

RESEARCH SUMMARY

Fifteen Years of Aggressive Discretionary Fiscal Policy

During the last two recessions, historically low interest rates have led to the unprecedented use of federal spending to provide stimulus for the economy. This has not been an effective approach and has caused a surge in federal debt. In “Fifteen Years of Aggressive Discretionary Fiscal Policy,” Keith Hall argues for a return to greater reliance on monetary policy and rules-based automatic stabilizers.

FISCAL POLICY HAS NOT PERFORMED WELL OF LATE

Over the past 15 years, US fiscal policy has taken a lead role in economic stabilization policy. In this role it has not performed well.

- **Debt:** The use of discretionary fiscal policy has caused the current surge in federal debt, up from \$5 trillion in 2007 to nearly \$22 trillion in 2021—from approximately 35 percent of GDP to 99 percent. In FY 2022 the primary deficit remained high at 3.6 percent of GDP, and debt continued to rise to \$24.3 trillion.
- **Overheating:** Discretionary fiscal policy continued to provide strong stimulus for the economy despite significant overheating and the highest inflation rate in more than 40 years (7.9 percent in 2022).
- **Inflation:** The Federal Reserve has carried the entire burden of reversing the excess stimulus, and therefore inflationary pressure, and has raised the federal funds rate from 0.1 percent to well over 4.5 percent. Even now, continued high budget deficits are making it harder for the Fed to get inflation under control.

RULES VERSUS THE EXERCISE OF DISCRETION IN STABILIZATION POLICY

Until the Great Recession, discretionary fiscal policy was little used. Before that, monetary policy with assistance from the rules-based automatic stabilizers worked well.

Automatic stabilizers provide stimulus to the economy when there is a negative output gap and remove stimulus when the gap is gone. By contrast, the timing of discretionary fiscal policy’s impact has shown a considerable lag that does not always match changes in the output gap or the effect of automatic stabilizers. This mistiming means that discretionary policy has been unnecessarily costly in terms of a very high accumulation of debt without a very effective countercyclical stimulus.

KEY TAKEAWAY

Ideally, with short-term interest rates well above zero, the United States will return to limiting or ending discretionary fiscal policy and to relying on monetary policy for economic stabilization. If policymakers want fiscal policy to continue to play an important role during downturns in the economy, they should instead look to strengthening the rules-based automatic stabilizers.