SENATE FINANCE COMMITTEE PLAN INCLUDES SOUND STIMULUS PROPOSALS

by Joel Friedman, Robert Greenstein, and Richard Kogan

The stimulus plan developed by Senator Max Baucus, chairman of the Senate Finance Committee, and adopted by that committee on a party-line vote focuses on boosting the economy in the short run while doing no long-term fiscal damage. Although consideration of the measure was blocked on the Senate floor, its provisions are expected to be among those discussed in forthcoming negotiations on a stimulus package among Congressional leaders and the Administration. Overall, the Senate Finance Committee plan includes a number of sound stimulus proposals that are not part of either the House-passed or Administration measures but that should be part of any final stimulus package.

Some have criticized the Finance Committee plan for including extraneous provisions such as agricultural assistance payments, tax incentives for New York City, and other targeted tax breaks. While many of these provisions do not belong in a stimulus package, they represent less than 10 percent of the package’s cost in 2002. The core provisions of the bill, on the other hand, do represent effective stimulus and account for the vast majority of the measure’s cost. The extraneous provisions in the Finance Committee plan are modest in comparison to proposals in the House-passed and Administration plans that would cost tens of billions of dollars and shower long-sought-after tax breaks on profitable corporations and upper-income taxpayers, while doing little to stimulate the economy.

The Senate Finance Committee measure has several virtues not found in the House or Administration packages. It would provide more adequate assistance to unemployed workers, offering several times the meager levels of assistance contained in the House and Administration proposals. It also would provide fiscal relief to states and thereby reduce the degree to which states must cut expenditures or raise taxes to comply with the balanced-budget requirements under which they must operate even in recessions. Neither the House nor Administration packages include funds for this purpose. A number of leading experts on the economy, including this year’s co-winner of the Nobel Prize in economics, Joseph Stiglitz, have identified the provision of additional benefits to the unemployed and fiscal relief to states as two of the most effective stimulus measures that Congress can adopt.¹

The Senate Finance Committee bill also includes proposals to stimulate business investment by providing subsidies to firms that make new investments in equipment and other

¹ See also the testimonies of William Gale and Peter Orszag, both of whom are senior fellows at The Brookings Institution, before the Senate Budget Committee, October 25, 2001.
items. In addition, the Committee measure temporarily adjusts the corporate Alternative Minimum Tax so it will not cancel out any portion of the bill’s business tax cuts. This is a more responsible approach than permanent repealing the corporate AMT, as the House bill and Administration plan would do.

The Finance Committee bill is broadly consistent with the principles for an effective stimulus package that the chairs and ranking Members of the House and Senate Budget Committees issued on a bipartisan basis on October 4, unlike the House and Administration plans, which represent a sharp departure from these principles.²

- All of the provisions of the Senate Finance bill are temporary. With minor exceptions, all of the bill’s provisions would expire on December 31, 2002. By contrast, the House bill and the package that the Administration favors include a number of tax cuts that would be multi-year or permanent and result in significant costs in years after 2002, when forecasters expect the economy to be in a recovery.

- Since the Finance Committee bill consists almost entirely of provisions that would expire by the end of calendar year 2002, it would not worsen the federal government’s long-term fiscal problems and would not risk driving up long-term interest rates. According to the Congressional Budget Office, the cost of the bill (excluding the appropriations for homeland security and a few minor provisions added on the Senate floor by a Manager’s amendment) would be $66.5 billion in 2002 and $71.7 billion over ten years. As these figures indicate, the legislation entails almost no net cost after the first fiscal year.

Figure 2

Finance Committee Plan Has Substantially Lower 10-Year Cost

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The House bill and Administration proposals, by contrast, would result in substantial costs after fiscal year 2002. In fact, nearly half of the $175 billion ten-year cost of the Administration’s proposals would occur after 2002, with the Administration package costing $82 billion more in years after 2002 than the Finance Committee plan. Similarly, the House bill would cost $54 billion more than the Finance Committee plan in those years.

Table 1

<table>
<thead>
<tr>
<th>Cost of the Senate Finance Committee’s Stimulus Bill*</th>
<th>2002</th>
<th>10-year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business tax cuts</td>
<td>19.4</td>
<td>2.4</td>
</tr>
<tr>
<td>Supplemental rebates to individuals</td>
<td>14.2</td>
<td>14.2</td>
</tr>
<tr>
<td>Unemployment insurance</td>
<td>14.9</td>
<td>20.1</td>
</tr>
<tr>
<td>State fiscal relief</td>
<td>4.7</td>
<td>5.1</td>
</tr>
<tr>
<td>COBRA health insurance</td>
<td>4.8</td>
<td>7.0</td>
</tr>
<tr>
<td>Medicaid</td>
<td>2.1</td>
<td>3.2</td>
</tr>
<tr>
<td>Expiring tax provisions</td>
<td>1.0</td>
<td>3.1</td>
</tr>
<tr>
<td>New York and distressed areas</td>
<td>1.8</td>
<td>5.3</td>
</tr>
<tr>
<td>Other provisions</td>
<td>3.7</td>
<td>11.3</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>66.5</strong></td>
<td><strong>71.7</strong></td>
</tr>
</tbody>
</table>

* Joint Committee on Taxation, “Comparison of Estimated Budget Effects of H.R. 3090, As Passed By the House of Representatives and As Scheduled for Consideration on the Senate Floor,” JCX-85-01, December 5, 2001. Estimates are adjusted to reflect a modification made by the Manager’s Amendment to the financing mechanism for the unemployment insurance provisions. Other modifications made by the Manager’s Amendment, such as the addition of spending for homeland security, are not reflected; official cost estimates for these changes are not available.

The principal provisions in the Finance Committee plan are designed to have a rapid impact on the economy both by giving individuals additional dollars to spend to meet current needs and by subsidizing immediate business investments. These provisions generally are well-targeted on low- and moderate-income individuals and the unemployed — the people most likely to spend quickly most of any additional dollars they receive — and on businesses that make new investments. In contrast, the House bill and the Administration proposals target most of their relief on higher-income individuals — who are likely to save, rather than spend, a larger portion of any new tax breaks they receive — and on rewarding businesses for investments that they made in prior years (or investments they may make after the recession is over), rather than new investments they make now.
The investment incentives for businesses included in the Senate Finance Committee bill, like those included in virtually all of the stimulus proposals under consideration, would result in most states losing tax revenue because of the links between federal and state business income taxes. Unlike other stimulus proposals, however, the Senate Finance Committee bill would provide fiscal relief to states to offset this loss and to reduce the degree to which states must cut their own expenditures and increase state taxes, actions that would undercut stimulus efforts. Most states are compelled to take such actions because they are required to balance their budgets even in recessions.

**Providing an Effective Stimulus**

The Senate Finance Committee bill contains five major components, all of which would provide stimulus: unemployment insurance expansions; health insurance for the unemployed; incentives for new business investment; fiscal assistance for states; and a rebate for low- and moderate-income individuals and families who received no tax rebate or only a partial rebate under the legislation enacted last summer. These provisions account for nearly 85 percent of the cost of the bill in 2002. These provisions meet the bipartisan criteria for sound economic stimulus set forth on October 4 by the chairmen and ranking members of the House and Senate Budget Committees.

**Unemployment Insurance**

Under the Senate Finance Committee bill, an additional 13 weeks of federally paid unemployment benefits would be made available to individuals who have exhausted their regular unemployment benefits but been unable to find a job. The bill would also provide an across-the-board increase in unemployment benefits that would average $35 a week. These two provisions would assist many persons who lose their jobs during the recession.

In addition, two widely recognized problems in unemployment insurance cause many deserving unemployed workers to be denied unemployment benefits under current law. First,
many unemployed workers are denied benefits solely because they are not available for full-time work. This includes mothers with young children who were working two-thirds or three-quarters time before being laid off and are now searching for comparable employment. Even if they meet all other criteria for unemployment benefits, they are ineligible for benefits simply because they are not available for work full time. Second, because of state rules developed before the advent of widespread computerization, most states do not count wages that a worker earned in either the current or the previous calendar quarter when determining if the worker has earned enough to qualify for benefits. For an individual who was laid off immediately after the terrorist attacks and applied for unemployment benefits in mid-September, no wages earned after last March are counted. This disqualifies a substantial number of low-wage workers who entered the job market fairly recently, such as single working mothers who have worked their way off welfare.

The Finance Committee bill addresses these problems. It would provide benefits to unemployed workers who meet all other criteria for benefits but are currently disqualified solely because they are available for work on less than a full-time basis. It also would allow workers to use their earnings in the most recently completed calendar quarter when their eligibility for unemployment benefits is determined. Both provisions would be temporary, expiring at the end of 2002, and are fully federally funded.

In a recent *Washington Post* article, Nobel Prize winning economist Joseph Stiglitz observed that expanding unemployment insurance provides a big “bang for the buck.” Stiglitz wrote that “America’s unemployment insurance system is among the worst in the advanced industrial countries; give money to people who have lost their jobs in this recession, and it would be quickly spent.”

By increasing consumer spending and boosting retail sales, the expanded unemployment benefits would help to protect the jobs of the workers who produce the goods and services that would thereby be purchased in larger quantities (see box on page 6).

It should be noted that the unemployment provisions of the Finance Committee plan are not excessively generous. The number of extra weeks of benefits that the Finance plan provides, and the amount by which it increases unemployment benefit levels, are both substantially smaller than the increases contained in the stimulus plan offered as the Democratic substitute on the House floor and than the proposals the AFL-CIO has advanced.

**Health Insurance for the Unemployed**

When people lose their jobs, they often lose their health insurance as well. Although many job losers are eligible to continue their health insurance coverage through “COBRA,” they must be able to pay the full COBRA premiums themselves to secure this coverage. (Under COBRA, individuals who lose their jobs can remain in their former employer’s health insurance plan for 18 months after the job loss, provided the individual pays the full premium costs.) The high cost of the premiums leads most unemployed workers to decline COBRA coverage.

The Finance Committee package includes several provisions to help people who lose their jobs maintain their health insurance. The bill provides a 75 percent subsidy of the cost of COBRA health insurance premiums for 12 months to those workers who lose their jobs after September 11, 2001 and are eligible for COBRA. In addition, the bill would allow states to use

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Strengthening Unemployment Benefits Can Save Jobs

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 not correct. In fact, unemployment benefits will do more than most corporate tax cuts to reduce the number of job layoffs during the downturn and to help the economy return 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. 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.

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 their 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 eased or 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 demand for, and 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 incomes 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.

Unemployment insurance promotes additional spending by households with unemployed workers, boosting demand for products and protecting the jobs of employees in the firms that produce the goods and services that unemployed workers purchase. Temporary expansions in unemployment insurance consequently are a “win-win” proposition: They are effective at helping more people keep their jobs during an economic downturn, and they also help those who are unfortunate enough to have lost their jobs. Overall, recent academic research has shown that, dollar for dollar, the unemployment insurance system is eight times as effective as the entire tax system in mitigating the impact of a recession.*

*Alan Auerbach and Daniel Feenberg, "The Significance of Federal Taxes as Automatic Stabilizers," Journal of Economic Perspectives, Vol.14, Number 3, Summer 2000, pages 37-56. The study found that the unemployment insurance system provides roughly 25 percent of the stabilizing impact as the entire tax system, despite the fact that unemployment insurance benefits equal only about 1.5 percent to 3 percent of the size of total federal revenue. Thus, adjusted for their relative sizes (i.e., “dollar for dollar”), the unemployment insurance system is at least eight times as effective as the tax system as a whole in offsetting the impact of a recession.

Medicaid funds to help pay the remaining 25 percent of COBRA premiums for low-income unemployed workers who are eligible for COBRA but cannot afford to pay one-quarter of the premium costs. Finally, the bill authorizes states to extend Medicaid coverage to low-income workers who lose their jobs after September 11 but are not eligible for COBRA. (Workers who formerly worked for businesses with fewer than 20 employees or firms that have since gone out of business are ineligible for COBRA.) States would receive an enhanced federal matching rate for the next 12 months for Medicaid expenditures made for these purposes.6

Health insurance for the unemployed stimulates the economy in at least four ways. First, health insurance coverage for jobless workers spurs spending on health care services, an important sector of the economy. People without insurance tend to seek treatment less frequently than people who are insured. This reduces the overall purchase of health care services, which has an effect similar to that of other reductions in consumer spending — it further dampens economic activity. Subsidizing health coverage encourages health care spending.

Second, workers who lose both their jobs and their health insurance will not only spend less on health care services but are likely to spend less on other consumer goods as well, since they may feel a need to save a greater amount than they otherwise would to maintain a cash reserve in case they or their families get sick and need medical care. In contrast, unemployed workers who can secure subsidized health insurance may not feel a need to maintain as high a level of precautionary savings and so may spend more on other consumer purchases. In this respect, providing subsidized health insurance may help increase consumer confidence, which is known to be important in maintaining consumer spending during otherwise uncertain times.

Third, for those who would buy health insurance even without a subsidy, a federal subsidy frees up money in a family’s budget that can be spent on non-health goods and services. To the extent that an unemployed individual’s limited income does not have to be spent for health care premiums or saved to cover the potential cost of health problems for which the individual has no insurance, that individual is likely to have more funds to spend on current consumption.

Finally, when workers lose their jobs and their health insurance, they or their family must resort to emergency room care for injuries or severe illnesses. Because most emergency rooms are in public hospitals, the added costs are borne by state or local governments that, with revenue shortfalls and balanced budget requirements, have to make up for these extra costs by cutting other services or raising taxes. In this respect also, health insurance provides stimulus by diminishing the extent to which state and local governments must take actions that will dampen

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6 The federal matching payments for the new, optional Medicaid coverage would be made at the same rates used in the SCHIP program (the federal/state program, enacted in 1997, to expand health insurance coverage for children in low-income families) rather than at the normal Medicaid rates. Under SCHIP, the federal government’s share of these children’s health care costs equals the normal federal Medicaid share for a state plus the amount needed to cover 30 percent of the state’s normal Medicaid share. On average, the federal government pays 57 percent of Medicaid costs and 70 percent of SCHIP costs, although the percentages vary from state to state.
economic activity. Thus, maintaining health care coverage for unemployed workers provides both a direct and an indirect stimulus to the economy.

New Business Investment

The Finance Committee bill would allow businesses to write off immediately (or “expense”) a larger portion of the cost of new investments they make in equipment and certain other items, thereby creating a tax incentive for businesses to spend more on purchases of new equipment. Under the Finance Committee plan, businesses would be allowed (for tax purposes) to subtract from current income 10 percent of the cost of new investments they make over the coming year. In addition, the total amount that small businesses can expense would be increased from $24,000 to $35,000, and the limit on the cost of property qualifying for this special treatment would be increased from $200,000 to $325,000. All of these provisions would expire on December 31, 2002.

The House bill allows businesses to subtract immediately 30 percent (rather than 10 percent) of the cost of new investments and keeps this provision in effect for three years rather than one. It also includes a small business “expensing” provision similar to the Finance Committee provision, except that it would be in effect for two years rather than one. The Administration proposal similarly provides for 30 percent expensing for three years, although it contains no provision on small-business expensing. Because these provisions would remain in effect for more than one year under the House and Administration plans, however, the incentive to undertake new investment in the current year — when the economy is in need of stimulus — would be weakened. Compared to the one-year Finance Committee provisions, the House and Administration proposals would allow firms to delay investment decisions for a year or more and wait for the business climate to improve, since firms would still get these tax breaks if they make the investments after 2002. To be effective as a stimulus, the measures must spur new investment in the next few quarters.

Furthermore, the House and Administration plans also include a number of corporate tax breaks that are not focused on encouraging new investment. In particular, both call for the repeal of the corporate Alternative Minimum Tax, a step that would provide little or no incentive to spur new business investment. A Brookings Institution analysis estimates that 90 percent of the tax benefits that corporations would derive from repeal of the corporate AMT would consist of tax reductions on profits from old investments — that is, investments in plant and equipment made in previous years — rather than profits from new investments. Only new business investment is stimulative. The Brookings analysis concludes that this proposal would be ill-advised as a stimulus measure, noting that “elimination of the corporate alternative minimum tax is an extremely blunt and inefficient approach to encouraging new investment in the short run.”

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Although the “expensing provision” in the Finance Committee bill holds the potential to stimulate new investment, it has one significant drawback. In 45 states, the treatment of depreciation in the state tax system is tied to the federal rules on depreciation and expensing. Thus, allowing businesses to write off the costs of equipment and other investments more rapidly for federal tax purposes results in additional tax breaks at the state level as well — and consequently causes losses in state tax revenues. States would lose approximately $2 billion in revenue in 2002 as a result of this provision of the Finance Committee bill. (Under the expensing provision in the House bill and the Administration plan, states would lose $5 billion a year for each of the next three years, for a total revenue loss of $15 billion.)

Most states now face sizeable budget deficits as a result of declining revenues, along with rising costs for programs based on need (particularly Medicaid) and increased expenditures they are incurring for homeland security. Revenue collections are being heavily affected by the downturn in the economy; more than half of the states collected less in revenue in July through September 2001 than in the same quarter of the previous year.8 The additional loss of state revenue that would result from the business tax-cut provisions of the various federal stimulus packages would increase the extent to which states must cut programs or raise taxes — actions that would weaken the economy further. It therefore is important for federal policymakers to offset any state revenue losses their stimulus proposals engender by providing fiscal assistance to states as part of their stimulus plans.

State Fiscal Relief

The Finance Committee legislation includes $5.1 billion in state fiscal relief, which would reduce the degree to which states must cut programs and raise taxes. State budget officials estimate that state deficits equal or exceed $40 billion, and the National Governors Association projects that shortfalls for the current fiscal year could rise to $50 billion.9

To provide this state fiscal relief, the Finance Committee bill would temporarily increase the share of the Medicaid program that the federal government pays. The federal Medicaid matching rate would increase by 1.5 percentage points in all states and by an additional 1.5 percentage points in states with higher-than-average unemployment rates. In addition, the bill would hold states harmless for scheduled decreases in the federal share of total Medicaid costs.10


10 The bill prevents a scheduled decline this fiscal year in the federal share of Medicaid costs for 29 states. This reduction in the federal share of Medicaid costs for these states is the result of the formula used to set the federal matching rates each year, which is based on a state’s per capita income relative to the national per capita income. (continued...)
These provisions would help states balance their budgets and avoid cutbacks in other programs. These increases in federal Medicaid payments do not constitute additional health care benefits because they are not accompanied by requirements to increase Medicaid benefits or coverage. Rather, they mean that state governments can provide the same level of Medicaid services at a lower state cost. This lower state cost means that the financial distress of state treasuries will be mitigated, so that cuts in state programs generally (or increases in state taxes generally) will be smaller than they otherwise would have to be. In addition, the increased federal funding would help states meet the costs of the expected increase in the number of people who become eligible for and enroll in Medicaid as a result of the economic downturn.

A portion of the $5 billion in fiscal relief the Finance Committee bill would provide would offset the impact of the business tax cuts in the bill that, as noted above, will cost states $2 billion in state revenues. Thus, the net state fiscal relief the Finance Committee package contains is actually closer to $3 billion. By contrast, the House bill and the Administration proposals not only include no fiscal relief for states, but their expensing provisions would result in larger losses of state revenue. In 2002, states thus would receive net relief of $3 billion under the Finance Committee bill but lose $5 billion under the House and Administration proposals (see Figure 2).

Rebates

The Senate Finance Committee bill includes a provision common to all of the major stimulus proposals, under which rebates would be provided to those low- and moderate-income individuals who were left out of the tax rebates provided this summer. Individuals and families who filed a tax return for 2000 but did not receive a rebate this summer would get one. Those

10 (...continued)
However, the data used for this calculation cover the three most recent years for which such data are available. As a result, federal Medicaid matching rates for fiscal year 2002 are based on state per capita incomes in 1997-1999, a period of strong economic growth. A number of states thus stand to have the federal share of their Medicaid costs reduced this year at a time when their economies are contracting and their ability to afford these costs is lessening.

11 Of the $3.1 billion, some $600 million would be used to prevent the federal share of Medicaid costs from declining in 29 states in fiscal year 2002, as discussed in the preceding footnote.
who received a partial rebate would receive amounts sufficient to bring their rebates up to the full amount — $300 for individuals, $500 for heads-of-household, and $600 for married couples.

In recent testimony before the Senate Budget Committee, Brookings Institution senior fellows William Gale and Peter Orszag noted that those lower-income taxpayers who would receive these rebates have a “higher propensity to consume” than do higher-income taxpayers. This means that the new rebates would be targeted on households likely to spend much of the money they receive. (By contrast, higher-income taxpayers are more likely to save, rather than spend, additional funds they secure.) The additional expenditures that low- and moderate-income taxpayers make with these funds could help to boost flagging demand in the economy and increase retail sales.

Conclusion

Overall, the package the Senate Finance Committee approved is a balanced and modest approach that would be relatively efficient in stimulating the economy. The package devotes a meaningful share of its funds to assisting the unemployed and providing fiscal relief to states, both of which should stimulate the economy quickly. Moreover, the plan’s tax incentives for business are tied to new investment and provide an incentive to accelerate investments from the future into this year. Finally, the rebates for individuals are directed at people with the greatest likelihood of stimulating the economy by spending the funds.

Note: Figures for Senate Finance Committee bill do not include appropriations for homeland security or other minor provisions added by the Manager’s Amendment.

Table 2

<table>
<thead>
<tr>
<th>Distribution of Provisions in Stimulus Plans</th>
<th>2002 costs</th>
<th>10-year costs</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Senate Finance</td>
<td>House-passed</td>
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<tr>
<td>Corporate and business tax cuts</td>
<td>32.8%</td>
<td>68.6%</td>
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<tr>
<td>Tax cuts primarily for upper-income taxpayers</td>
<td>none</td>
<td>14.5%</td>
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<tr>
<td>Tax cuts primarily for low- &amp; moderate-income taxpayers</td>
<td>21.3%</td>
<td>13.3%</td>
</tr>
<tr>
<td>Spending and tax provisions for unemployed workers</td>
<td>32.7%</td>
<td>3.2%</td>
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<tr>
<td>Fiscal relief for states</td>
<td>7.1%</td>
<td>none</td>
</tr>
<tr>
<td>Extension of expiring provisions and other</td>
<td>6.1%</td>
<td>0.4%</td>
</tr>
</tbody>
</table>

The Finance Committee package presents a marked contrast to the House and Administration plans, which would do relatively little to address the needs of the unemployed and would worsen the fiscal crisis that states face, while devoting the majority of their resources to generous tax benefits for businesses and upper-income individuals that are not likely to yield much immediate stimulus. The Finance Committee plan would provide considerably more “bang for the buck” and also be more focused on those who are hurting the most as a result of the economic downturn. Finally, it is far more restrained in its long-term impact on the federal budget.