A Social Insurance Perspective on Pandemic Fiscal Policy, and Implications for Monetary Policy

David Romer

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How to Think about the Economic Policy Response to a Pandemic
Approach 1: "Fighting the Last War"

- That is, respond as one would to a conventional recession.

- Address massive falls in output and employment with large-scale aggregate demand stimulus.

- And in light of the aftermath of the global financial crisis, err on the side of doing too much rather than too little.

- “the financial crisis also teaches us another lesson. Rather than trying to tailor the response to one’s best guess of the precise size of today’s crisis, go big ….”

  – Gene Sperling, Feb. 2, 2021.

Problems with Approach 1

- Getting output and employment quickly back to normal isn’t a good idea during a pandemic!
- General stimulus will do little to help workers in industries that can’t operate safely.

Approach 2: “Social Insurance”

- Use of taxes and transfers to provide people with insurance that they would have liked to have had.
- Intuitively appealing; grounded in welfare economics.
- Our paper: Develops this idea formally, and examines U.S. pandemic fiscal policy from this perspective.
- Closest antecedents: Milne (2020); Guerrieri, Lorenzoni, Straub, and Werning (2022); Woodford (2022).

Outline

- Sketch of our simple model; its main messages; and a little about some extensions and their messages.
- Looking at some of the main parts of the U.S. policy response through the lens of our model.
- Broader implications for fiscal policy.
- Interactions with monetary policy.

Key Features of Our Baseline Case

- Model is deliberately very simple.
- A static setting with the possibility of a concentrated shock—one that shuts down part of the economy (a “pandemic”).
- There are assumed to be no private markets for pandemic insurance.

Two Messages from Our Baseline Case

- The government can use ex post targeted taxes and transfers to replicate what the outcome would have been with ex ante markets for pandemic insurance.
- This policy doesn’t involve any “stimulus”.

Three Messages from Some Sensible Extensions of the Model

- There’s a strong case for government-provided “hazard pay”—extra pay in sectors that are high-risk but whose output is high-value in a pandemic.

- There’s a strong case for insurance to be less complete for higher-income households.

- A pandemic is likely to lead to an aggregate demand shortfall.

Application #1: Unemployment Insurance Policy in the U.S. in the Pandemic

- UI should have broad coverage. YES.
- Search requirements should be relaxed. YES.
- Duration should be extended to match duration of the pandemic. MIXED.
- Replacement rates should be ≤ 100%, and decreasing in pre-pandemic income. MIXED.
- It’s a plus if UI is an effective way of providing aggregate demand stimulus. LARGELY YES.

Application #2: Hazard Pay in the U.S. in the Pandemic

- There should be hazard pay. LARGELY NO.
- Hazard pay should be fairly narrowly targeted and/or tiered. NO.
- The magnitude should roughly compensate for the additional risks. PERHAPS.
- Likely phase out at high incomes. LARGELY YES.
- It’s a plus if it’s an effective way of providing aggregate demand stimulus. LARGELY YES.

(Implicit) Application #3: General Stimulus

- There shouldn't be massive, repeated measures to raise aggregate demand. NO.

Broader Implications for Fiscal Policy—1

- There are likely to be other large shocks that, like Covid, affect both aggregate demand and aggregate supply, and whose impact is concentrated.
  - Examples: Other pandemics, regional climate-related disasters.

Broader Implications for Fiscal Policy—2

- The social insurance perspective has implications for conventional recessions:
  - Points to enhanced UI and a stronger safety net in recessions.
  - And perhaps to support for distressed homeowners in the Great Recession.

Implications for Monetary Policy: A Proposed Baseline Hierarchy

- Step 1: Fiscal authorities take actions implied by a social insurance perspective.
- Step 2: Taking those actions as given, if the resulting level of aggregate demand isn’t what’s wanted, the central bank uses conventional tools to manage aggregate demand.
- Step 3: If Steps 1 and 2 aren’t enough to generate sufficient aggregate demand, fiscal authorities and the central bank use some mix of general fiscal stimulus and unconventional monetary policy.

The Logic Behind the Proposed Hierarchy

- Social insurance should come first because it's warranted on micro, efficiency grounds.
- Conventional monetary policy should take the lead on aggregate demand management because it's the most flexible and general tool for controlling aggregate demand.

Implications for Monetary Policy (continued): Should Monetary Policy Support the Social Insurance Role of Fiscal Policy?

- “No” is probably a good starting point.
  - Conventional monetary policy isn’t targeted!
  - Unconventional monetary policy can be targeted, but there are good reasons for policies targeted to specific sectors or groups to be mainly the province of elected officials.
- That said, there may be a social insurance case for some central bank lending programs.

Messages

- Social insurance provides a good way of thinking about desirable fiscal policy in “pandemic-like” recessions.
- In the pandemic, the U.S.’s record in following the social insurance approach was very mixed.
- The social insurance approach has implications for fiscal policy in conventional recessions.
- To a large extent, leave social insurance to the fiscal authorities and macro stabilization to the central bank.