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CBPP STATEMENT

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STATEMENT BY ROBERT GREENSTEIN EXECUTIVE DIRECTOR IN RESPONSE TO ADMINISTRATION COMMENTS ON ECONOMIC STIMULUS

In outlining its principles for economic stimulus today, the Administration helpfully called for measures that would be temporary and would take effect right away. At the same time, however, the Administration also included several principles that would substantially reduce the effectiveness of a stimulus package.

First, the reported Administration plan would provide either no tax rebate or only a partial one to 49 million working households — some 30 million of which would receive no rebate at all. Millions of additional households without earnings, such as low-income seniors on fixed incomes who do not file tax returns, also would receive no rebate, bring the total number of households who would not benefit or receive only a partial rebate to 77 million.)¹

Second, the President disparaged the idea of including spending measures in a stimulus package even though they can be among the most effective stimulus options available.

Treasury Secretary Paulson said today the tax rebate should go only to people who pay taxes, which could mean the Administration would limit it to those who pay *income* taxes and exclude those who don't earn enough to owe income tax but pay *payroll* taxes. The Administration's plan that was disclosed yesterday would do just that. It also would give only a partial rebate to millions of taxpayers who are in the 10 percent tax bracket because their incomes are modest. Families of four with incomes below \$41,000 would get nothing or only a partial rebate. These are, however, the very consumers who would spend most of the rebate rather than save it. Federal Reserve Chair Ben Bernanke yesterday noted the importance of covering low- and moderate-income households for this reason.

The President spoke last week of using the tax rebate to enable Americans "to help meet their monthly utility bills, cover higher costs at the gas pump, or pay for other basic necessities." Yet the Americans who most need help meeting those expenses, and would quickly spend all or most of the rebate, would be fully or partially left out of the Administration's plan.

The Administration's assumption that tax cuts are inherently more stimulative than spending measures does not withstand scrutiny. Both spending measures and tax cuts can be effective — or ineffective — as stimulus depending on their nature and design. As Nobel laureate Joseph Stiglitz and now-CBO director Peter Orszag have written, "Basic economic analysis indicates that increased government expenditures can indeed be

¹ These data are from the Tax Policy Center. See TPC Table T08-0012.

stimulative, and, in fact, are often more effective as stimulus measures than tax cuts.”² In addition, a new CBO report of January 15 finds the two measures that would have the highest bang-for-the-buck *and* be the quickest acting are two spending measures: temporary increases in unemployment insurance and food stamp benefits.

Although the Administration calls for substantial tax cuts for business investment, studies found that such measures had modest effects, at best, in the last recession. Whatever their merits, most such measures would drive state budgets deeper into deficit; due to the linkage between federal and state tax codes, they would cause the majority of states to lose tax revenue. Since states must balance their budgets even in recessions, states would have to impose even deeper budget cuts or larger tax increases than would otherwise be needed to bring their budgets back into balance. Yet state budget cuts and tax increases during recessions withdraw demand from the economy, weakening it further. That’s the *last* thing that the federal government should do. (In fact, to address this problem in the last downturn, Congress and the President provided \$20 billion in state fiscal relief, which can be an effective stimulus measure.) Unfortunately, that is the direction in which the Administration’s principles point, since they omit state fiscal relief while calling for measures that would result in larger state deficits.

Late Thursday evening, the Center issued a statement based on details of the President's stimulus plan that had been disclosed in the media. That statement, which (like this one) has been updated to reflect estimates from the Urban-Brookings Tax Policy Center on how many people would receive no tax rebate or only a partial one, can be viewed at <http://www.cbpp.org/1-17-08tax-stmt.htm>.

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The Center on Budget and Policy Priorities is a nonprofit, nonpartisan research organization and policy institute that conducts research and analysis on a range of government policies and programs. It is supported primarily by foundation grants.

² Peter Orszag and Joseph Stiglitz, “Tax Cuts Are Not Automatically the Best Stimulus: A Response to Glenn Hubbard,” Center on Budget and Policy Priorities, November 27, 2001, <http://www.cbpp.org/11-27-01tax.htm>.