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# NEW HOUSE STIMULUS PROPOSAL DOMINATED BY MULTI-YEAR OR PERMANENT TAX CUTS

## Many of Bill's Tax Measures Likely to Do Little to Stimulate the Economy

by Robert Greenstein and Richard Kogan

The tax component of the new stimulus proposal that the House of Representatives approved early in the morning of December 20 contains a number of similarities to the tax component of the stimulus bill the House passed in October. Although several tax provisions included in October were dropped from the new bill or modified, the legislation continues to be dominated by multi-year (and, in some cases, permanent) tax cuts for corporations and higher-income individuals.

Estimates issued by the Joint Committee on Taxation show that 92 percent of the cost of the new package over five years — and 95 percent of its cost over ten years — consists of tax cuts, most which are multi-year or permanent. Many of these measures would be either of limited effectiveness in stimulating the economy or far more effective as stimulus if their duration were limited to one year.

Of particular concern, these multi-year and permanent tax cuts would have significant budgetary effects in years after the recession is over, widening budget deficits in those years.

- The Joint Tax Committee estimates show the legislation would cost approximately $75 billion in fiscal year 2003 and $50 billion in fiscal year 2004. Those are years when the economy is expected to be in recovery and further stimulus is not expected to be needed. Some 91 percent of cost in 2003 — and 99 percent of the cost in 2004 — would come from tax cuts.

- The nation already faces deficits in the unified budget in these years. The Administration reportedly is planning to propose cuts in a number of domestic programs in its forthcoming fiscal year 2003 budget on the basis that such budget reductions are needed to help address these deficits.

**House Package Consists Largely of Tax Cuts**

| | Five years (2002-2006) | Ten years (2002-2011) |
|---|---|---|
| Proportion of package consisting of tax cuts | 92% | 95% |

Note: If the $300/$600 tax rebate to lower-income workers and the refundable portion of the health insurance tax credit are considered budget increases rather than tax cuts, the percentages are 83% of the first five years and 84% over ten years.

- Only 40 percent of the tax cuts the plan would provide over the next five years would come in fiscal year 2002. Tax cuts in years after 2002 would not stimulate the economy during the current downturn. Moreover, many of the tax cuts that would be provided in 2002 would not be very stimulative — because those tax cuts would go to higher-income individuals who tend to save rather than spend additional income they receive or to corporations regardless of whether the corporations make new investments now. As a result, only a quite small fraction of the generous tax cuts in the bill would help the economy recover from the downturn and protect workers from further lay-offs.

- The package would cost $214 billion over five years, not counting the additional interest payments on the debt that would have to be made as a result of the package. When the additional interest costs are included, the total cost is approximately $260 billion over five years. (Over ten years, the cost with interest is more than $270 billion, but that number may be deceptively low; it assumes that every one of the multi-year tax cuts in the bill ends on schedule, with none of these tax cuts being extended.)

The multi-year nature of these provisions makes sense only if one of the goals of the legislation is to heighten the chances that these corporate tax cuts will be extended when they are scheduled to expire and thus will become ongoing fixtures of the tax code. Such a course would add several hundred billion dollars in additional cost over the coming decade.

The plan does drop some tax provisions included in the original House bill, such as a capital gains tax cut and large, retroactive corporate tax refunds. Most other tax provisions of the House stimulus bill remain intact in whole or in large part, however, and the plan adds several new special interest tax provisions, such as changes in pension rules that would enable firms to reduce pension contributions as well as changes in the individual Alternative Minimum Tax that would principally benefit high-income taxpayers. Indeed, tax cuts for businesses and for taxpayers in the top quarter of the income spectrum account for more than three-fourths — 77 percent — of the plan's costs over the next five years.

The plan also includes provisions that would expand unemployment insurance by $10.6

**Percentage Share of the Costs Over Five Years of the Provisions in the House-Passed Package**

| | **Share of Costs 2002-2006** |
|---|---|
| Corporate and business tax breaks | 49% |
| Tax cuts for higher-income taxpayers | 28% |
| Tax and benefit provisions primarily for moderate and low-income persons | 23% |
| Total | 100% |

billion over two years, according to the Congressional Budget Office. Although this represents a significant change from the earlier House bill, this amount is considerably smaller than the amount that some proponents of the bill have mistakenly cited as the level of unemployment benefit expansions it includes. On the one hand, the bill would extend unemployment benefits by 13 weeks in all states, a distinct improvement over the earlier House stimulus legislation. On the other hand, the bill continues to exclude any measures to extend unemployment insurance benefits, at federal cost, either to low-wage workers who would qualify if the wages they earned in recent months were counted or to workers who meet all other criteria for unemployment benefits but are disqualified because they are available for part-time rather than full-time work. Many unemployed low-wage workers would still fail to qualify for unemployment benefits as a result. In addition, while larding costly tax breaks on corporations that would endure long after the downturn ends, the plan excludes even a modest, short-term increase in unemployment benefit levels.

## The Plan's Tax Provisions

The plan's tax provisions include the following:

- *Depreciation:* The plan contains a generous depreciation provision under which 30 percent of the cost of equipment and other items could be deducted immediately. This provision would make sense if it were to be in effect for one year. Instead, the plan leaves the provision in effect for three years, a move that substantially reduces its effectiveness as stimulus but substantially increases the chances it will be made an ongoing feature of the tax code. As Brookings analyses have shown, making the provision effective for three years lessens its stimulative effect because it enables firms to wait a year or more and see what the economy looks like before making purchases; firms could defer making purchases and still get the tax break. Furthermore, because of its three-year nature, the tax break would remain in effect long after the downturn ends, making it more likely that it would come to be seen as a normal feature of the tax code and thus making its extension at the end of the three-year period more probable. In fact, the tax break is designed so that it would expire on September 11, 2004, shortly before the elections, making it even more likely it would be extended at that time. If this tax break is extended and remains in effect throughout the decade, its cost — according to the Joint Tax Committee — will be nearly $230 billion over ten years.

- *Corporate AMT:* One of the areas where the plan appears to be more moderate than the original House bill is with regard to its treatment of the corporate Alternative Minimum Tax. Nevertheless, the changes in this area are not as large as the rhetoric surrounding the new House package would suggest. Although the new proposal does not formally repeal the corporate AMT, it largely eviscerates the AMT, with the result that the AMT would not have much effect. The Joint

Tax Committee cost estimates indicate that nearly two-thirds of the already small corporate AMT would be eliminated.

Moreover, many of the corporations that would receive large checks under the original House bill would still get a substantial portion of these tax benefits. The tax benefits would be spread over a number of years rather than paid up front. Moreover, since the proposal would largely eviscerate the corporate AMT on a permanent basis, another of its effects would be to enable a number of profitable corporations to avoid paying any income tax.[1]

- *Individual AMT:* These changes in the AMT would be extended to the *individual* AMT as well, which would result in some further tax cuts for high-income individuals. The provision making these changes in the individual AMT was not part of the original House bill. It, too, would be permanent.

- *Tax breaks for financial corporations with foreign operations:* The new bill would extend for five years a tax break for multi-national financial corporations with overseas operations. Under the "Subpart F" rules of current law, U.S. firms are taxed on some types of income earned by foreign corporations that they control, regardless of whether the income is distributed back to the United States. The purpose of these rules is to prevent international firms from using internal organizational shifts and distorted internal pricing practices to hide income from U.S. taxation. A temporary provision, due to expire in 2002, exempts income earned in banking, finance, and insurance from these rules and therefore effectively provides a subsidy to income that is earned abroad and not distributed

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[1] In determining whether a firm must pay the corporate AMT, a number of adjustments and "preferences" are added to the firm's income as calculated for regular tax purposes. The most important of these adjustments is for depreciation.

The proposal would delete depreciation tax breaks from those added to a firm's income in calculating the firm's AMT liabilities. An examination of IRS corporate tax return data for 1998, the most recent such data available, shows that the depreciation adjustment in the AMT accounted for more than 100 percent of the adjustments and preferences added to income for the calculation of corporate AMT payments. (Depreciation can be more than 100 percent because there are some items that are subtracted.) Thus, removing depreciation from the calculation would largely eviscerate the AMT.

These changes also would enable corporations to secure billions of dollars of tax credits, as would have been the case under the original House stimulus bill. It was these credits that would have resulted in huge checks being written to a number of corporations under the House bill. Corporations have build up credits from prior payments of the AMT. They may use these credits to reduce their regular corporate income tax liability if — and only if — the credits do not reduce their tax liability below the level at which they would have an AMT liability. If the corporate AMT is eviscerated to the point that few corporations have a significant AMT liability, then corporations will be able to use these credits to reduce their regular tax liability. This is what would happen under the corporate AMT provision in the new plan. Many corporations would be able to receive billions of dollars of tax credits, although the credits would be spread over a number of years rather than paid in full now.

back to the United States. The new stimulus package would extend this special exemption for five years, providing a significant tax benefit to firms in the banking, finance, and insurance industries. This provision would have little, if any, stimulative effect since only *four percent* of the $6.5 billion in tax cuts it would provide over the next five years would come in fiscal year 2002. Some 96 percent of its tax cuts would come in subsequent years. There is little practical difference between this provision and the version of the provision in the original House bill, which made this provision permanent. Extending the provision for five years so it is in effect for nearly half a decade after the recession is over would set the provision up to be extended at the close of the five-year period and become an ongoing part of the tax code.

- *Rate reductions:* The plan retains the original House provision to accelerate to 2002 the reductions in the 27.5 percent income tax rate that are now scheduled for 2004 and 2006. As various Brookings and CBPP analyses have shown, this provision is mistargeted and would have little stimulative effect. While expensive — it would cost $60 billion[2] — it would affect only the top quarter of all tax filers and would confer the largest tax cuts on the top five percent of filers. A married couple with two children that makes $65,000 a year would receive nothing from the tax cut, while such a family with income of $70,000 would receive $70 in 2002 and $210 over four years. By contrast, a married filer with income of $135,000 or above would receive $1,300 in 2002 and nearly $4,000 over four years. High-income individuals spend a smaller share (and save a larger share) of each additional dollar of after-tax income they receive than do individuals with more moderate incomes. As a result, this provision would not have much stimulative effect.

  Furthermore, 77 percent of the $60-billion tax reduction that this proposal would provide would come *after* 2002 — that is, after the economy is expected to be in recovery. Overall, the provision would be highly inefficient as a stimulus measure, producing little bang for the buck.

- *Leasehold Improvements:* Under current law, changes made to commercial office buildings to accommodate specific occupants are depreciated over 39 years. The new package would permanently shorten that depreciation period to 15 years. Such a permanent change in the tax code is difficult to justify on stimulus grounds, since only $78 million — or one percent — of its $7 billion ten-year cost would occur in 2002.

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[2] This proposal includes a corresponding change in the individual Alternative Minimum Tax to prevent the rate reductions from causing more taxpayers to be subject to the AMT in the next few years. The combined cost of the rate reductions and corresponding AMT change, as reflected in the new Joint Tax Committee estimates, is $60 billion.

- *Reduction in Employer Pension Contributions:* The plan also includes a new provision not contained in any previous stimulus bill or any tax bill the House or Senate has approved that would allow firms to reduce pension contributions to pension funds for their employees.[3]

- *Low-income Rebates:* Finally, like the House bill and most other stimulus packages, the plan includes a tax rebate for lower-income workers who received no rebate or only a partial rebate this summer. Because the rebate is a one-time measure while most of the upper-income and corporate tax cuts would be multi-year or permanent, the rebate accounts for only seven percent of the cost of the plan's tax cuts over the next five years.

## Assistance for the Unemployed

### Unemployment Insurance

The new plan would provide an additional 13 weeks of unemployment benefits for workers in all states who lost their jobs after March 15 and have exhausted their regular benefits. This represents a marked improvement over the earlier House bill, which contained no comparable provision.

However, the plan rejects all other temporary improvements in unemployment benefits contained in the Finance Committee stimulus plan. Those provisions would make more part-time and recently employed workers eligible for benefits when they are laid off and provide for a modest increase in unemployment benefits.

The new plan retains a provision of the House bill that would speed up the transfer of $9.2 billion already slated to be shifted from the federal unemployment insurance trust funds to state unemployment accounts.[4] While this transfer can help states whose unemployment accounts are running low on funds, it would neither offer much assistance to the unemployed nor

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[3] Funding requirements for defined benefit pension plans depend on an interest rate: The higher the interest rate, the lower the pension contributions a firm is required to make, since a higher interest rate means that smaller contributions to a pension fund are needed to provide workers a given level of pension benefits in future years. Accordingly, firms are allowed to make lower pension contributions when interest rates are high but must make larger contributions when interest rates are low. As interest rates have fallen in recent months, the required contributions into defined benefit plans have risen, balancing the lower contributions that many firms made when interest rates were high. The new stimulus package would artificially raise the assumed interest rate used to determine the required level of pension contributions for the next two years, thereby reducing the contributions that firms are required to make. Some adjustment to the assumed interest rate may be justified because the 30-year bond is disappearing, but it appears that the adjustment included in the new package will exceed what can be justified on this basis.

[4] Under current law, $5 billion will be transferred to states under the Reed Act in 2002. The proposal also would make $4 billion that would not have been transferred until 2003 available in 2002, making a total of $9.2 billion available in 2002, and would provide these funds quickly after enactment.

do much to stimulate the economy. This is because most of the funds it would transfer to state unemployment accounts *would not be spent*. Most states would use a large share of these funds to strengthen the reserves in their state unemployment trust funds, rather than to expand or extend unemployment benefits. States have no way of knowing how long or deep the recession will be, and they understandably are concerned that their reserves be adequate to weather the recession.

A new survey of states conducted by the National Association of State Workforce Agencies confirms that most states would *not* use any of these funds to expand or extend unemployment benefits.[5] The survey findings, which have been known for a number of weeks, also demonstrate that statements about this provision made in documents circulated late Monday by Rep. Bill Thomas are misleading. The Thomas documents declare that states would have the option of using these transferred funds to extend unemployment insurance coverage to laid-off part-time workers and to workers who would be eligible if the wages they earned in recent months were counted. This may suggest that Rep. Thomas has moderated his position on these matters. In fact, the new proposal represents no progress on these issues. States have long had the option to count more recent wages and to cover part-time workers; most states have declined to do so because of the potential impact on state unemployment insurance tax rates. That is why the Senate Finance Committee bill would cover part-time workers and count more recent wages for a one-year period at 100 percent federal cost. Moreover, the recent survey by the National Association of State Workforce Agencies, in which states were specifically asked what uses they would make of the $9.2 billion in transferred funds if the House proposal became law, shows most states would not spend *any* of the transferred funds either to extend coverage to these workers or to improve unemployment benefits in other ways. The survey found that “most responding states said they would not expand or extend benefits if they received the $9.2 billion in transferred funds.” Most of the 38 states that responded specifically said they would not use these funds to count more recent wages, to extend coverage to part-time workers, or to increase the weekly benefit amount.

These survey findings also are supported by Congressional Budget Office estimates. CBO estimates indicate that if the $9.2 billion in funds are transferred now, only a very small fraction of these funds — only $500 million according to the Congressional Budget office — will actually be used in fiscal year 2002 to maintain or expand benefits or fund administration of the program.

Temporarily expanding unemployment insurance benefits would be highly effective as economic stimulus. In a recent analysis, Nobel Prize winning economist Joseph Stiglitz and Brookings Institution senior fellow Peter Orszag noted that “in a recession, the primary problem is that the nation's firms face a reduction in demand for their products — not that they lack

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[5] The survey, “How Would Your State Use An Accelerated Reed Act Distribution? A Summary of A State Survey by the National Association of State Workforce Agencies” is available on the NASWA website (www.naswa.org).

available workers, equipment, or anything else needed to produce goods and services."[6] Increasing unemployment benefits addresses this critical demand problem by boosting consumer spending and thereby helping other workers keep their jobs.[7] Stiglitz, Orszag, and other economists also have noted by increasing aggregate demand, improvements in unemployment benefits would be more effective in providing economic stimulus and reducing lay-offs than most of the tax cuts included in the new package.

### Health Insurance for the Unemployed

The health insurance provisions of the package also are problematic. The principal such provision would provide a tax credit for 60 percent of health insurance premiums that laid-off workers pay. A second proposal would increase funding for a small Labor Department block-grant program known as the National Emergency Grants program and make the provision of health insurance one of the allowable uses of the block-grant funds. Both of these proposals are poorly designed and likely to prove of limited effectiveness.

- The tax credit could be used either to purchase employer-based coverage through COBRA or to purchase insurance in the individual health insurance market. With the costs of a family health insurance policy under COBRA averaging around $7,000, it is unlikely that many unemployed workers — particularly those with low or moderate incomes — could afford to pay 40 percent of COBRA premium costs while unemployed.[8]

- The aspect of the plan that would make the tax credit available for the purchase of insurance in the individual market is particularly problematic. The individual market is largely unregulated and lacks the advantages of group insurance purchased through employers. Many plans sold on the individual market impose high deductibles and offer limited coverage. Furthermore, premiums in the individual market can vary based on risk factors such as age and medical history. The new proposal lacks substantive insurance-market reforms to ensure that individual health insurance policies that provide adequate coverage will be made available at affordable prices to unemployed workers in the individual health insurance market. Under the proposal, states would have to guarantee that some

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[6] 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.

[7] Peter Orszag, "Strengthening Unemployment Benefits Would Be Much More Effective in Saving Jobs than Most Corporate Tax Cuts," Center on Budget and Policy Priorities, November 14, 2001.

[8] Another problem is that only unemployed workers eligible for unemployment insurance could receive the tax credit. A substantial number of low-income unemployed workers do not receive unemployment insurance. Indeed, because the plan does not include the proposals in the Senate Finance Committee stimulus bill that would expand access to unemployment insurance to part-time workers and low-wage workers who would be eligible if wages they earned in recent months were counted, a substantial number of lower-income unemployed workers would be excluded from eligibility for the health tax credit.

form of individual coverage is made available to laid-off workers who previously had employer-based coverage, but similar requirements are part of current law and most states comply with them simply by allowing individuals who otherwise cannot secure coverage to purchase insurance through "high-risk pools." Because premiums for policies sold through high-risk pools generally are unaffordable and the coverage provided is usually limited, few individuals purchase insurance through these pools.

The likely reason for inclusion of this tax credit in the package is that supporters of the credit view its inclusion as an opening for the subsequent establishment of a broader individual tax credit for the purchase of health insurance. Rep. Bill Thomas has essentially said as much. If the tax credit in the House bill is enacted, subsequent efforts almost surely will be made to broaden this credit into a general individual health insurance tax credit that can be used to purchase insurance in the individual market by employed as well as unemployed individuals.

Such a general individual health insurance credit could have deleterious effects. It almost certainly would encourage significant numbers of businesses not to offer health insurance to their employees. (With employees able to receive a tax credit to subsidize the purchase of insurance on their own, many employers likely would feel less compunction to offer insurance.) In addition, where employers continued to provide insurance, such a tax credit could encourage some younger, healthier workers to opt out of employer-based coverage and instead to use their tax credit to purchase a policy in the individual market. That would result in the workers who remained in employer-based coverage being older and sicker, on average, than workers in employer-based coverage are today, which in turn would drive up premiums for employer-based insurance and thus could discourage still more employers from providing it.

- The plan also would provide $4 billion through the National Emergency Grants (NEG) program and specifies that at least 30 percent of each state's grant be used to provide health insurance to dislocated workers. The NEG program — which is currently funded at about a $200 million annual level and provides grants each year to respond to job dislocations in a modest number of areas that have resulted from a plant closing, a natural disaster, or another such event — is not likely to provide an effective or expeditious way to provide health insurance to unemployed workers.[9] This grant program is designed to address the need for job training and related employment services in a modest number of individual localities, not to respond to problems created in most or all states as a result of a

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[9] Sandra Clark, "Do Proposals to Increase Funding for National Emergency Grants Provide an Effective Way to Meet the Health Insurance and Other Needs of Laid-off Workers?," Center on Budget and Policy Priorities, revised November 27, 2001.

national recession or to provide health insurance for unemployed workers who lack it.

The program has no experience in purchasing health insurance or providing health care coverage. States would likely need a number of months to make decisions and develop eligibility rules and procedures for what would effectively be a new health insurance program, to determine the nature and scope of the insurance coverage to be offered, to contract with health insurers and plans, and to train and hire new staff. By the time health insurance coverage could be provided to workers, the recession could well be over. For this and other reasons, CBO estimates that only $1.3 billion of the $4 billion in National Emergency Grant grants — or less than one-third of this funding — would actually be spent in fiscal year 2002.

Given these shortcomings, the health insurance proposals in the new stimulus plan are unlikely to provide adequate assistance to low- and moderate-income workers who lose their jobs.

## Impact on State Budget Shortfalls

An area where the plan represents a significant improvement over the earlier House plan is its inclusion of $4.6 billion in fiscal relief to states in fiscal year 2002. This money would be provided as additional federal funds for states to use in covering costs in Medicaid or other health insurance programs. Yet even with the inclusion of these funds, states still would be affected adversely — and would face larger budget shortfalls — as a consequence of the House bill. Analyses by both the Congressional Research Service and the Center on Budget and Policy Priorities show that the major business depreciation tax cut in the package would cause the 50 states to lose $5.4 billion in state tax revenue in the coming year. When the additional revenue losses that the District of Columbia and New York City would incur are taken into account, the total revenue loss reaches $5.9 billion, or well above the $4.6 billion in payments that would be provided. Furthermore, both the CRS and the Center analyses show that the depreciation provision, which would remain in effect for three years, would cause states to lose an additional $5 billion in 2003 — a year when states are again expected to face budget shortfalls — and another $4 billion in 2004. In contrast, the $4.6 billion in increased federal payments to states for health insurance expenditures would end after one year.

**Effect on State Treasuries in 2002 of House-Passed Bill of December 20, 2001**
*(in millions of dollars)*

| | Cost to States of Depreciation Provision, federal fiscal year 2002 | Grants to States to Assist Paying for State Medicaid and SCHIP Costs, calendar year 2002 | Net loss (-) or gain |
|---|---|---|---|
| **Alabama** | -56 | 51 | -5 |
| **Alaska** | -70 | 32 | -38 |
| **Arizona** | -110 | 69 | -41 |
| **Arkansas** | -53 | 38 | -15 |
| **California** | not affected | 483 | 483 |
| **Colorado** | -87 | 37 | -50 |
| **Connecticut** | -99 | 60 | -39 |
| **Delaware** | -31 | 10 | -21 |
| **DC** | -40 | 18 | -22 |
| **Florida** | -210 | 165 | -45 |
| **Georgia** | -180 | 119 | -61 |
| **Hawaii** | -21 | 13 | -8 |
| **Idaho** | -31 | 13 | -18 |
| **Illinois** | -360 | 176 | -184 |
| **Indiana** | -180 | 66 | -114 |
| **Iowa** | -60 | 32 | -28 |
| **Kansas** | -57 | 27 | -30 |
| **Kentucky** | -73 | 83 | 10 |
| **Louisiana** | -57 | 84 | 27 |
| **Maine** | -30 | 23 | -7 |
| **Maryland** | -120 | 60 | -60 |
| **Massachusetts** | -270 | 122 | -148 |
| **Michigan** | -60 | 156 | 96 |
| **Minnesota** | -180 | 114 | -66 |
| **Mississippi** | -55 | 55 | 0 |
| **Missouri** | -87 | 75 | -12 |
| **Montana** | -22 | 10 | -12 |
| **Nebraska** | -33 | 32 | -1 |
| **Nevada** | not affected | 15 | 15 |
| **New Hampshire** | -42 | 15 | -27 |
| **New Jersey** | -260 | 116 | -144 |
| **New Mexico** | -40 | 39 | -1 |
| **New York*** | -1100 | 574 | -526 |
| **North Carolina** | -190 | 189 | -1 |
| **North Dakota** | -15 | 9 | -6 |
| **Ohio** | -200 | 166 | -34 |
| **Oklahoma** | -48 | 49 | 1 |
| **Oregon** | -100 | 71 | -29 |
| **Pennsylvania** | -340 | 227 | -113 |
| **Rhode Island** | -19 | 45 | 26 |
| **South Carolina** | -58 | 95 | 37 |
| **South Dakota** | -8 | 20 | 12 |
| **Tennessee** | -110 | 103 | -7 |
| **Texas** | -340 | 290 | -50 |
| **Utah** | -43 | 31 | -12 |
| **Vermont** | -11 | 10 | -1 |
| **Virginia** | -140 | 67 | -73 |
| **Washington** | not affected | 110 | 110 |
| **West Virginia** | -36 | 31 | -5 |
| **Wisconsin** | -140 | 93 | -47 |
| **Wyoming** | not affected | 12 | 12 |
| **Total** | **-5,872** | **4,600** | **-1,272** |

*NOTE: 45% of the $4.6 billion grant in the House-passed bill will be spent in 2003 according to CBO. Thus, even some states that are net gainers may find that, in the 2002 fiscal year in which they must balance their state budgets, they are net losers.*

** The total for New York includes a $390 million revenue loss for New York City resulting from the interaction between the depreciation provision and the city's income tax, as well as the $710 million revenue loss to the State.*

As a result, the plan would not help states cope with the large budget shortfalls they face as a result of the economic downturn. The National Governors Association recently estimated that state budget shortfalls will total between $35 billion and $50 billion for the current fiscal year. Since states must balance their budget even in recessions, they will be compelled to institute sizeable budget cuts and/or tax increases in coming months. Such actions by states will further dampen the economy. Although a number of economists have advised that providing fiscal relief to states to lessen the magnitude of these state fiscal actions would be one of the most effective forms of economic stimulus the federal government could provide, the bill the House approved on December 20 provides no *net* fiscal relief.[10]

## Conclusion

The new offer package consists primarily of multi-year tax cuts for businesses and upper-income individuals that would be of limited effectiveness as stimulus, while offering relatively modest assistance for the unemployed and no net fiscal relief to states. With the Administration projecting unified budget deficits at least in 2003 and 2004, there is little rationale for enacting proposals that would produce substantial revenue losses in these years but constitute inefficient and ineffective ways of stimulating the economy now. Furthermore, by fashioning key business tax cuts in the package as multi-year cuts that extend beyond the period for which the recession is forecast, the plan would virtually ensure there will be significant pressure to make these tax breaks permanent, creating yet another danger for the budget. In addition, the plan includes several permanent tax cuts, which would further exacerbate the nation's long-term budget difficulties.

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[10] As noted above, the plan also includes the provision of $4 billion in grants to states through a one-time expansion of the Labor Department's "National Emergency Grants" program and directs that states use at least 30 percent of those funds on health insurance for unemployed workers. NEG funds also could be used for employment, training, and related services for dislocated workers. Not much of this money is likely to constitute fiscal relief, because these funds would largely be used for new expenditures for dislocated workers that states are not currently making, not to help states cover costs they already face. As a result, the provision of these funds would not have a large effect in narrowing the gap between state revenues and the costs that states already are incurring.

For example, health insurance could be provided with NEG funds only to people not eligible for Medicaid or separate state children's health insurance programs funded under SCHIP. Furthermore, the language of the House bill prohibits a state from using any of NEG funds to substitute for state or local expenditures for health insurance. Thus, NEG funds spent on health insurance would represent new state expenditures and would not help states close existing budget shortfalls.

It is possible that some of the NEG funds that would be used for employment and training assistance for dislocated workers could substitute for planned state spending in these areas and consequently could represent some fiscal relief. The Congressional Budget Office estimates, however, that states would spend only $1.3 billion of the NEG funds in fiscal year 2002. Since only a fraction of that $1.3 billion could constitute fiscal relief, and since the state and local government revenue losses that the plan would engender would exceed the Medicaid payments the plan would provide to states by nearly $1.3 billion, states in aggregate would appear to be modest net losers in 2002 as a result of the stimulus legislation. They would be larger net losers in 2003 and 2004.