CENTER ON BUDGET AND POLICY PRIORITIES

820 First Street, NE, Suite 510, Washington, DC 20002
Tel: 202-408-1080 Fax: 202-408-1056 center@cbpp.org http://www.cbpp.org

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STRENGTHENING UNEMPLOYMENT BENEFITS WOULD BE MUCH MORE EFFECTIVE IN SAVING JOBS THAN MOST CORPORATE TAX CUTS

by Peter Orszag[1]

In the debate over economic stimulus proposals, some have argued that corporate tax breaks help to protect jobs while payments to households — especially unemployed households — do not. This argument is misguided: In fact, unemployment benefits will do more than most corporate tax cuts to reduce the number of job layoffs during the downturn and to return the economy to full strength so it can again become an engine for job creation.

Job layoffs in an economic slowdown occur primarily because the nation's firms face a reduction in demand for their products, not because they lack cash. As the number of unemployed workers increases, a downward economic spiral can occur: households with unemployed workers, facing a sharp decline in their income, cut back on spending and further reduce the demand for products, which in turn leads to additional layoffs. This harmful cycle — by which an economic slowdown can build into a more serious recession — can be broken by boosting demand for the goods and services that American companies produce. Only when a company faces renewed demand for its products will it end the process of shedding workers and begin to create new jobs. As a result, the primary objective of a stimulus package should be to spur spending on these products.

Temporary expansions in unemployment insurance help to break the downward economic spiral created by job layoffs by providing benefits to families of unemployed workers. Because the spending needs of these families typically exceed their income following the loss of a job, the families are likely to spend a high percentage of any additional income they receive during their period of unemployment. As Nobel prize-winning economist Joseph Stiglitz recently wrote in the *Washington Post*, "give money to people who have lost their jobs in this recession, and it would be quickly spent."

Unemployment insurance thereby promotes additional spending by households with unemployed workers, boosting demand for products and protecting the jobs of workers in the firms that produce those goods and services. Temporary expansions in unemployment insurance consequently are a "win-win" proposition: They are quite effective at helping more people to keep their jobs during an economic downturn, while also helping those who are unfortunate enough to lose their jobs.

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[1] Peter Orszag is the Joseph A. Pechman Senior Fellow in Economic Studies at the Brookings Institution.

Many corporate tax breaks, on the other hand, would do little to encourage firms to avoid layoffs. Some of the corporate tax breaks being discussed — such as the repeal of the corporate alternative minimum tax — would give more cash to corporations without providing much, if any, incentive for new investments or retention of workers. Such proposals would provide tax breaks to firms regardless of whether the firms lay off workers. Simply injecting more cash into firms will do little to avoid layoffs if the firms are employing more workers than they need to produce what they can sell.

- The problem facing most firms is not a shortage of cash on hand. (Indeed, from the end of 1999 to the middle of 2001, non-financial, non-farm corporations raised their liquid financial assets by $100 billion and their total financial assets by $700 billion.) Rather, the problem is that the customers of these firms are reducing their purchases.

- When consumer demand falls, firms will not produce goods that cannot be sold and will not pay employees to sit idle — no matter how big a tax break the company receives. Companies do not employ people out of altruism; they employ workers so they can produce goods that will sell at a profit.

To be sure, some corporate tax breaks could boost spending and thereby help protect jobs. Business tax breaks that are available to firms only if the firms undertake new activities can help to spur demand and boost the economy. For example, a temporary incentive for new investment that is made available only to firms that actually make such investments would help to increase demand in the short run, because it would create an incentive for firms to purchase equipment and goods that other companies produce. For example, if a firm decides to build a new plant or to purchase new computers, it must purchase services or materials from another firm — in this case, the construction company or the computer manufacturer.

Unfortunately, however, most of the corporate tax breaks included in the House stimulus bill do not provide such an incentive. And providing tax breaks to corporations regardless of whether they undertake new investment would do little to raise the demand for goods and services in the economy and thus do little to minimize layoffs during the recession. Instead, companies generally would either hold on to the extra cash, using it to hire employees or buy new equipment only when the economic outlook improves, or distribute the benefits of the tax breaks to their shareholders. Corporate shareholders tend disproportionately to be high income individuals, however, and higher-income households tend to spend — rather than save — relatively little of any additional income they receive. As a result, little additional demand for goods and services would be created in this manner. In other words, neither of the principal uses to which companies would put the extra money would do much to stimulate the economy.

The bottom line is that certain spending proposals, such as temporary expansions in unemployment insurance, would stimulate the economy and minimize job loss, while many of the corporate tax breaks being discussed would have a relatively low “bang for the buck” in bolstering demand and be of little help in averting layoffs.