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820 First Street, NE, Suite 510
Washington, DC 20002

Tel: 202-408-1080
Fax: 202-408-1056
center@cbpp.org
www.cbpp.org

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CRITICISMS OF HOUSE RECOVERY PACKAGE ARE MISPLACED

Contrary to criticisms by some, the House economic recovery package unveiled yesterday is well designed to boost employment and the economy. It contains a number of spending measures crafted to inject more aggregate demand into the sagging economy over the next two years. It also contains tax measures that, while generally less effective as stimulus than most of its spending measures, are more likely than competing tax proposals to create jobs quickly. Finally, while the package is large and costly, it will not have much effect on the nation's serious long-term budget problems.

- **The package will add little to the nation's long-term budget problems.** It will add just 3 percent to the budget shortfall through 2050. Without the recovery package, the fiscal gap through 2050 equals a projected 4.2 percent of the Gross Domestic Product. With the recovery package, the fiscal gap would equal 4.3 percent of GDP.¹

The main reason the recovery package would have such a small effect on the long-term fiscal problem is that the package's costs, while large, will be *temporary*, lasting just a few years. In contrast, the main contributors to the long-term budget problem — the rapid growth in health care costs, the aging of the population, and the expensive tax cuts enacted in 2001 and 2003 — will add to deficits by increasing amounts each year.

Some critics of the package have failed to grasp this essential point. They are arguing simultaneously that the package is too expensive *and* that it should include permanent tax cuts. Including permanent tax cuts (or permanent spending increases) in the package, however, would greatly increase its impact on the long-term budget problem. For example, permanently extending the 2001 and 2003 tax cuts (without offsetting their cost) would enlarge the long-term budget gap by *more than 15 times* as much as the entire House recovery package would.

- **Major spending elements of the package, particularly fiscal relief for states and help for low- and moderate-income families, should be quite effective in helping boost the economy.** States face massive deficits, estimated to equal approximately \$350 billion over the next two and a half years. Most states managed their finances responsibly — states entered the recession with the largest reserves in their history — but those reserves are now mostly gone because of the sharp downturn in the economy. At least 33 states have already made or proposed budget cuts in areas such as health care and education, and at least 14 states have raised revenues; in coming months, state budget

¹ A fiscal gap of 4.2 percent of GDP through 2050 means that budget cuts and/or tax increases equal to 4.2 percent of GDP would be needed each year to keep the debt in 2050, measured as a share of the economy, at the same level as at the end of 2009.

cuts and tax increases will get much larger and more widespread. These state budget cuts and tax increases will further weaken the economy, by shrinking overall demand.

The amount of federal fiscal relief in the recovery package equals about *half* of states' projected deficits, so states will still have to enact very painful budget cuts and tax increases. But the fiscal relief will enable states to avert the worst of these measures and limit the negative effect on the economy, while preserving some needed state and local services.

- **Help for struggling families is effective stimulus.** Provisions to extend the weeks of jobless benefits and modestly expand those benefits will boost consumer spending, since unemployed families will spend those benefits quickly to meet household expenses. The package also includes incentives for states to modernize their unemployment insurance programs, which now cover fewer than half of all jobless workers, so that more low-wage and part-time workers can receive coverage. In addition, the package temporarily boosts food stamp benefits for low-income families, seniors, and people with disabilities, which will quickly put money into the economy by helping those who are struggling.
- **These safety net and fiscal relief provisions are effective job creators.** A recent study by Christina Romer, who will chair the President's Council of Economic Advisers, and Jared Bernstein, who will be Chief Economist in the Office of the Vice President, analyzed the job impacts of a recovery package similar to the new House proposal. Our analysis of their findings shows that temporary increases in safety net programs like food stamps and unemployment insurance, along with fiscal relief to states, would account for nearly two-fifths of the jobs the package would generate in 2009 and 2010, even though they would make up considerably less than two-fifths of the package's cost. Although they differ in their details, other analyses by Moody's Economy.com and Macroeconomic Advisers reach similar conclusions about the short-run macroeconomic effects of a stimulus package like this one.
- **The investments in higher education and training are well-timed.** The package also includes resources for job training, increases in Pell grants and work-study funding to give more low-income students a chance for a college education, and tax help for families paying tuition. These measures should help jobless workers and young people become more productive workers, which should increase U.S. competitiveness over the long term.
- **The individual tax cuts are well-targeted on low- and middle-income households.** Economists agree that these households are likely to spend rather than save a much higher proportion of any new tax benefits they receive — thereby boosting the economy — than more affluent households are.

The recovery package improves the Child Tax Credit and Earned Income Tax Credit to help more low-income working families make ends meet, and its Making Work Pay tax credit would provide the same benefit — \$1,000 — to a couple earning \$20,000 as to a couple earning \$150,000; that should make it more effective as stimulus than last year's rebates.

There surely is room for improvement in some aspects of the package. However, some of the other stimulus measures that have been proposed — such as permanent individual or corporate tax rate cuts — would be far less effective at boosting demand and creating jobs over the next few years and would add substantially more to the long-term budget deficit. Congress should ensure that the package continues to focus on cost-effective measures to put the brake on job losses and turn the economy around.

In coming days, some members of both parties may propose additional spending increases or tax cuts that would significantly expand the size of the package. There are, however, few additional spending or tax provisions to add that would both be temporary and have a large bang for the buck as stimulus over the next two years. Members should resist the temptation to add provisions that would significantly expand the package, unless those provisions can be shown to have high effectiveness as stimulus.