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Special Series: **Economic Recovery Watch**

March 3, 2010

DON'T LET THE IDEAL PREVENT THE NECESSARY
Why Offsets Are Not Needed for Temporary Economic Recovery Legislation

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Federal policymakers face two daunting challenges this year with regard to economic and fiscal policy. First, they must enact legislation that will help sustain and accelerate the nascent economic recovery and create jobs more quickly than would occur otherwise. Second, they must show that they are serious about putting the budget on a sustainable path that will avoid the explosion of deficits and debt that will occur in future decades under current policies. In addressing these challenges, policymakers should not confuse the goals of one with the other. That is, they should understand that the temporary measures needed immediately to strengthen the economy are *not* a threat to long-term deficit reduction, while efforts to offset the costs of those measures now *are* a threat to the recovery.

Some policymakers insist that Congress must offset the costs of any new temporary measures to boost the economy in order to avoid making the deficit problem worse. While, ideally, policymakers would offset the near-term cost of temporary stimulus measures with savings that will take effect in years *after* the economy has recovered (so that projected longer-term deficits do not rise at all), they should not delay enactment of such temporary measures in the absence of finding those longer-term savings. For one thing, finding politically feasible "offsets" for economic recovery legislation can be difficult and time-consuming — indeed, it may prove impossible at the present time. For another, the impact that well-designed economic recovery measures will have on long-term deficits will be minimal even without offsets because those measures will be temporary.

The widespread and significant decline in economic activity that defines a recession ended sometime this past summer, and the economy is in the early stages of recovery. That is good news, but it does not mean that the economy no longer needs stimulus. The economy is just beginning to climb out of the longest and most severe recession since the Great Depression. Without additional stimulus, and soon, many economists fear that the pace of recovery will be particularly sluggish — and the economy could even fall back into recession. As economist Mark Zandi of Moody's Economy.com, puts it, for example:

> The probability of going back into recession is still low. It is about 1 in 4, 1 in 5. But that is too high, and, more important, if we do go back into recession … it will be very painful, it will be very difficult to get out of it. So I think it is very important to guard against that [with more stimulus].[1]

Accordingly, policymakers should not allow concern about a very small effect on the long-term deficit problem to derail legislation that is needed to address a very big and immediate economic problem. Congress should quickly enact legislation needed to boost the economy, whether or not it includes offsets that would take effect after the economy has recovered.

The Need for Stimulus Legislation

Economists broadly agree that last year's American Recovery and Reinvestment Act (ARRA) has significantly boosted economic growth and reduced unemployment compared with what would have happened without it.[2] The Congressional Budget Office estimates that the U.S. Gross Domestic Product will be 1.4 percent to 4 percent larger this year due to ARRA, and that 1.3 million to 3.3 million more Americans will have jobs.[3]

Even with the benefits of that legislation, unemployment will likely remain near 10 percent throughout this year and the recovery will still be fragile. Moreover, the ARRA measures will start winding down in the second half of this year, and private demand is not expected to replace the lost positive economic impact. Congress should take additional steps now to ensure that the recovery does not stall and to increase the pace of job creation and more quickly reduce unemployment. Among the best ways to reach those goals is to do more of what has already worked — particularly by extending certain expiring provisions of ARRA such as unemployment insurance benefits for long-term unemployed workers and fiscal relief for states, which are facing huge budget shortfalls due to falling revenues caused by the weak economy.[4]

At a time when many people want to work but cannot find jobs and the demand for goods and services falls well short of what businesses are capable of supplying, the key to boosting economic activity and strengthening the fragile recovery is to create additional demand. Financial relief for

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[1] Mark Zandi, chief economist and cofounder of Economy.com, interview with the *Christian Science Monitor,* December 29, 2009, http://www.csmonitor.com/USA/Politics/monitor_breakfast/2009/1229/Economist-Mark-Zandi-chance-of-second-recession-1-in-4.

[2] See David Leonhardt, "Judging Stimulus by Job Data Reveals Success," *New York Times,* February 17, 2010, http://www.nytimes.com/2010/02/17/business/economy/17leonhardt.html?sq=dave%20leonhardt&st=cse&scp=2&pagewanted=print.

[3] Congressional Budget Office, "Estimated Impact of the American Recovery and Reinvestment Act on Employment and Economic Output From October 2009 Through December 2009," February 2010, Table 3.

[4] Aid to the unemployed ranks at or near the top of almost all analysts' estimates of demand- and job-creating bang for the buck. See, for example, Congressional Budget Office, "Policies for Increasing Economic Growth and Employment in 2010 and 2011," January 2010. With respect to state fiscal relief, CBO says "federal aid that was provided promptly would probably have a significant effect on output and employment in 2010 and 2011." Other analysts, including Goldman Sachs and Mark Zandi, concur. See Goldman-Sachs US Economic Analyst, "The State and Local Sector: What a (Fiscal) Drag!," July 10, 2009; and testimony of Mark Zandi before the Joint Economic Committee, "The Impact of the Recovery Act on Economic Growth," October 29, 2009, pp.10-12.

low- and moderate-income individuals and unemployed workers who need to replace lost income does this directly. Similarly, fiscal relief for cash-strapped states reduces the amount of demand-reducing, job-killing budget cuts and tax increases that states otherwise will have to enact to meet their balanced-budget requirements.[5] For Congress to require contemporaneous cuts in federal spending or tax increases so that measures to boost the economy do not increase short-term deficits would be unwise and counter-productive — it would reduce the overall demand for goods and services and thereby partially or fully cancel out the economic boost that the recovery measures were designed to provide.[6]

Legislation that includes offsets that take effect only *after* the economy is fully back on track would not cause this problem to occur. But, requiring their inclusion may make it impossible for Congress to pass the legislation in the first place, particularly given the need for 60 votes in the Senate to enact virtually any legislation.

Temporary Stimulus Legislation Adds Little to the Long-term Fiscal Problem

Budget experts and economists overwhelmingly agree that, under current policies, the nation faces a serious long-term federal fiscal problem.[7] The Center on Budget and Policy Priorities projects that, if current policies remain unchanged, deficits will exceed 20 percent of GDP by 2050 and debt held by the public will grow to approximately 300 percent of GDP in that year.[8] Persistent deficits and debt anywhere near these levels would risk serious harm to the economy and threaten the government's ability to meet crucial public needs.

Policymakers need to take steps to bring these projected deficits under control, and, as an important first step, they should avoid taking actions that make the long-term problem worse. But legislation making *temporary* changes in spending and tax policy to help boost the economy in the short run has only a small effect on the long-term deficit problem, even if the short-term budgetary effect of the legislation is substantial. The Center on Budget and Policy Priorities estimated last year, for instance, that a stimulus bill with temporary policy changes that cost about $800 billion in the short run would account for only about 3 percent of the projected long-run budget gap through 2050.[9]

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[5] Chad Stone, "Relief for States and Struggling Families Provides Substantial Boost to Employment," Center on Budget and Policy Priorities, November 20, 2009.

[6] Tax increases targeted on wealthy individuals would not substantially undermine the effort to boost the economy, since economic research indicates that changes in such people's taxes have a much smaller impact on their spending behavior than an equivalent change would have on lower-income households' spending behavior.

[7] See, for instance, Congressional Budget Office, "The Long-Term Budget Outlook," June 2009; Alan J. Auerbach and William G. Gale, "The Economic Crisis and the Fiscal Crisis: 2009 and Beyond: An Update," Tax Policy Center, September 2009; Government Accountability Office, "The Federal Government's Long-Term Fiscal Outlook: Fall 2009 Update," October 2009.

[8] Kathy Ruffing, Kris Cox, and James, R. Horney, "The Right Target: Stabilize the Federal Debt," Center on Budget and Policy Priorities, January 12, 2010.

[9] See Kris Cox and Paul Van de Water, "Economic Recovery Bill Would Add Little to Long-Run Fiscal Problem," Center on Budget and Policy Priorities, January 16, 2009.

That's because the principal drivers of the projected large long-term budget imbalances under current policies are *permanent* factors — the rapid growth of per-person health care costs and the inadequate level of revenues. Major legislation that makes permanent changes in taxes or spending would have a far larger impact on the long-term fiscal gap than additional, temporary stimulus legislation. For example, legislation permanently extending the expiring 2001 and 2003 tax cuts without offsets would have an impact on the long-term fiscal gap *35 times as large* as the impact of the additional economic recovery measures that President Obama's 2011 budget proposes.

To sum up: optimally, policymakers would include provisions in recovery legislation that offset the short-run increases in the deficit with savings that would take effect after the economy is fully back on track (perhaps in 2015), so that the legislation would not have even a small impact on long-term deficits. But policymakers should not let the desire to reach that goal imperil prompt enactment of economic recovery legislation. It is much more important for Congress to enact legislation now to boost economic growth and jobs — even if policymakers do not offset the costs and the legislation adds a small amount to the long-term fiscal problem — than to forgo such legislation, suffer a considerably longer period of slow growth and high unemployment, and increase the risk of a double-dip recession.