HOUSE COMMITTEE ON THE BUDGET
Chairman John Yarmuth

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Congress Must Strengthen Our Recession-Fighting Toolkit

Over the last ten years, we have experienced the longest uninterrupted period of economic expansion in U.S. history. While economic expansions do not necessarily have an expiration date, many economists believe that this period of economic expansion may be growing fragile.

"No one hopes for a downturn, and no one can know when one will hit, how long it will last, or which sectors or families will be impacted the most," Chairman John Yarmuth said at a hearing earlier this month. "As Members of Congress, it is a responsibility of ours to make sure the federal government is ready to respond to a crisis before we are in one."

At the hearing, "Strengthening our Fiscal Toolkit: Policy Options to Improve Economic Resiliency," the House Budget Committee heard testimony from expert witnesses on how the resources available to the federal government to combat economic downturns look different now than in the past. In addition, witnesses discussed policy options for strengthening the recession-fighting tools, known as automatic stabilizers, which are already in law.

Fiscal Policy Will Be More Important Than Ever

Policymakers generally have two types of tools to respond to recessions: monetary policy and fiscal policy. Both are traditionally deployed in the event of a downturn, but our witnesses cautioned that monetary policy (such as manipulating interest rates) may be less effective going forward – and fiscal policy will need to fill in the gaps.

"Vigorous use of countercyclical tax and spending policies will be crucially important for limiting the severity of the next recession" — Dr. Doug Elmendorf, dean of the Harvard Kennedy School and former director of the Congressional Budget Office (CBO), noted that our recession-fighting toolkit looks different now than it has in the past. During the Great Recession, the Federal Reserve lowered its primary policy tool, the federal funds rate, by more than 5 percentage points to near zero in the span of little more than a year. These cuts were in line with previous recessions, which saw the Fed lower the federal funds rate by an average 6 percentage points. Today, however, the federal funds rate sits at 1.75 to 2 percent – and is projected to remain historically low even in the absence of a recession – leaving the Fed with very little room to cut interest rates in the face of another downturn. While the Fed has additional "unconventional" policy tools, its most effective form of stimulus – cutting interest rates – will not be as potent going forward. "That will leave more for fiscal policy to do," Dr. Elmendorf added.

We Have the Fiscal Space to Fight the Next Downturn

In addition to the challenge described above, another potential obstacle to fighting the next recession is our fiscal situation. Today, the debt-to-GDP ratio is 79 percent – more than double the ratio on the eve of the Great Recession – and is projected to rise to 95 percent of GDP over the next decade. This has led some to worry that we lack the "fiscal space," or budget capacity, to increase government spending or cut taxes to counter the next downturn. Witnesses at the hearing, however, disagreed.

"Notwithstanding the historically large amount of federal debt outstanding, the government has plenty of budget capacity to use fiscal stimulus vigorously" — Dr. Elmendorf acknowledged that the current trajectory of debt is unsustainable, and that policymakers will eventually need to act. "But market interest rates on federal debt are now at historically low levels and have been trending down for decades," he continued. "Federal borrowing is thus less costly, less risky, and less harmful to the economy in the long run than most economists have expected. The urgency of putting federal debt on a sustainable path is, therefore, greatly lessened."

Not only do we have fiscal space to fight the next recession, utilizing it is also good economic and budget policy. While policies like infrastructure investments or transfers to state governments may raise deficits, their stimulative effects on the economy as a whole – particularly when interest rates are low – partially mitigate that effect. Effective fiscal stimulus that reduces the severity and length of recessions and fosters a fast-paced and broadly shared recovery can significantly improve our long-term economic and budgetary outlooks.

Automatic Stabilizers are Fiscally Responsible Recession-Fighting Tools

In addition to discussing the importance of fiscal stimulus more broadly, the Committee discussed one tool in detail: automatic stabilizers. CBO defines automatic stabilizers as "automatic changes in revenues and outlays that are attributable to cyclical movements in gross domestic product (GDP) and unemployment." They are automatic because they do not require a new act of Congress to kick in; they are already in law. They stabilize the economy because they tend to dampen the ups and downs of the business cycle. When the economy is weak, more federal resources flow to people in need and tax collections are lower; when the economy is strong, fewer people are eligible for means-tested programs, so spending on those programs is reduced, and government revenues rise. Three examples of automatic stabilizers that involve federal spending include Medicaid, the Supplemental Nutrition Assistance Program (SNAP), and Unemployment Insurance (UI).

"**Automatic stabilizers are a tool that can help mitigate the effects of [a] recession**" — Dr. Olugbenga Ajilore, senior economist at the Center for American Progress, described how these programs stabilize the economy during times of crisis. In particular, he shared with the

Committee some of the positive effects of UI during the last downturn. "During the Great Recession, unemployment insurance kept more than 5 million people out of poverty and prevented 1.4 million foreclosures. Unemployment insurance closed more than 18 percent of the shortfall in GDP in the aftermath of the Great Recession."

"**The logic of automatic stabilizers is impeccable**" — Dr. Doug Holtz-Eakin, president of the American Action Forum and also a former CBO director, noted the economic rationale of automatic stabilizers in his opening statement. Automatic stabilizers provide support that is timely and targeted, thereby helping reduce the severity and length of recessions. Also, because they turn on and off automatically, they are fiscally responsible.

"**Automatic stabilizers are important because it is difficult for the Congress to always act very quickly when economies fall into recession**" — Dr. Elmendorf highlighted an important feature of automatic stabilizers: they do not require a new act of Congress to kick in. "Economists are bad at predicting recessions, but quick responses from fiscal policy are important. And the way to do that with quick responses is to build them in ahead of time." In his opening statement, Chairman Yarmuth agreed: "While the world is moving at 100 miles per hour, Congress, at its optimum efficiency, moves at about 10 miles per hour. That is why it is crucial that we start the process of strengthening these programs now, before we hit a downturn."

Policymakers Should Strengthen Automatic Stabilizers

Congress originally created programs like Medicaid and SNAP to help Americans afford health care and put food on the table. Stabilizing the economy during downturns is a secondary benefit, but, as witnesses pointed out, these programs were not created for that purpose. Witnesses on the panel also outlined how existing automatic stabilizers should be strengthened to better serve American families and how making the stabilizers more automatic could bolster our response to the next downturn.

"The strength of those stabilizers was not by design by you or your colleagues" — Dr. Elmendorf noted, "You built tax provisions and spending programs to achieve other ends, and out of those decisions we end up with a certain amount of automatic stabilization." The automatic stabilizers under current law have "arisen by accident," Dr. Elmendorf said, and should be bolstered to provide anti-recessionary support when the economy is weakest.

"**It is crucial that Congress update existing automatic stabilizers using both academic studies of previous efforts and policy professionals' experience in implementation gleaned from the Great Recession**" — In his testimony, Dr. Ajilore outlined four principles that Congress should consider when developing policies that strengthen automatic stabilizers:

> "First, 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. Two, when appropriate, tie the triggers to activate automatic stabilizers to economic indicators such as unemployment and GDP. Third, make federal fiscal relief to states substantial, automatic, and prolonged so that states do not engage in austerity measures before the economy is recovered. And then, finally, require strong maintenance of effort provisions during downturns so that states do not use the federal funds simply just to replace their own."

Several witnesses recommended strengthening the role of **unemployment insurance**, which Dr. Ajilore described as "the first line of defense when we have a recession." Dr. Elmendorf described two advantages of bolstering UI: it would provide additional relief to people who lose jobs, and it would increase consumer spending when the economy is faltering, providing a stimulative effect. Policy options suggested included incentivizing states to maintain the maximum benefit duration and offering more federal support to states with higher unemployment rates. In addition, Dr. Ajilore discussed a proposal known as the "Jobseeker's Allowance," which would provide a weekly unemployment benefit to independent contractors and other people who are not otherwise eligible for unemployment insurance.

Witnesses also discussed strengthening **Medicaid's** role as a recession-fighting tool by increasing the federal share of Medicaid payments during a recession. In recessions, states face declining revenues and increased demand for services, and Medicaid enrollment growth is a major driver of the latter. Given Medicaid's size – nearly one-third of state's budgets—states are frequently tempted to cut the program to fill budget holes, often at a time when vulnerable families need it the most. For this reason, Congress legislated temporary increases to the Medicaid matching rate to respond to past recessions in 2003, 2009, and 2010.

"The timing of the expiration of federal aid during recessionary periods could be improved by targeting based on specific economic or fiscal metrics rather than a fixed date" — Mr. John Hicks, executive director of the National Association of State Budget Officers, suggested that Congress could bolster the countercyclical nature of Medicaid financing.

Medicaid is a particularly effective way of providing aid to states during recessions, according to Mr. Hicks. "If you want to get spending done quickly and you want to keep states from raising taxes or really reducing education spending because that is where most of our big dollars go to, that is a very effective tool, and it has proved effective in the last two recessions." Because all states already have the mechanics in place to receive federal Medicaid dollars, federal recession-fighting aid can be spent quickly. Other witnesses proposed that policymakers could automatically increase federal payments to states for Medicaid by a certain amount each time a state's unemployment reaches a certain threshold.

In addition, Committee members discussed and rejected Trump Administration actions that would weaken automatic stabilizers. Time and time again, the Administration has attacked programs that help struggling Americans put food on the table and keep a roof over their heads. From a proposal that would change the way the federal government measures poverty, to implementing work requirements, to reducing benefits and eligibility, the Trump Administration's assault on automatic stabilizers continues at a time when we should be shoring up the programs that Americans most rely on when the economy worsens.

"**When people look for a job, they still have to eat**" — Dr. Ajilore discussed the harm that work requirements pose for SNAP and Medicaid, particularly during a recession when large numbers of people are laid off and families are most in need of support. Work requirements in Medicaid – currently on hold due to ongoing litigation – would add an onerous and discriminatory barrier to health care for our most vulnerable Americans. In fact, research shows that the vast majority of adults receiving Medicaid are already working or report real barriers to working, such as school attendance, serious medical conditions, care-taking responsibilities, or disability. Removing work requirements would improve the stimulative effects of these critical stabilizers.

Promoting Long-Term Economic Growth and Preparing for Recession Are Not Mutually Exclusive

Republican Committee members spent much of the hearing arguing that a recession is not imminent, and that Congress should focus on raising the trend rate of economic growth rather than bolstering anti-recessionary programs**. This choice is false: policymakers can build a stronger economy in the long term *and* prepare for the consequences of a possible recession.**

Moreover, high levels of economic growth are not enough to protect an economy from recession. In the years prior to the 2001 recession, real GDP growth rate averaged nearly 4 percent. Prior to the Great Recession, real GDP growth averaged 2.6 percent – faster than our current pace of growth. In neither case were strong growth rates enough to protect the economy from crisis.

"I think that is a complement to, not a substitute for, also thinking about what will happen when a recession hits. So to use your analogy, we should build buildings out of floodplains, but we still need FEMA to turn up when the hurricanes hit" — In response to Ranking Member Steve Womack's remark that recessions, like hurricanes, are inevitable but impossible to predict, Dr. Elmendorf argued that this should give policymakers even more reason to prepare for the next downturn *before* it hits. Strengthening existing automatic stabilizers and building additional automatic anti-recessionary policies into law would help mitigate the recession's destruction and accelerate the economic recovery. Dr. Elmendorf agreed that Congress should pursue broad-based economic growth but pushed back on the false choice between promoting economic growth and preparing for a recession. If anything, the opposite is true: improving our responses to recessions will strengthen our long-term economic prospects.