# Recession Ready: Fiscal Policies to Stabilize the American Economy

A new book by The Hamilton Project and Washington Center for Equitable Growth, titled R*ecession Ready: Fiscal Policies to Stabilize the American Economy*, offers detailed proposals from leading economists and policy experts for better fiscal policy responses to recessions. These proposals aim to strengthen our automatic stabilizers: policies that inject money into the economy in a downturn and withdraw stimulus when the economy is strong.

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

A proposal by Matthew Fiedler (Brookings Institution), Jason Furman (Harvard University), and Wilson Powell III (Harvard University) aims to avoid state budget cuts during recessions by increasing the federal matching rate for Medicaid and the Children's Health Insurance Program during economic downturns. Specifically, the program would:

- **Automatically increase the federal share of expenditures on Medicaid and the Children's Health Insurance Program during recessions.** When a state's unemployment rate exceeds a threshold level, the share of these programs financed by the federal government (commonly referred to as the state's matching rate) would rise by an amount proportional to the excess of the state's unemployment rate over this threshold.
- **Be designed to offset approximately two-thirds of the state budget shortfalls** that emerge in economic downturns with increases in state matching rates.

## Issue Overview

- **Declines in state revenues and increased demands on government programs**, together with states' balanced budget requirements, lead states to reduce spending, increase taxes, or do both during recessions and their aftermaths. Those responses deepen recessions, slow subsequent recoveries, and deprive residents of valuable public and private goods.
- **Automatic increases in the state matching rate** would reduce pressure on state budgets, reduce incentives to cut health spending when need is large, and diminish the severity of economic downturns.

## The Challenge

State governments face significant fiscal pressures during recessions. Economic activity declines, which reduces receipts from sales tax, income tax, and other taxes. In addition, the number of people eligible for means-tested programs operated by state governments rises, putting pressure on state resources. Unlike the federal government, state governments generally must balance their budgets annually, which means the budget shortfalls that emerge when the economy is weak require states to take steps to increase revenues, reduce spending, or some combination of the two.

The authors point out that these state responses reduce aggregate demand when the economy is weak, thereby deepening the economic downturn both in the state implementing the changes and in other states as well. States' residents lose valuable services supported by state governments—such as education, transportation, and public safety—and they are able to consume fewer privately produced goods and services.

Fiscal pressures may spur states to cut the two largest safety-net programs they operate: Medicaid and the Children's Health Insurance Program. These programs, which are jointly funded by the states and the federal government, provide health insurance (and long-term care) to low-income people and people with disabilities, so cuts to these programs have the potential to seriously harm vulnerable state residents.

## The Path Forward

Drawing from lessons learned from past discretionary increases to the matching rates for Medicaid and the Children's Health Insurance Program in response to economic downturns, Fiedler, Furman, and Powell propose to make this practice automatic.

1. **When a state's unemployment rate exceeds a threshold level**, the matching rate would rise by an amount proportional to the amount by which the unemployment rate exceeded this threshold. The matching rate would increase by 4.8 percentage points for every percentage point the state's unemployment rate exceeded the threshold.

2. **This proportional increase is designed to offset around two-thirds of the state budget shortfalls that emerge in economic downturns.**

3. **As a state's economy recovers, its matching rate would gradually and automatically phase down** to its level under current law. Matching rates would be capped at 90 percent under the proposal in order to continue to provide states with some incentive to manage their programs efficiently, though the cap would bind relatively infrequently in practice.

This approach would have the same broad benefits as a general fiscal relief program for states, but with several important advantages. First, increasing the federal share of expenditures under Medicaid and the Children's Health Insurance Program would particularly discourage states from cutting these programs, thereby better protecting states' low-income residents, and discourage responses that do serious macroeconomic damage. Further, delivering fiscal relief via these two programs would economize on administrative costs, as the federal government already finances the majority of state spending on them. Finally, it may be more politically feasible than other approaches since Medicaid and the Children's Health Insurance Program attract support from a range of influential constituencies, most notably medical providers.

This recommendation for a new automatic stabilizer builds on past practice. Congress has legislated temporary increases to Medicaid matching rates on a discretionary basis in 2003, 2009, and 2010 to address recessions and their aftermath. This proposal would create an automatic mechanism to ensure that states would receive this assistance in a timely fashion even amid political gridlock. It would also ensure that the amount of this assistance would be appropriately calibrated to the magnitude of the economic shock and the duration of the subsequent recovery.

## About the Authors


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