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STRENGTHENING OUR FISCAL TOOLKIT: POLICY OPTIONS TO IMPROVE ECONOMIC RESILIENCY

Committee on the Budget

U.S. House of Representatives

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Thank you Chairman Yarmuth, Ranking member Womack, and members of the committee for inviting me to testify on the steps the federal government can undertake to ensure the United States economy is prepared in the event of a recession. It's an honor and a privilege to contribute to this committee's work.

The United States is currently experiencing one of the longest periods of economic expansion in its history.[1] However, the expansion has not reached all households and many continue to struggle with long-term unemployment.[2] At the same time, economic growth appears to be slowing, and there are warning signs that a recession is possible in the near future. While downturns are difficult to predict, policymakers have a responsibility both to assess whether the country is prepared for the next recession and to implement approaches to protect Americans from the worst outcomes.

Fortunately, the U.S. government has a variety of tools available to help pull the national economy out of a recession. These tools generally fit into two categories. First, there is monetary policy, which is conducted by the Federal Reserve Board, the independent central bank responsible for setting interest rates, among other things. Second, there is fiscal policy, which is conducted by the executive and legislative branches of the U.S. government. However, these tools may prove less effective in the next recession, in part because the Fed has less room to cut interest rates, its traditional tool to tackle

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downturns.[3] And discretionary fiscal policy, while still potentially effective, relies on politicians' willingness to use it in the right way, which has not always been the case. For example, during the Great Recession, Congress engaged in austerity measures, reducing spending well before the economy fully recovered.[4] This is not to say the Fed cannot be effective in the next recession, but it will likely have to do so through unconventional policies, the effects of which are harder to predict, and which are more likely to have unintended consequences because we have less experience with these tools.

Automatic stabilizers are another, well-understood and highly effective tool that can help mitigate the effects of a recession. Automatic stabilizers inject funds into the economy in the event of a downturn either through transfer payments or tax reductions. While a form of fiscal policy, they are automatic because they do not require action by Congress. They play a vital macroeconomic role by boosting aggregate demand when it lags, helping make downturns short and less severe than they otherwise would be. Enabled once the economy hits a downturn, these stabilizers—such as the expansion of unemployment insurance (UI)—are effective in helping steady the economy.[5] For example, UI kept more than 5 million people out of poverty during the Great Recession and prevented 1.4 million foreclosures, all while boosting demand for business as they struggled to survive.[6] Unfortunately, since the latest recession, states have reduced these benefits, thereby diminishing their positive and protective effects.[7]

How automatic stabilizers should work

It is crucial that Congress update existing automatic stabilizers using both academic studies of previous efforts and policy professionals' experience in implementation gleaned during the Great Recession. Several guidelines should be implemented in existing policies to create an instant response that would bolster the United States' economic stability without the need for legislative action in a potentially gridlocked Congress. These principles should underlie almost any automatic stabilization policy:

1. Ensure that policymakers can increase and extend the benefits of automatic programs and that they are not tightened before all demographic groups and regions have recovered.

2. When appropriate, tie the triggers to activate automatic stabilizers to economic indicators such as unemployment, GDP, and business cycle indices.

3. Make federal fiscal relief to states substantial, automatic, and prolonged so that states do not engage in austerity measures—policies that contract the economy by

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cutting government programs and/or raising taxes—before the economy has recovered.

4. Require strong maintenance of effort (MOE) provisions during downturns so that states do not use federal funds to simply replace their own.

Unemployment Insurance Since the Great Recession

The UI system is a crucial automatic stabilizer that provides a soft landing for individuals who face layoffs or experience joblessness. UI is one of the most crucial tools in helping the economy recover from the deepest economic recessions since the Great Depression. In periods of high unemployment, the federal government has provided more assistance through the Emergency Unemployment Compensation (EUC) program and even more in high-unemployment states through the Extended Benefits (EB) program, though these programs are not automatic and expired in 2013.[8]

Not only did UI help prevent poverty for some individuals and kept many people in their homes, UI provided a large economic stimulus when it was greatly needed. UI closed more than 18% of the shortfall in GDP in the aftermath of the Great Recession.[9] This is because individuals who were on layoff were able to continue pumping money into the economy from receipt of UI benefits. This added boost also led to job creation. Economist Wayne Vroman found in 2010, that unemployment benefits increased employment by an average of 1.6 million jobs, 900,000 from regular unemployment benefits and 700,000 from the EUC and EB programs.[10]

Due to the severity of the Great Recession, many states ended up depleted their reserves and had to borrow from the federal government to cover UI benefits. In response to the funding issues, many states have decreased UI payouts through dramatic and historically unprecedented reductions. These include reductions in the number of weeks of available benefits, cuts to wage replacement rates, stricter eligibility requirements, direct benefit cuts that reduce how much of workers' prior wages UI can replace, and new disqualifications. These cuts occurred instead of increasing the revenue from employer taxes to replenish the state programs' trust funds.[11]

Despite the urgent need to prepare the UI system for the next recession, state policymakers continue to undermine it. For example, many states have switched to an online system that disenfranchises individuals who have limited or low-quality access to broadband service, like rural communities. Also, as recently as May 2019, a Republican-sponsored bill was passed in Alabama that reduced the duration of unemployment

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benefits below the current 26-week limit.[2] In addition to Alabama, Arkansas, Florida, Georgia, Idaho, Kansas, Michigan, Missouri, North Carolina, and South Carolina reduced their benefit duration to below 26 weeks. Reducing the maximum duration below this threshold is particularly counterproductive when the stabilizing effect of these benefits is needed most.

Steps to Shoring Up Unemployment Insurance

Unemployment Insurance is financed by a combination of federal taxes under the Federal Unemployment Tax Act (FUTA) and state taxes under each state's State Unemployment Tax Act (SUTA). Employers pay an effective net tax rate of 0.6% on the first $7,000 of each employee's earnings (no more than $42 per worker per year). State tax paid by employers is on at least the first $7,000 of the employee's earnings and the tax rate is based off experience rating, which is determining by the firm's past UI behavior. If a firm has high number of layoffs, that means that firm is drawing upon the state's trust funds and therefore leads to higher taxes for that firm.

In the aftermath of the Great Recession, state trust funds have taken a significant hit. 36 of the 53 states and territories ended up borrowing money from the Treasury to cover their UI obligations because they depleted their trust fund.[12] To strengthen the fiscal toolkit prior to the next recession, there are several steps that should be taken to make state UI trust funds solvent.

- Currently, 16 states index the taxable base to inflation so that this base naturally increases over time. The remaining states should follow suit so that their base automatically increases. The 16 states that indexed their taxable base to inflation had fewer solvency issues. During the Great Recession, only six of the sixteen states that index their base needed Treasury loans, while 29 of the 35 that do not index their base needed Treasury loans.[13]

- At the federal level, the tax base should be increased from its current level of $7,000 (which was last raised in 1983) to something significantly higher. In 2014, there were proposals to increase in the federal tax base from $7,000 to $15,000, but the federal government should be much bolder – simply adjusting the existing base to account for inflation would call for increasing the base to just over $18,000. Since states tie their own taxable base to the federal level, this would have the effect of increasing the state tax base and improving solvency.

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In addition to improving trust fund solvency, all states should maintain a maximum benefit duration of 26 weeks. As stated previously, several states since the Great Recession have reduced the maximum benefit duration to fewer than 26 weeks.

Economists Gabriel Chodorow-Reich and John Coglianese outline several further steps that would make the UI program much stronger and a much more effective automatic stabilizer. They argue that policymakers should expand eligibility, reform the EB program by making it fully federally financed and by creating new triggers and increase the weekly benefit amount from $25 to $50.[14]

Other Automatic Stabilizers

Strengthening UI is an important, concrete step for getting the economy ready for a recession and providing the platform for helping the American workers and our economy bounce back. However, there are other steps Congress should take beyond UI to strengthen the economy. This includes helping those who are ineligible for UI, easing the burden on states by supplementing spending on various programs during a recession, and expanding SNAP during downturns while eliminating work requirements that threaten the macroeconomic stabilization purpose of UI.

There are many people who are not eligible for UI but who would benefit from a program that would increase their attachment to the labor force. These are individuals who have a limited work history, or they were independent contractors are therefore did not pay into the UI system. A Jobseekers' Allowance, that provides a stipend of roughly $170 for at least 13 weeks is one promising approach to reaching these workers. The target population would be new labor market entrants, re-entrants, UI exhaustees, self-employed workers, and intermittent workers with limited resources.

One issue for states during a downturn is that almost all face balanced budget rules. This becomes especially problematic during a downturn because spending rises, while revenues fall. Thus, states must make decisions about which programs to cut, which inevitably falls on programs like SNAP, Medicaid, and education programs. The federal government can provide assistance in this case by having them provide federal funds to help states maintain the existing levels of spending for specific programs like Medicaid and the Children's Health Insurance Program (CHIP). The federal government has done this during the past two recessions. This policy can be turned into an automatic stabilizer by linking federal disbursement to rising state unemployment rates. Economists Matthew Fiedler, Jason Furman, and Wilson Powell III develop a proposal where the federal share of expenditures for Medicaid and CHIP would automatically increase when a state's

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unemployment rate hits a certain threshold.[15] This policy has the benefit of maintaining spending on the programs that are crucial for those affected by downturns while easing the burden on states. Legislators concerned about states free riding on the federal government could condition federal assistance on states reforming balanced budget rules to be less harmful during recessions.

The Supplemental Nutrition Assistance Program (SNAP), formerly the Food Stamp program, provides a crucial role in reducing economic hardship and providing food assistance for low-income citizens. In 2018, SNAP provided food assistance to one out of eight Americans, including the elderly, disabled, and children.[16] It not only helps individuals out, but it is an effective automatic stabilizer that boosts the economy during a downturn. Individuals who receive benefits during periods of unemployment or underemployment immediately spend this money which provides a rapid fiscal stimulus to the economy. Economists Hilary Hoynes and Diane Whitmore Schanzenbach argue that SNAP could be strengthened as an automatic stabilizer by removing work requirements and by increasing benefits by 15% during downturns.[17] These provisions have the benefit of expanding eligibility for the program which in turn improves the stimulus effect of spending by SNAP recipients.

Conclusion

Everyone is asking when the next recession will be coming. I believe that this is the wrong question to ask. The right question to ask is, “Are We Ready?” We are not ready because the tools at our disposal are less effective than they were during the Great Recession.[18] We can rectify this by strengthening automatic stabilizers like Unemployment Insurance, SNAP, and Medicaid especially since they will commence once the economy enters a downturn. But the time update them is now, we cannot wait.

Thank you again for the opportunity to address this committee.

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