is Slow to Cut Rates Now

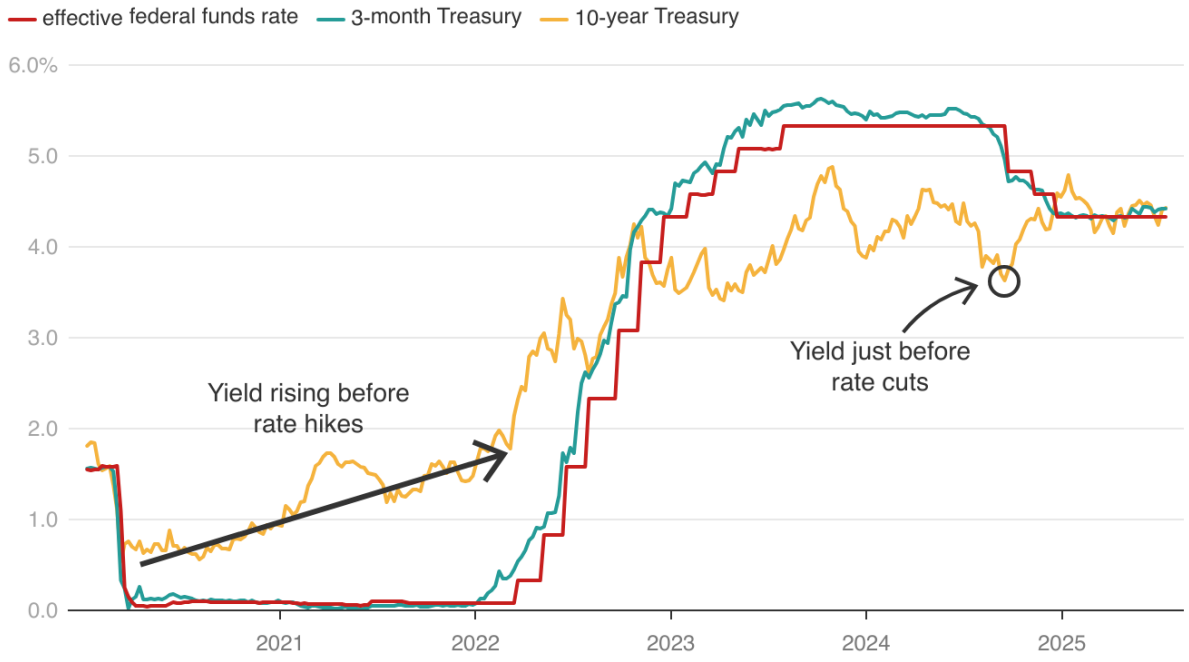
The Fed—and Chair Powell specifically—have repeatedly been called on by the administration and members of Congress to cut interest rates. So far, the Fed hasn't budged—and for good reason. That is because cutting the FFR may have unintended consequences: higher, rather than lower, interest rates and a return to high inflation.

Divergence between short- and long-term rates

The first lesson for policymakers to remember is that while the Fed largely controls short-term interest rates, it has less control over long-term interest rates. Two recent examples illustrate this point.

Figure 7 shows the FFR, the three-month Treasury yield, and the 10-year Treasury yield. The FFR and the three-month yield moved together very closely through the entirety of the time span

FIGURE 7. Short-term rates versus long-term rates



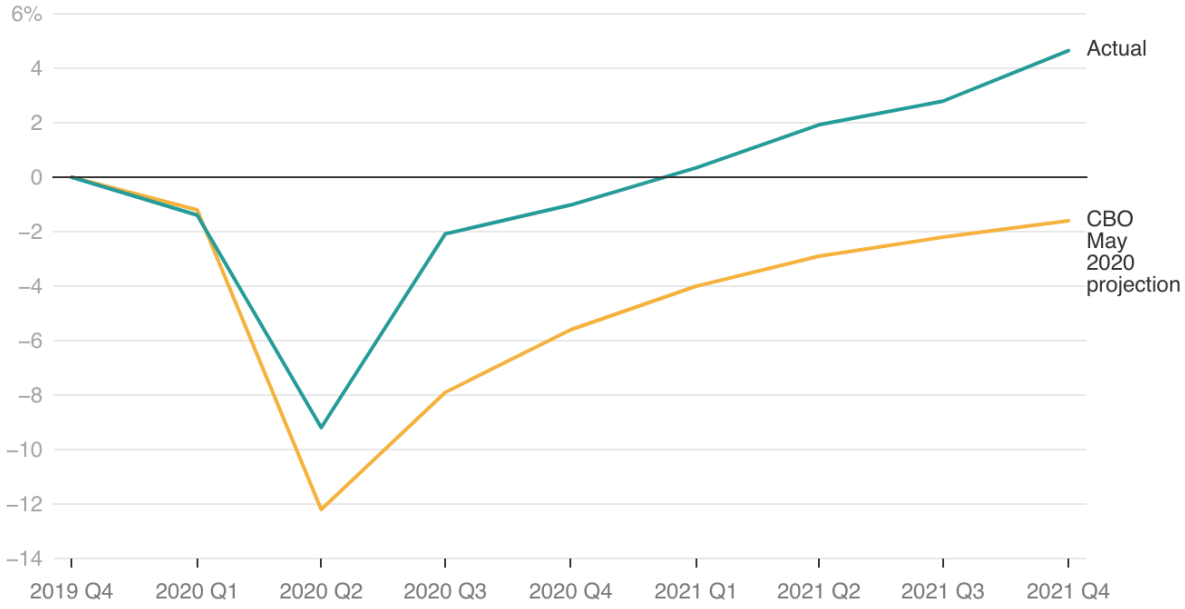
Source: Board of Governors of the Federal Reserve System via the Federal Reserve Economic Database (FRED).

covered by the figure, but notice what happened to the 10-year yield on the left-hand side of the figure from early 2020 through early 2022, just before the Fed's initial rate hikes. The 10-year yields fell to about 0.5 percent after the FFR was set at 0 percent but then gradually rose to 1.8 percent before the Fed began raising rates.

Part of this increase in the 10-year Treasury rate was attributable to improved growth prospects. At the onset of COVID-19, CBO and other forecasters were projecting a drawn-out economic recovery, with the economy failing to return to the pre-COVID level until after 2021. However, figure 8 shows that the economy returned to its Q4 2019 size by Q1 2021. This outcome was in large part driven by a smaller-than-expected decline in Q2 2020 that was followed by a much more rapid recovery in Q3 2020.[21] An improved economic outlook makes the market relatively more attractive, shifting resources away from low-risk government securities toward higher-return market investments and, thus, pushes up government yields.

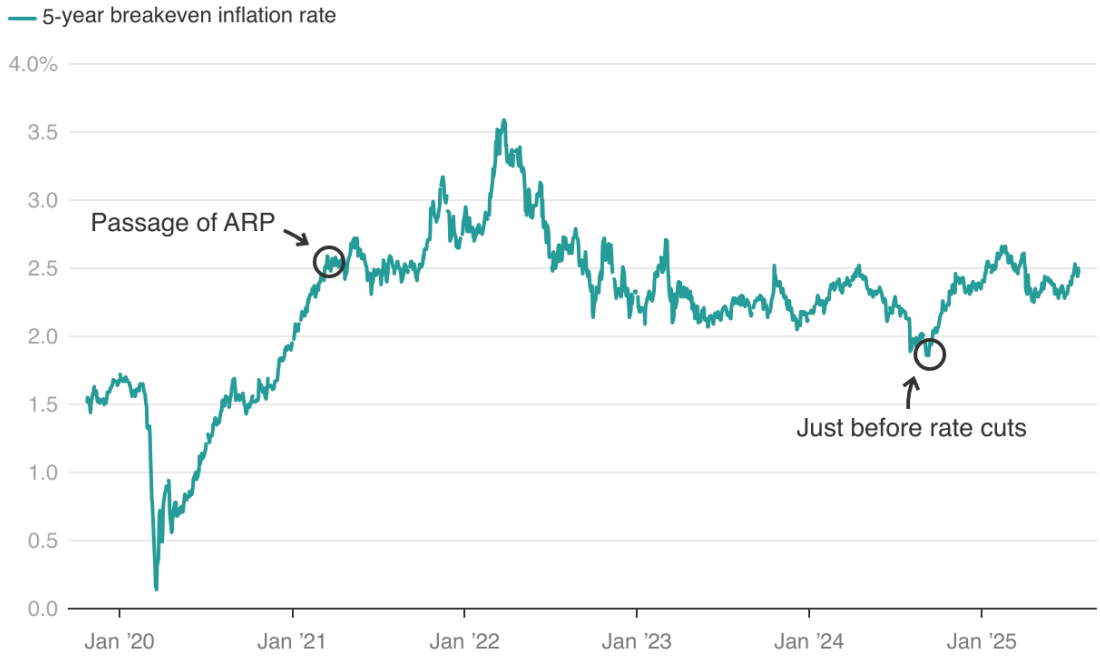
Another driving force was inflation expectations, which steadily rose prior to ARP. Using the five-year break-even inflation rate, which approximates what the market believes inflation will average over a five-year period, figure 9 shows that expectations plummeted during the early part of the COVID pandemic but returned to the pre-COVID level of 1.6 percent by August 2020. By the time that ARP had passed, expectations had already risen to 2.5 percent, where they stayed for another six months following ARP before peaking at 3.6 percent in March 2022.

FIGURE 8. Difference in real output compared to Q4 2019, percent



Sources: Data from the Congressional Budget Office and the US Bureau of Economic Analysis.

FIGURE 9. Break-even inflation rate, percent



Source: Board of Governors of the Federal Reserve System via the Federal Reserve Economic Database (FRED).

The second period worth emphasizing is early September 2024, when the Fed began cutting rates. Returning to figure 7, one notes that just prior to the Fed's surprise half-point cut that month, the 10-year yield was 3.6 percent compared to an effective FFR of 5.3 percent. Following this and two subsequent quarter-point cuts, the 10-year yield reached a high of 4.8 percent in January—a 1.2 percentage point increase despite a 1.0 percentage point reduction in the FFR.

Inflation expectations also drove this counterintuitive increase in long-term rates. Following the rate cuts, the five-year break-even inflation rate increased from 1.9 percent to as high as 2.7 percent in February 2025. And while the current break-even rate of 2.5 percent remains well below the March 2022 peak of 3.6 percent, it is higher than 82 percent of all observations over the past three years and higher than at any time from summer 2008 through February 2021.

Given this recent lesson with inflation expectations after the Fed's *unprovoked* rate cuts, it is worth considering how markets would react to a rate cut under current political pressures.

Liquidity effects

In addition to changing expectations, lowering the FFR would directly increase liquidity and put upward pressure on prices. To lower the FFR, the Fed could conduct another round of QE, but

such overt money printing may be politically unpalatable. Instead, it could lower the interest on reserves (IOR) rate, a move that currently has political support.

The Fed uses the IOR rate as a tool to encourage banks to hold money at the Fed rather than lending it in the market. Its effectiveness depends on how competitive the IOR rate is relative to other short-term yields. The Fed currently pays an IOR rate of 4.4 percent on the $3.4 trillion in reserves held at the Fed—roughly equal to the current three-month Treasury yield.

Consider a scenario in which the IOR rate was brought to zero. This situation would eliminate the incentive for banks to hold reserves and push those funds back into the market, thereby increasing the money supply from its current level of $22 trillion. Since every dollar added to the market "multiplies," this change would lead to a greater than $3.4 trillion increase in the money supply.

Assuming the current money multiplier of 3.8 remained unchanged and that all reserves returned to the market, the result would be an almost $13 trillion (or 58 percent) increase in the money supply.[22] However, the reduction in reserves would likely cause the money multiplier to increase. Realistically, if all reserve balances were eliminated, the multiplier could return to (or even exceed) the pre–Great Recession level of about 9.0. This would instead mean an increase of over $30 trillion to the money supply—more than doubling the money supply and potentially causing the price level to more than double.[23] By comparison, the CPI has increased by just 22.7 percent since January 2021; doubling the price level would mean three-and-one-half times more inflation.

Effect of cutting the IOR rate while reducing the Fed's balance sheet

One proposal to cut the IOR rate suggests a simultaneous reduction in the Fed's balance sheet to mitigate these risks, offering the best of both worlds: lower interest rates and therefore smaller budget deficits without returning to inflation. That's an unrealistic goal.

Cutting the IOR rate and reducing the Fed's balance sheet have opposing effects. As noted earlier, reducing the Fed's balance sheet puts pressure on financial markets to purchase this debt, thus requiring interest rates to rise. To account for this outcome, the proposal would use the Treasury's buyback program to purchase the Fed's securities. The buyback would effectively swap short-term debt for the Fed's long-term debt, allowing the Fed to more quickly unwind the balance sheet without directly having to sell those assets to the market. But this solution still fails to address the problem that someone must buy that debt, regardless of whether it is rolled off gradually.

Once the debt matures, its principal must be repaid by the Treasury. But without a budget surplus, the Treasury would have to issue new debt to the market to raise the dollars needed to pay off that principal—moving the debt from the Fed's balance sheet to the market and putting upward pressure on rates, increasing interest payments to public debt holders, and lowering remittances from the Fed.

To get the desired outcome of lower interest rates without risking a return to inflation, the government should address the demand side of the loanable funds market by reducing its deficit spending. Doing so would take pressure off limited market resources, lower rates, and allow those resources to be allocated to their most productive uses through the market.

Conclusion

A complete accounting of COVID-era inflation must consider both the fiscal and monetary pressures that were present. The federal government issued a combined $4.6 trillion in deficit spending in 2020 and 2021 alone, with $3.5 trillion (or 75 percent) of this total coming from legislation enacted in 2020.

Large-scale money printing by the Fed was initially used to accommodate this deficit spending but appears to have been prolonged because of fiscal pressures, which have resulted in sustained high inflation.

The current calls for a return to looser monetary policies risk a return to inflation without the economic benefits. Instead of trying to force interest rates in their favor with the Fed, Congress should use the power it does have to lower rates: the power of the purse. By reducing deficit spending, Congress can reduce the demand for loanable funds, thereby taking pressure off interest rates and the federal budget while shifting resources out of the government's hands and back into the market.

Appendix: Alternative Methods for Estimating Outlays

A valid concern with the method using the original CBO cost estimates for the various pieces of legislation passed by Congress is that the CBO scores reflect initial projections prior to implementation of the legislation. Therefore, the CBO scores cannot accurately represent when federal dollars were spent. Two other methods could have been used instead.

The first would be to analyze CBO Budget Outlooks for legislative changes that were made to the CBO baseline following enactment of each legislation. The relevant updates can be found in CBO publications 56517, 56970, and 57263.[24] Using the legislative changes in those documents, changes which are almost entirely attributable to COVID legislation, I calculate the total deficit increase (2020–2031) to be $6.3 trillion, with $4.9 trillion in 2020 and 2021. This amount increases to $5.4 trillion if 2022 is included. Looking only at 2020 and 2021, I find that $3.8 trillion (or 78 percent) of the $4.9 trillion came from pre-ARP legislation—compared to 75 percent using the method I employed. However, this method does not address the concern over when actual spending took place, while it simultaneously introduces a new issue: how to incorporate technical and economic changes, which are reported separately in CBO's publications, without a way to assign their effects to each legislation.

Another method would be to use data from CBO's annual report on the accuracy of its fiscal year projections. These data are found in CBO publications 56885, 57614, and 58603.[25] According to these reports, CBO made legislative adjustments in 2020, 2021, and 2022 showing deficit increases of $1.8 trillion, $2.3 trillion, and $45 billion, respectively. This method corrects for the issue of actual versus projected deficits, but in addition to the issue of how to assign economic changes, which the previous method also faced, a new challenge arises in that this method does not allow for distinguishing between the sources of the deficit increase. For example, in its accuracy report on 2021 projections, CBO reports a legislative adjustment of $2.3 trillion for the 2021 deficit, but this figure is relative to the March 2020 baseline. Consequently, this $2.3 trillion adjustment incorporates every piece of COVID legislation except for one—the $8 billion Coronavirus Preparedness and Response Supplemental Appropriations Act—the first and smallest Covid stimulus law, which was enacted prior to the March 2020 baseline.

About the Author

Joshua Rowley is a Gibbs Scholar and research fellow at the Mercatus Center at George Mason University. He formerly worked as an economist for the House Budget Committee.

Notes

1. Thomas Catenacci, "Biden Scrambles to Fix Inflation Problems He Helped Create," *Fox News*, August 1, 2022.
2. Andrew Davis, "Summers Sees 'Least Responsible' Fiscal Policy in 40 Years," *Bloomberg*, March 20, 2021.
3. Phillip L. Swagel, "CBO's Budget and Economic Analysis During the Pandemic," Congressional Budget Office presentation at Brown University, October 13, 2021.
4. The Coronavirus Aid, Relief, and Economic Security (CARES) Act shows a decrease in deficits in several years after 2021. Notably, it shows a deficit reduction of $116 billion in 2022 and $156 billion in 2023. This reduction is largely due to a temporary delay of employer payroll taxes, pushing revenue from 2020 and 2021 to these later years. For additional details, see the Joint Committee on Taxation's original score of tax provisions in the CARES Act in Joint Committee on Taxation, "Estimated Revenue Effects of the Revenue Provisions Contained in an Amendment in the Nature of a Substitute to H.R. 748, The 'Coronavirus Aid, Relief, and Economic Security ("CARES") Act,' as Passed by the Senate on March 25, 2020, and Scheduled for Consideration by the House of Representatives on March 27, 2020" (Document JCX-11R-20, April 23, 2020). See also Joint Committee on Taxation, "Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ('CARES') Act (Document JCX-12R-20, April 23, 2020).
5. While overall prices are not affected, individual prices may be. For instance, a deficit-financed program to purchase peanuts for school lunch programs will increase the demand for peanuts and lead to higher peanut prices. Those funds would have been used elsewhere in the economy, causing a reduction in demand and lower prices where those forgone uses would have taken place. This effect on prices is no different than if the program had been financed with taxes.
6. From James M. Buchanan:

   > Debt issue in inflationary periods has as its only purpose the reduction of the liquidity in the private economy. It is not, therefore, akin to the classical model in that government does not utilize the proceeds to purchase real goods and services. Presumably, the government should neutralize the proceeds collected from the sale of securities. (In the modern context this should mean retiring that part of the national debt held by the central banks.) . . . With anti-inflation debt issue, government does withdraw current command over resources from the private sector, but it does not use this source to finance collective purchases.

James M. Buchanan, "A Review of Pre-Keynesian Debt Theory," in *The Collected Works of James M. Buchanan, Vol. 2., Public Principles of Public Debt: A Defense and Restatement* (Liberty Fund, 1999). Thus, debt creation is deflationary if the new debt is borrowed from private markets and used to retire debt owned by the central bank—debt that was previously purchased through money creation. Alternatively, the same deflationary effect could be achieved by either raising taxes or reducing spending and using the new surplus to likewise retire debt held by the central bank. The difference between these latter two deflationary tactics and the issuance of debt is who bears the burden of the deflation. Under taxation and spending reduction, the cost falls on the current generation; under debt issuance, the cost is borne by future taxpayers.

7. Davis, "Summers Sees 'Least Responsible' Fiscal Policy in 40 Years."
8. Veronique de Rugy, "Inflation as Chronic Illness," *Law and Liberty*, March 12, 2025.
9. De Rugy, "Inflation as Chronic Illness."
10. Federal Reserve Board of Governors, "Federal Reserve Issues FOMC Statement," press release, March 15, 2020.
11. Prior to the COVID-19 pandemic, the Fed required depository institutions to hold a minimum amount of liquid assets to satisfy sudden withdrawal needs. Those institutions had the option to hold those assets in the form of "reserves" at the Fed, where the Fed would pay an interest rate. If this IOR was above market interest rates, it would encourage banks to increase their reserve balances, thus removing liquidity from the market. At the onset of the pandemic, the Fed increased liquidity by eliminating reserve requirements and lowering the IOR rate to zero.
12. Federal Reserve Board of Governors, "Federal Reserve Issues FOMC Statement" (emphasis added), March 15, 2020.
13. Congressional Budget Office, "Workbook for How Changes in Economic Conditions Might Affect the Federal Budget, June 2021," Excel spreadsheet dated June 4, 2021, https://www.cbo.gov/publication/57191. The current estimate is over $3.2 trillion, given the current public debt of $29 trillion.
14. Veronique de Rugy, "Americans Learned a Financial-Crisis Lesson. Washington Did Not," *Creators Syndicate*, October 19, 2023.
15. Federal Reserve Board of Governors, "Transcript of Chair Powell's Press Conference," December 16, 2020.
16. Federal Reserve Board of Governors, "Federal Reserve Issues FOMC Statement," press release, March 15, 2020.
17. Federal Reserve Board of Governors, "Transcript of Chair Powell's Press Conference," December 16, 2020.
18. Jerome H. Powell, "Current Economic Issues," speech at the Peterson Institute for International Economics (virtual), May 13, 2020.
19. Lael Brainard, "Remaining Patient as the Outlook Brightens," speech at the National Association for Business Economics 37th Annual Economic Policy Conference (virtual), March 23, 2021.
20. Veronique de Rugy and Jack Salmon, "Biden's Strategy to Fight Inflation Ignores Its Root Causes," *Discourse*, June 1, 2022.
21. Congressional Budget Office, "Interim Economic Projections for 2020 and 2021" (Publication 56351, May 19, 2020).
22. The money multiplier is calculated by dividing M2 ($22 trillion) by the monetary base, M0 ($5.7 trillion). Figures for each can be found on the Federal Reserve website at https://www.federalreserve.gov/releases/h6/current/default.htm.

23 I would like to thank former George Mason University Professor Lawrence H. White for sharing this example with me.

24. Congressional Budget Office, "An Update to the Budget Outlook: 2020 to 2030" (Publication 56517, September 2020); Congressional Budget Office, "The Budget and Economic Outlook: 2021 to 2031" (Publication 56970, February 2021); Congressional Budget Office, "Additional Information about the Updated Budget and Economic Outlook: 2021 to 2031" (Publication 57263, July 2021).
25. Congressional Budget Office, "The Accuracy of CBO's Budget Projections for Fiscal Year 2020" (Publication 56885, December 2020); Congressional Budget Office, "The Accuracy of CBO's Budget Projections for Fiscal Year 2021" (Publication 57614, January 2021); Congressional Budget Office, "The Accuracy of CBO's Budget Projections for Fiscal Year 2022" (Publication 58603, January 2023).