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CBPP STATEMENT

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ADMINISTRATION STIMULUS PLAN FAILS TESTS FOR ACHIEVING MOST EFFECTIVE STIMULUS

GIVES LESS FAVORABLE TREATMENT TO FAMILIES UNDER $40,000

Statement by Robert Greenstein, Executive Director

The centerpiece of the President's new stimulus plan — a rebate provided by temporarily eliminating the 10 percent income tax bracket — fails crucial tests for providing the most effective stimulus, because it is not targeted on the tens of millions of families most likely to spend that rebate. In so doing, the plan flouts the advice offered last week by Federal Reserve chair Ben Bernanke. The plan also includes a business tax component that, at best, would provide modest stimulus.

This plan would bypass altogether, or provide only partial help to, 52 percent of U.S. households — 77 million households — most of whom have low or moderate incomes. While some of these are households that have no earnings and do not file tax returns (such as low-income elderly people living on fixed incomes), *49 million working households* would receive nothing or only a partial rebate. (These data come from the Tax Policy Center.)

The plan is being described as featuring a rebate of $800 to individuals and $1,600 to couples. That, however, is misleading. Only tax filers with incomes high enough to be in the 15 percent tax bracket or a higher bracket could get those amounts. As a result, fewer than half of all households — and fewer than 60 percent of all working households — would qualify for the full rebate.

- Households that earn too little to be in the 10 percent bracket would get nothing. The fact that many of these households pay large amounts of payroll tax would be ignored. Families of four making less than $24,900 would be shut out entirely. The Tax Policy Center data show that 30 million working households would receive nothing.

- All households in the 10 percent bracket — families of four with incomes between $24,900 and $40,950, and many families somewhat above that range as well — would get only a partial rebate.[1] Some 19 million working households would receive a partial rebate. Overall, 42 percent of working households would receive either no rebate or a partial one.

Not Well Designed to Give Economy the Most Help

[1] For a family taking the standard deduction, the 10 percent bracket begins at $24,900 for a family of four. In fact, because of interactions with the child tax credit, a family with two children would not be able to benefit from the President's proposal until its income exceeded $25,190. Moreover, some families take additional credits, like the dependent care tax credit, or itemize deductions. As a result, a significant number of families with incomes somewhat above $25,000 would get nothing, and a significant number of families somewhat above $41,000 would get only a partial rebate.

As the Congressional Budget Office explained this week and as virtually all reputable economists agree, low- and moderate-income households will spend a larger share of any tax rebate dollars they get (and save as smaller share) than higher income households. As CBO has also explained, this means that tax rebates focused on lower- and moderate-income households inject more money into the economy quickly and are more effective as stimulus.

Federal Reserve Chairman Ben Bernanke made this point in testimony before the House Budget Committee yesterday. As the *Wall Street Journal* reported:

> The greatest economic effect of the stimulus would come from people with lower incomes, Mr. Bernanke said. "If you're somebody who has lots of financial assets and you receive an extra dollar, you may not change your spending much because you can simply either put the dollar in your bank account or take out a dollar as you need it," Bernanke said. "If you're somebody who lives paycheck to paycheck, you're more likely to spend that extra dollar."

The Administration plan ignores these basic economic realities and *excludes* the very families it is most important to *include* if the stimulus is to be as effective as possible. The plan thus would save fewer jobs and do less to shore up a weak economy than it should.

Relatively Ineffective Business Tax Component

The plan also includes business tax incentives that CBO and various studies, including studies by Federal Reserve economists, have said had only modest effects at best when tried as economic stimulus in the last downturn. But if the effects of the proposed business tax cuts in boosting the economy are uncertain, one effect of those tax cuts is quite clear — they would drive states whose revenues are already declining because of the slowdown deeper into deficit, due to the linkages between federal and state tax codes.

States are required to balance their budgets even in recessions, so the plan’s business tax cuts would trigger larger state budget cuts or tax increases to close the bigger deficits. The areas of state budgets most likely to be cut would be health care — including health insurance for low-income children — education, and assistance to local governments, many of which are already suffering financially due to falling property tax revenues. These are the budget areas where the largest share of state budget cuts typically are made during recessions. In recent weeks, states already have begun to propose cuts in them.

While including relatively ineffective business tax subsidies, the plan omits any additional weeks of unemployment insurance benefits for laid-off workers whose UI benefits run out before they can find a new job, despite the fact that CBO and other analysts rate this very high as effective stimulus and it has been a basic component of stimulus packages adopted in every recession for decades.

The plan thus seems to favor Administration ideological or political preferences over the evidence on what would work best in helping to keep the economy out of a painful recession.

Both for the economy and for the sake of millions of struggling families, policymakers should do substantially better than this in fashioning a stimulus package.

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