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

October 12, 2001

The Administration's Stimulus Proposal: Is it a Sound and Balanced Package?

The full report can be viewed at http://www.cbpp.org/10-5-01bud.htm

On October 9, the Center on Budget and Policy Priorities released a report, *The Administration's Stimulus Proposal: Is It a Sound and Balanced Package?* The report analyses the stimulus plan outlined by Administration officials on October 4, as well as a more detailed proposal the Administration released that day on assistance to the unemployed. While the officials presented the plan as being half tax cuts and half spending provisions, the Center's report finds that in fact, tax cuts make up 90 percent or more of the package's cost over the next ten years. Furthermore, the plan's help for unemployed workers is extremely modest when compared either to the assistance the plan would give to large corporations or to the assistance unemployed workers received in the last recession. The report's findings include:

- The Administration package is said to include $60 billion for tax cuts and $15 billion for programs for the unemployed. To justify its claim that this package is balanced, the Administration combines this $15 billion in new spending with the $45 billion in expenditures estimated to occur in 2002 from recent legislation to boost funding for defense, security, and counter-terrorism, provide funds to rebuild New York and the Pentagon, and bail out the airlines.

  The claim that the plan is evenly split between spending and tax cuts rests on budgetary sleight-of-hand. Many of the proposed tax cuts are permanent, yet the Administration's $60 billion tax-cut figure includes the cost of the tax cuts only in their first year or two (it is not clear which). Over the long term, the proposal is more than 90 percent tax cuts and less than 10 percent aid to the unemployed. Furthermore, the Administration's spending total includes the defense spending increases it proposed last June, when there was little sign of recession, but its tax cut total does *not* include the $38 billion in tax rebates sent out this summer or the additional tax cuts that took effect on July 1 or will take effect on January 1.

- The Administration's plan would provide surprisingly meager assistance to the unemployed. Unemployed workers who exhausted their 26 weeks of unemployment benefits and were unable to find jobs could not receive additional weeks of federal unemployment benefits until mid-March, and then only in states where the unemployment rate rises 30 percent above its June/July/August average. (Assuming a recession comparable to that of the early 1990s, the Labor Department estimates that only 10 to 20 states would qualify. By contrast, in the recession of the early 1990s, these benefits were provided in all states.) Moreover, workers who lost their jobs *before* September 11 and exhausted their regular benefits would be ineligible for additional weeks of benefits regardless of the level of unemployment in their state.

  In sum, if the recession proves to be comparable to that of the early 1990s, the additional unemployment benefits provided under the Administration's plan would constitute only a modest fraction of the amount provided in the earlier recession — $5 billion as estimated by the Labor Department, compared to $35 billion (in 2002 dollars) in the earlier recession.

The Administration's other proposals to assist the unemployed also are quite modest. For example, the proposed $3 billion in grants to state and local workforce boards for health insurance coverage, income supplements, and/or job training for unemployed workers would not make much of a dent in the need for health insurance among workers (and their families) who lose employer-based coverage when they lose their jobs, even if all $3 billion were devoted to this purpose.

- While all aid to the unemployed, as well as the tax cut the Administration is contemplating for low- and moderate-income workers, would be temporary — as they should be — the corporate tax cuts would be permanent. This would worsen the nation's deteriorating medium- and long-term budget outlook and consequently could exert upward pressure on long-term interest rates, which are sensitive to long-term fiscal problems.

  Federal Reserve chairman Alan Greenspan and former Treasury Secretary Robert Rubin have emphasized that long-term interest rates have failed to follow short-term rates down because of market nervousness over the government's long-term fiscal position and have warned that the stimulus package should not worsen this outlook and thereby risk pushing long-term rates higher. Increased long-term rates would dampen economic activity and undercut some of a recovery package's stimulative effect.

- The Administration's plan would accelerate income-tax reductions for higher-income Americans, which makes little sense as a stimulus measure. A proposal that Treasury Secretary O'Neill has mentioned — to accelerate the reduction in the 28 percent rate to 25 percent — would benefit only the top quarter of households and be of greatest benefit to the top five percent. These households tend to save rather than spend much of any new income they receive, so this change is unlikely to have a substantial stimulative impact. This proposal seems designed to lock in tax rate reductions so policymakers will not have the option of deferring or cancelling them when the recession ends, the need to meet budget targets returns, and policymakers confront serious medium- and long-term budget problems.

  It is worth noting that the Committee for Economic Development, an organization of leading corporate executives and university presidents, has just issued a report warning of long-term fiscal difficulties and pointing to the gradual phase-in of provisions of the tax cut as providing a possible budgetary safety valve, since tax cuts could be deferred or removed before taking effect. The Administration's plan would weaken this safety valve.

- One of the plan's principal permanent corporate tax cuts, called "partial expensing," would allow corporations to write off the costs of equipment and other capital items immediately rather than depreciating the equipment over its useful life. Most economists concur that partial expensing would be more stimulative if it were temporary rather than made permanent law. If it were temporary, it would encourage firms to accelerate certain purchases to take advantage of the tax break. If this change is made permanent, as the Administration has suggested, the inducement to accelerate purchases will be lost. The Administration seems to be choosing to weaken the stimulative effect of the plan in order to confer a sizeable permanent tax cut on profitable corporations.

- The plan also calls for permanent repeal of the corporate Alternative Minimum Tax, which would be very poorly targeted as a stimulus measure because it would benefit corporations whether or not they make additional investments. Furthermore, since the AMT was created to ensure that corporations could not use so many tax loopholes that they paid little or no income tax, its repeal would make new tax breaks more lucrative and thus encourage corporations and their lobbyists to seek more of them.