THE HAMILTON PROJECT

Washington Center for Equitable Growth

Recession Ready: Fiscal Policies to Stabilize the American Economy

Identifying the most-effective policy responses to mitigate the damaging effects of a recession can pose significant challenges for policymakers, who are often operating under intense time constraints and political pressure at the onset of an economic downturn. Historically, the United States has responded to recent recessions with a mix of monetary policy action and discretionary fiscal stimulus. However, since monetary policy options may be limited during the next recession, policymakers should consider adopting a range of fiscal policy measures now to help stabilize the economy when a future downturn inevitably occurs. This can be achieved with a range of fiscal policy responses aimed at expediting the next recovery through strengthening job creation and restoring confidence to businesses and households.

PAPER

The Damage Done by Recessions and How to Respond

Heather Boushey (Washington Center for Equitable Growth)
Ryan Nunn (The Hamilton Project and the Brookings Institution)
Jimmy O'Donnell (The Hamilton Project)
Jay Shambaugh (The Hamilton Project, the Brookings Institution, and The George Washington University)

From December 2007 to June 2009, the United States experienced the longest and most severe recession since World War II. Although the Great Recession was particularly damaging, recessions occur frequently and are devastating to workers, families and the overall economy. Historically, the United States has responded to these downturns primarily with a combination of monetary and fiscal policies, the majority of which are discretionary. In this paper, Heather Boushey, Ryan Nunn, Jimmy O'Donnell, and Jay Shambaugh discuss some of the concerns with relying too much on discretionary policy, highlighting opportunities to make greater use of automatic fiscal stabilization. This paper assesses the various policy responses available to the federal government and argues that when well designed, automatic stabilizers can be an effective part of the policy tool kit for responding to recessions.

PAPER

How Stabilizing Has Fiscal Policy Been?

Louise Sheiner (Hutchins Center on Fiscal and Monetary Policy and the Brookings Institution)
Michael Ng (Hutchins Center on Fiscal and Monetary Policy)

U.S. fiscal policy has been strongly countercyclical over the past four decades, but the degree of stabilization and the responsibility of different components of U.S. policy have changed over time. Louise Sheiner and Michael Ng investigate these trends using a measure that weights the changes in the components of fiscal policy by their likely impact on the economy. They find that automatic stabilizers, mostly through the tax system and unemployment insurance, provide roughly half the stabilization, with discretionary fiscal policy in the form of enacted tax cuts and increased spending accounting for the other half. Federal fiscal policy accounts for all the stabilization. State fiscal policy has been very mildly procyclical in downturns, on average.

PAPER

Direct Stimulus Payments to Individuals

Claudia Sahm (Board of Governors of the Federal Reserve System)

As household incomes fall during a recession, tax revenue automatically declines, helping to mitigate the downturn. Moreover, federal tax rates are often cut during or after recessions as a way to provide additional fiscal stimulus. However, this is generally implemented only slowly in the wake of a recession, and without any automatic mechanisms. Drawing on recent research that examines the effects of fiscal stimulus delivered through tax cuts, Claudia Sahm proposes a set of reforms that would make the tax code a better automatic stabilizer.

PAPER

Increasing Federal Support for State Medicaid and CHIP Programs During Economic Downturns

Matthew Fiedler (USC-Brookings Schaeffer Initiative for Health Policy and the Brookings Institution)
Jason Furman (Harvard Kennedy School and Peterson Institute for International Economics)
Wilson Powell III (Harvard Kennedy School)

During a recession, the federal government is in principle able to counteract declines in economic activity by increasing spending even while revenues decline, making up the difference through additional borrowing. However, a large portion of U.S. public spending occurs at the state and local levels, where borrowing is typically not possible and declines in tax revenues necessitate declines in spending. Consequently, state and local fiscal policy can exacerbate economic downturns rather than help provide stabilization. Matthew Fiedler, Jason Furman, and Wilson Powell III address this concern in the context of Federal Medical Assistance Percentage (FMAP) formula funds, which were adjusted during the Great Recession and could be automatically adjusted to provide state-level fiscal stimulus during future recessions.

PAPER

Infrastructure Investment as an Automatic Stabilizer

Andrew Haughwout (Federal Reserve Bank of New York)

Infrastructure policy is sometimes overlooked as an instrument of automatic stabilization—or fiscal stimulus more generally—due to its long lead times and the necessity of choosing carefully among various potential projects. However, the unprecedented duration of the Great Recession led some economists and policymakers to reconsider the fiscal stimulus role of infrastructure investments. Andrew Haughwout draws on this experience as he proposes that policymakers embed infrastructure investments more deeply and more automatically in the response to future recessions.

PAPER

Unemployment Insurance and Macroeconomic Stabilization

Gabriel Chodorow-Reich (Harvard University)
John Coglianese (Board of Governors of the Federal Reserve System)

The unemployment insurance (UI) system is a core part of the U.S. response both to individual employment loss and overall labor market disruptions. By insuring workers against job loss, UI partially protects them from important risks while also mitigating the decline in consumption that occurs during a recession. However, the extended benefits component of UI has not always performed well during economic downturns, expiring too quickly and providing insufficient fiscal stimulus. Gabriel Chodorow-Reich (Harvard University) and John Coglianese (Federal Reserve Board) assess the evidence on countercyclical impacts of UI, considering reforms that could improve its functioning as an automatic stabilizer.

PAPER

Improving TANF's Countercyclicality through Increased Basic Assistance and Subsidized Jobs

Indivar Dutta-Gupta (Georgetown Center on Poverty and Inequality)

For typical workers, the most damaging effects of a recession are employment losses. Well-timed employment subsidies can offset disemployment effects that are generally larger for low-wage workers. Indivar Dutta-Gupta therefore reviews the experience of TANF job subsidies enacted as part of the American Recovery and Reinvestment Act of 2009. Dutta-Gupta proposes to expand on this approach during subsequent economic downturns, explaining how employment subsidies can play an important role as part of an overall policy response. Dutta-Gupta also considers how TANF more generally can function as an automatic stabilizer.

PAPER

Strengthening SNAP as an Automatic Stabilizer

Hilary Hoynes (University of California, Berkeley)
Diane Whitmore Schanzenbach (Northwestern University)

The Supplemental Nutrition Assistance Program (SNAP), formerly known as the Food Stamp Program, is the nation's most important food support program—but it is also an automatic stabilizer that supports the economy during downturns. Hilary Hoynes and Diane Whitmore Schanzenbach propose reforms to SNAP that would make it a more-effective automatic stabilizer and increase its ability to protect families during downturns.