During COVID, Did Fiscal Policy 'Get in all of the Cracks'?

Pierre-Olivier Gourinchas, Şebnem Kalemli-Özcan, Veronika Penciakova, Nick Sander

Questions:

1. Did fiscal policy provide enough liquidity support to struggling SMEs?
2. Did fiscal stimulus help support aggregate activity?
3. How big are fiscal policy spillovers globally?
4. Implications of a two-speed recovery?

Answers:

1. Despite poor targeting, fiscal support **reduced SME failures without sustaining or creating 'zombies'**.
2. **Fiscal policy reallocated demand towards sectors with slack, sustaining overall employment**.
3. **Spillovers from fiscal policy are small**, negative on output, positive on employment. **AEs fiscal tide does not lift all boats**.
4. **Rising global interest rates and risk premia. Strong headwinds for EMs.**

Fiscal policy *can* get in all of the 'domestic' cracks, but it requires fiscal space.

Did government liquidity support mitigate SME failures?

1. Model individual firms operating in different sectors with a rich input-output structure
2. Represent COVID-19 as country- & time-varying supply/demand, aggregate/sectoral shocks.

Shocks:
- Sectoral *supply* shocks
- Sectoral *demand* shocks
- Aggregate demand

Variation (sector × country):
- O-Net and OxGRT
- O-Net and Google mobility
- Realized and forecast GDP growth

3. Firms fail when cash balances and operating profits are insufficient to cover financial expenses
4. Map the model to firm-level financial statements for 18 AEs and 9 EMs.
5. Fiscal support calibrated to actual spending on tax waivers, cash grants and pandemic loans.

Result 1: Fiscal support reduced SME failures

- Without support, failures increase by 9pp.
- With fiscal support, increase *only* by 4.3pp.
- Substantial variation across countries. Full offset in AEs due to size of fiscal programs.

Result 2-3: Poorly targeted, but no zombies

- 88% of funds disbursed went to firms that would have survived.
- Zombies account for 2% of funds and 13% of firms at risk.
- In 2021, failure rate *only* 2.6pp above normal. *Saved firms are viable after policy ends.*

Table 1. Failure Rate and Policy Cost

	No Policy Support	With Policy Support	
	Δ (pp)	Δ (pp)	Support (%, GDP)
All	**9.00**	**4.30**	**4.05**
Advanced	5.65	**-0.43**	6.08
Emerging	12.53	9.28	1.91

Q: Did fiscal support provide enough liquidity to struggling firms?

A: Despite poor targeting, **fiscal support reduced SME failures without creating 'zombies'**.

Did fiscal policy support economic activity, domestically and globally?

1. Develop a global, dynamic, heterogeneous agent general equilibrium model, with nominal wage rigidities and a rich global trade and production network.
2. Fiscal policy includes *transfers to households, not just firms.* Much larger in AEs than EMs.

Figure 1a. Fiscal Spending (% of GDP), Advanced

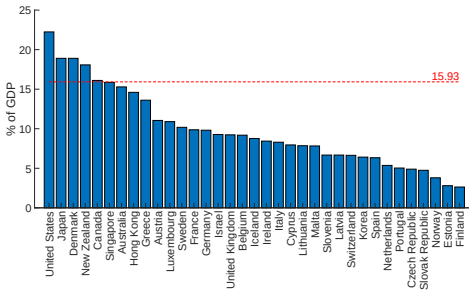
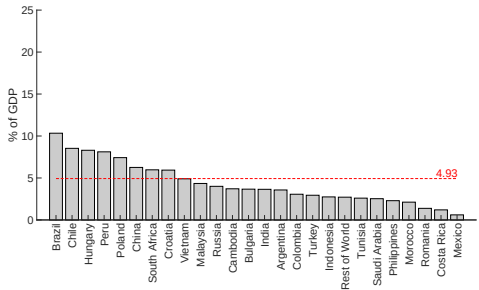


Figure 1b. Emerging



3. COVID shocks as before + *country-specific precautionary shocks*
4. Discipline the model with ICIO's global IO matrix for 64 countries, 36 sectors
5. Evaluate the impact of fiscal policy on output, trade balances, and global interest rates under COVID and perform a series of counterfactuals.

Result 4: Sizeable demand-constraints

- **Supply-** vs. **demand-** constraints. **Demand-constrained = slack**.
- 31% of global GDP in demand-constrained sectors.

Result 5: Low multiplier... but employment support

- *Low multiplier (0.06) is misleading*:
  COVID creates supply bottlenecks.
  Many policies not designed to stimulate output
- *Employment support*: reallocates spending towards sectors with slack.
- Keynesian unemployment ↓ from 2.67% to 1.40%.

Table 2. Fiscal Multipliers & Demand Reallocation
(relative to no fiscal policy)

	Δ Real GDP %	Δ Keynesian Unemployment (pp)
All Country Stimulus	**0.67**	**-1.27**

Q: Did fiscal stimulus help support activity?
A: **Yes. Despite low multiplier, it reallocated spending towards sectors with slack.**

Result 6: Fiscal spillovers are small

- Spillovers to output are small – and mostly negative (interest rate and terms of trade effects)
- Spillovers to employment are small – and mostly positive (demand created in sectors with slack)

Figure 2. U.S. Policy Output Spillovers...

(Note: U.S. on different scale)

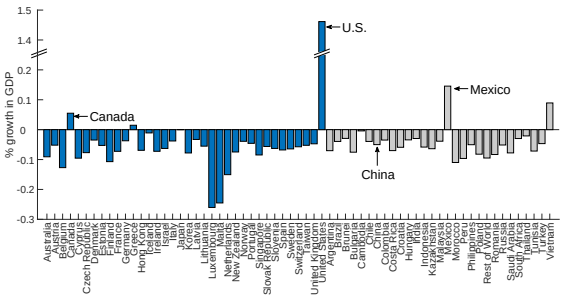


Table 3. ...and Unemployment Spillovers

	Δ Share Demand Constrained (%)	Δ Keynesian Unemployment (pp.)
All	-2.92	-0.57
U.S.	-11.22	-2.04
Advanced ex U.S.	-0.07	-0.09
Emerging	-0.28	-0.08

Q: How big are fiscal policy spillovers globally?

A: Mostly small. **AEs fiscal tide does not lift all boats.**

What are the implications of a two-speed recovery?

Result 7: Strong headwinds for EMs

- AEs private savings ↓, global interest rates ↑, global imbalances ↑
- Output falls in EMs (-0.47% relative to 2020)

Result 8: EM financial vulnerabilities

- Higher global rates translate into higher risk premia for EMs
- Monetary policy tightening in US increases (decreases) govt. bond spreads in EMs (AEs).

Table 4. Two-speed Recovery (rel. to 2020)

	Trade Balance (% GDP)		Δ Real GDP (%)		Interest Rate (%)
	AE	EM	AE	EM	
AE Recovery	**-0.76**	**1.12**	8.68	**-0.47**	**2.62**

Q: What are the implications of a two-speed recovery?
A: **Increase in global rates, widening global imbalances and financial headwinds for EMs.**

Findings	Policy Implications
1. **Fiscal Policy 'got in all of the domestic cracks'**	1. **SMEs Fundamentals in AEs are strong.** – **AEs should pivot away from fiscal support to SMEs.** – Possible fragilities from corporate leverage.
2. **Cross-border spillovers of fiscal policy are small**	2. **AE's fiscal tide does not lift all boats.** – **Countries need to rely on domestic policies.**
3. **Two-speed recovery will create serious headwinds for EMs**	3. **Close the vaccination gap!** Beyond that, **Improve resiliency in EMs.** – Encourage FDI and LT local currency debt. – Monetary policy credibility in EMs. – AEs tapering: faster fiscal, careful monetary – Global financial safety nets by IFIs.