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HOUSE OPTS TO PRESS FOR MORE TAX CUTS RATHER THAN ENSURE QUICK ENACTMENT OF EXTENDED UNEMPLOYMENT BENEFITS

by Robert Greenstein, Joel Friedman, and Edwin Park

On February 14, the House of Representatives passed virtually the same tax-cut-heavy stimulus package it adopted in December, avoiding a clean vote on a Senate-passed measure to provide additional weeks of unemployment insurance benefits to workers who have exhausted their regular benefits. The House revisited the same tax cuts despite the fact that this approach has been rejected by the Senate, where it attracted 48 votes, well short of the 60 votes needed to pass a stimulus bill in that body.

Since the House last passed its stimulus package in December, the Congressional Budget Office issued an analysis of various tax-cut proposals under consideration as stimulus measures. CBO found that only one of the tax cuts in the House package — rebates for low- and moderate-income families — would be reasonably effective stimulus. Other major House tax cuts — modifying the corporate Alternative Minimum Tax, accelerating implementation of the 25 percent income tax rate, allowing much larger depreciation deductions for businesses for the next *three* years rather than for one year, and extending a tax break for financial corporations with overseas operations — received failing grades as stimulus from CBO. In passing these measures once again last week, the House demonstrated that it continues to be wedded to multi-year and permanent tax cuts that offer low "bang for the buck" in stimulating the economy and would worsen an already troubling long-term budget outlook.

The House bill also retains a controversial tax credit for health insurance that would likely do little to help many low- and moderate-income unemployed workers obtain health coverage and could set the stage for future tax credits that would weaken the employer-based health insurance system. In addition, the House measure would enlarge the budget deficits that many states face. As a result, it would force states to institute deeper budget cuts or larger tax increases than those they are already adopting to balance their budgets. Although the House bill would provide some fiscal relief to states, that relief is smaller than the amount of revenue that states would lose as a result of the bill's business tax cuts, making states worse off with the legislation than without it.

Costly Multi-year and Permanent Tax Cuts

Estimates that the Joint Committee on Taxation has issued show that 88 percent of the cost of the House package over six years (2002 to 2007) — and 92 percent of its cost over eleven years (2002 to 2012) — consists of tax cuts, most which are multi-year or permanent. Many of these measures would either be of limited effectiveness in stimulating the economy now or be much more effective as stimulus if their duration were limited to one year.

The Joint Tax Committee estimates also show that less than 42 percent of the bill's cost over the next six years would come in fiscal year 2002. In other words, the multi-year and permanent tax cuts in the legislation would have significant budgetary effects in years after the recession is over and would widen budget deficits in those years.

- The Joint Tax Committee estimates show the legislation would cost approximately $79 billion in fiscal year 2003 and $45 billion in fiscal year 2004. Those are years when the economy is expected to be in recovery. Further stimulus is not expected to be needed in those years.

- According to the Congressional Budget Office, the nation already faces a deficit in the unified budget in 2003 and only a small surplus in 2004. Moreover, because of the deterioration in the budget outlook and the increased expenditures planned for defense and homeland security, the Administration is proposing cuts in a number of domestic programs in 2003 and subsequent years. This raises the question as to why it is necessary to dedicate billions of dollars for "stimulus" tax cuts in these same years.

- The House package would cost $193 billion over six 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 $246 billion over six years. Furthermore, these numbers may be deceptively low; they assume that every one of the multi-year tax cuts in the bill will end on schedule, with none of these tax cuts being extended.

- Given that the recession is expected to end during 2002, the multi-year nature of a number of these corporate tax cuts makes little sense as stimulus policy. In fact, the multi–year design of these tax cuts makes sense only if one of the unstated goals of the legislation is for the corporate tax cuts to come to be seen over time as a normal part of the tax code and for the stage thus to be set to extend these tax cuts when they are scheduled to expire. If these measures are extended and remain in effect throughout their decade, several hundred billion dollars in additional cost will be incurred.

This analysis examines some of the more questionable and controversial tax provisions of the House legislation.

Corporate Alternative Minimum Tax

The House has doggedly refused to abandon its desire to slash the corporate Alternative Minimum Tax. While no longer calling for outright repeal of the corporate AMT or for the Treasury to mail large rebate checks to a number of corporations that paid the AMT in the past, the House still is seeking a large permanent tax cut for these corporations by eliminating the bulk of the AMT. The House bill contains a provision that would cut the corporate income tax paid by firms subject to the AMT by about half to two-thirds, on average, and do so on a permanent basis. The bill would accomplish this by eliminating AMT adjustments for depreciation, limitations on net operating losses, and foreign tax credits.[1]

This step would confer large tax benefits on a number of corporations. Yet it would provide little incentive for firms to undertake new investment now and thus would do little to stimulate the economy while it is weak. In its recent study examining various tax stimulus proposals, CBO reported that eliminating the corporate AMT "does little by itself to change the near-term incentive for businesses to invest. Its bang for the buck [as stimulus] is small because it primarily reduces taxes on the return from capital already in place rather than provides an incentive for new investment." Only new investment by business stimulates the economy.

The CBO report also explained that the corporate AMT proposal in the current House bill suffers from many of the same shortcomings as the proposal to repeal the AMT altogether. (The AMT provision in the new House bill is identical to the AMT provision in the bill the House passed in late December, which the CBO report analyzed.) CBO stated that, because the change the bill would make in the treatment of depreciation under the AMT would be permanent, this change would provide no incentive for firms to accelerate future investment into the present. This undermines its effectiveness as near-term stimulus. CBO also concluded that "the revised treatment [under the corporate AMT] of net operating losses and foreign tax credits would do little to make new domestic investment more attractive to firms."

Moreover, the House AMT provision would enable a number of major corporations to secure billions of dollars of tax credits, much as they would have been able to do under the original stimulus bill the House passed in October. These credits ignited controversy last fall because they would have resulted in huge checks being written to a number of corporations,

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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 year such data are 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.

including a check for $254 million to Enron.[2] Under the current House bill, many of the same corporations would continue to receive large tax benefits, but instead of the tax benefits being paid upfront in the form of a Treasury check, they would be spread over a number of years.

A number of corporations have built up substantial tax 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, however, corporations will be able to use these credits to reduce their regular tax liability in the years ahead. This is what would happen under the current House bill. As a result, a number of profitable corporations would be able to avoid paying any income tax in the future.

Accelerating Implementation of 25 Percent Rate

The new House bill retains the original House provision to accelerate to 2002 the reductions in the 27 percent income tax rate now scheduled for 2004 and 2006. This constitutes a poorly targeted and ineffective means of stimulating the economy. In its recent analysis, CBO concluded that "compared with other personal tax cuts, the first-year stimulus that this proposal would generate relative to its total revenue loss is probably small."

CBO noted that the bulk of the measure's cost would occur after 2002 — i.e., after the recession is expected to be over. It also pointed out that higher-income taxpayers — who tend to spend less and save more of any tax-cut dollars they receive than taxpayers with lower incomes do — would be the primary beneficiaries of this tax cut.

- This proposal would cost $51 billion, of which 85 percent would come *after* 2002.[3] This measure thus would induce little new consumer spending in the short-term relative to its full cost. The measure also would worsen the budget outlook for several years after the recession is over. Recent CBO and OMB budget analyses show the outlook for these years already has deteriorated markedly.

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[2] Citizens for Tax Justice, "House GOP 'Stimulus' Bill Offers 16 Large, Low-Tax Corporations $7.4 Billion in Instant Tax Rebates," updated October 26, 2001.

[3] This $51 billion total includes $45 billion for the rate acceleration and $6 billion for an associated provision increasing the exemption for the individual Alternative Minimum Tax. Without that change in the AMT, the number of taxpayers subject to the individual AMT would increase as a result of the rate reduction, thereby cancelling out some of the benefits for these taxpayers of the proposed rate cut. See Joint Committee on Taxation, "Estimated Budget Effects of the Revenue Provisions of the Economic Security and Worker Assistance Act of 2002," JCX-07-02, February 14, 2002.

- Despite statements by a number of policymakers (including President Bush) that this proposal is targeted on moderate-income taxpayers, Congressional Budget Office data conclusively demonstrate it would affect only the top quarter of tax filers and would confer the largest tax cuts on the top five percent of filers.[4] As CBO explained, these taxpayers are likely to save more and spend less of a tax cut than taxpayers with lower incomes. The economy will receive the desired boost only if these dollars are spent.

Three-year Depreciation

Another House provision would allow businesses to write-off more quickly the cost of various purchases and investments. A number of economists, as well as CBO, have said such a proposal could provide useful near-term stimulus *if* it were made effective for one year. Doing so would encourage firms to accelerate purchases into 2002 to take advantage of this tax break.

The House bill, however, would make the provision effective for *three* years rather than one. In its recent report, CBO warned that lengthening the effective period of this provision would weaken its ability to stimulate the economy. "Temporarily cutting taxes on investment can provide one-time opportunities for saving that may induce firms to advance their investment plans to the present," CBO noted, but advised that firms "might not take [such action in the near-term] if they knew that the tax advantage would remain in place and be available to them later."

Simply stated, to provide short-term economic stimulus, business tax provisions must induce immediate business investment. But a three-year effective period would allow firms to delay investment decisions until after the economy is recovering and still secure the tax break. Why should a firm accelerate investments into 2002 — the time the economy needs them — if it knows it can get the same tax break if it waits to see what the economy looks like and delays the investment until 2003?

CBO concluded that "extending the period during which such expensing could be used would reduce the bang for the buck because it would decrease businesses' incentive to invest in the first year and increase the total revenue cost." The president of the Business Roundtable, John Castellani, as well as economists at the Brookings Institution and various academic institutions, have made the same point.

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[4] The perception that this provision would benefit moderate-income taxpayers is based on a failure to distinguish between a family's "taxable income" — which is its income *after* deductions and exemptions are subtracted — and the family's full income, as well as on confusion created by the use by some policymakers of the income level at which the 27 percent bracket starts for *single filers* in a way that implies this is the income level at which the bracket starts for families as well. For a discussion of these issues and the substantial confusion and misinformation that surrounds this matter, see Robert Greenstein and Joel Friedman, "Middle-Income Taxpayers Will Receive Little or No Benefit From Proposal to Accelerate Implementation of the 25 Percent Rate," Center on Budget and Policy Priorities, revised February 15, 2002.

Furthermore, extending this provision to three years would cost $30 billion in 2003 and $26 billion in 2004, worsening the budget outlook in those years. And because the tax break would remain in effect long after the downturn had ended, it would be more likely that it would come to be seen as a normal feature of the tax code, thus making its extension at the end of the three-year period more probable. Indeed, the tax break is designed so that it would expire on September 11, 2004, shortly before the elections. That would further increase the likelihood it would be extended at that time. If this tax break were extended and remained in effect throughout the decade, its cost — according to the Joint Tax Committee — would be more than $200 billion over ten years.

Depreciation Provision Would Worsen the Budget Situation in the States

A depreciation tax cut at the federal level also would cause 46 states to lose state tax revenues because state corporate tax codes are tied to the federal code. The business depreciation tax cut in the House bill would cause states to lose $4.6 billion in state tax revenue in the coming year.[5] When the additional revenue losses the District of Columbia and New York City would incur are taken into account, the total revenue loss reaches $5.0 billion. In addition, because the depreciation provision would remain in effect for three years, states (including DC and New York City) would lose an additional $4.5 billion in 2003 — a year when they are again expected to face budget shortfalls — and another $3.8 billion in 2004.

The House bill includes a provision to provide states $4.6 billion in grants for fiscal relief in 2002. That money, however, would not fully offset the state revenue losses the bill would engender in 2002, let alone compensate for the more than $13 billion the states would lose over all three years (see table on following page).[6]

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[5] This estimate is consistent with the $5.4 billion estimate produced in separate analyses by the Congressional Research Service and the Center on Budget and Policy Priorities. The previous estimate was based on last year's Joint Committee on Taxation cost estimate of the depreciation provision. The Joint Tax Committee has now released a new cost estimate of the stimulus bill that the House passed on February 14, which reflects a somewhat lower cost for the depreciation provision. The $4.6 billion loss of state revenues noted above is consistent with the new Joint Tax Committee estimate. See Joint Committee on Taxation, "Estimated Budget Effects of the Revenue Provisions of the Economic Security and Worker Assistance Act of 2002," JCX-07-02, February 14, 2002.

[6] Various stimulus measures considered in the Senate would have provided net fiscal relief to the states — that is, they would have provided relief that exceeded the level of revenue losses that states would have incurred as a result of the depreciation provisions also included in these stimulus packages. The stimulus measure that Senate Majority Leader Tom Daschle brought to the Senate floor in late January included a one-year depreciation provision, coupled with one year of state fiscal relief provided through a temporary increase in the federal Medicaid matching rate. The increase in the Medicaid matching rate would have slightly more than offset the state revenue losses associated with the depreciation provision. The Daschle proposal was amended on the Senate floor to extend the depreciation tax cut to two years; as part of that amendment, the increase in the Medicaid matching rate also was extended to two years.

Effect on State Treasuries in 2002-2004 of House Bill
(in millions of dollars)

	Cost to States of Depreciation Provision, federal fiscal years 2002 – 2004	Grants to States to Assist Paying for State Health Care Costs calendar year 2002	Net three-year loss (-) or gain
Alabama	-128	51	-77
Alaska	-159	32	-127
Arizona	-248	69	-179
Arkansas	-122	38	-84
California	not affected	483	483
Colorado	-199	37	-162
Connecticut	-227	60	-167
Delaware	-70	10	-60
DC	-91	18	-73
Florida	-484	165	-319
Georgia	-404	119	-285
Hawaii	-47	13	-34
Idaho	-71	13	-58
Illinois	-826	176	-650
Indiana	-410	66	-344
Iowa	-138	32	-106
Kansas	-129	27	-102
Kentucky	-167	83	-84
Louisiana	-130	84	-46
Maine	-68	23	-45
Maryland	-268	60	-208
Massachusetts	-612	122	-490
Michigan	-136	156	20
Minnesota	-405	114	-291
Mississippi	-126	55	-71
Missouri	-200	75	-125
Montana	-49	10	-39
Nebraska	-77	32	-45
Nevada	not affected	15	15
New Hampshire	-97	15	-82
New Jersey	-600	116	-484
New Mexico	-90	39	-51
New York*	-2507	574	-1933
North Carolina	-445	189	-256
North Dakota	-35	9	-26
Ohio	-449	166	-283
Oklahoma	-109	49	-60
Oregon	-233	71	-162
Pennsylvania	-771	227	-544
Rhode Island	-43	45	2
South Carolina	-132	95	-37
South Dakota	-17	20	3
Tennessee	-248	103	-145
Texas	-768	290	-478
Utah	-99	31	-68
Vermont	-25	10	-15
Virginia	-313	67	-246
Washington	not affected	110	110
West Virginia	-82	31	-51
Wisconsin	-320	93	-227
Wyoming	not affected	12	12
Total	**-13,376**	**4,600**	**-8,776**

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

The National Governors Association recently estimated that state budget shortfalls will total between $40 billion and $50 billion for the current fiscal year. Since states must balance their budgets even in recessions, they are being compelled to institute sizeable budget cuts and/or tax increases. Such actions by states 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 House bill provides no net fiscal relief and instead makes the budget shortfalls larger in a number of states.

Finally, most states anticipate serious fiscal difficulties to continue at least through 2003, due to lagging revenues and high unemployment levels that are expected to continue for a number of months after the recession ends. Some states, including Alabama, Florida, North Carolina, and Ohio, have already enacted major budget cuts and/or tax measures that will carry over into 2003. Other states have been able to draw upon reserves and make other budget adjustments to avoid major service cuts and tax increases in 2002, but will not be able to forestall such cuts in the 2003 fiscal year. If states lose an additional $4.5 billion in 2003 as a result of Congress' extending the depreciation tax cut into a second year, they will have to cut programs or raise other taxes to a greater degree to make up for this loss.

Many state legislatures are meeting now to consider and act on their fiscal year 2003 budgets. Examples of tax changes that governors have recently proposed to help balance their 2003 budgets include increased sales, cigarette and gasoline taxes in Kansas, postponement of an income tax cut in Maryland, broadening the sales tax base in Minnesota, excise tax increases in Missouri, and rollback of an income tax reduction in Oregon. Many states also have implemented or are seriously considering reductions in an array of programs in 2003, including cuts in Medicaid and the State Children's Health Insurance Program (SCHIP) that would affect thousands of low-income children and elderly and disabled people. For example, Oklahoma and New Mexico may eliminate their SCHIP programs for children entirely.[7] Tennessee has proposed cutting Medicaid eligibility for 180,000 low-income people. Some states, such as Florida and Oregon, are likely to cut coverage for the "medically needy," a group of low-income people who incur catastrophic health care expenses. Some other states will no longer cover disabled workers returning to work and low-income women with breast and cervical cancer. In addition, a number of states, including Indiana, Maine and New Jersey, are suspending measures to reach more of the uninsured.

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[7] Under SCHIP, states may chose to expand Medicaid or establish separate state programs as a way to provide expanded coverage for low-income children. Both states elected to use Medicaid and may drop those Medicaid expansions.

Health Insurance for the Unemployed

The health insurance provisions of the package are problematic as well. The principal such provision would provide a tax credit for 60 percent of health insurance premiums that laid-off workers pay through 2003. 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. Neither of these proposals is well-designed, and they are likely to prove of limited effectiveness. Other approaches to providing health insurance to the unemployed represent sounder policy.

Health Insurance Tax Credit

The proposed tax credit could be used to purchase either employer-based coverage through COBRA or insurance in the individual health insurance market. The design of this credit, however, would make it of little benefit to many low- and moderate-income families with unemployed workers.

- The costs of a family health insurance policy under COBRA average approximately $7,000. It is unlikely that many unemployed workers — particularly those with low or moderate incomes — could afford to pay 40 percent of these premium costs while unemployed.

- The tax credit would require unemployed workers who are not eligible for COBRA to obtain health insurance in the individual market. As described in greater detail below, the individual market is largely unregulated, and insurers generally vary premiums based on age and medical history (and refuse to cover some people entirely). As a result, older and sicker workers who cannot get coverage through COBRA likely would be unable to access health insurance they could afford with this tax credit.

- This temporary tax credit would be in effect for two years. Its supporters have made clear, however, that their intention would be to extend the credit before it expired and, in so doing, to broaden it beyond unemployed workers so it also covered workers whose firms offer employer-based coverage. This would turn the credit into a much broader and more costly measure, akin to that included in the Administration's budget. As explained below, a general tax credit for the purchase of health insurance, such as that which the Administration has proposed, could significantly weaken the employer-based health insurance system and would likely cause some older or sicker workers who currently have such coverage to lose it and become uninsured.

- Finally, unemployed workers who are eligible for unemployment insurance could receive the House tax credit.[8] A substantial number of low-income unemployed workers do not receive unemployment insurance. For example, in many states, unemployed workers who are employed on less than a full-time basis and are not available for full-time work — such as mothers who have very young children and can work three-quarters time — are ineligible for unemployment insurance when they are laid off solely because they are not available for full-time work. In addition, numerous low-income workers are ineligible because, in most states, the wages that a worker earned in both the current calendar quarter and the quarter before that are *not counted* in determining whether the worker earned enough to qualify for unemployment benefits. Because they are not eligible for unemployment insurance, these recent entrants would be excluded from eligibility for the health tax credit as well.

Tax Credit Relies on Problematic Individual Market for Health Insurance

Making the tax credit available for the purchase of insurance in the individual market is problematic. As noted, the individual market lacks the advantages of group insurance purchased through employers or public programs. Many plans sold on the individual market impose high deductibles and offer limited coverage. Furthermore, premiums in the individual market generally vary based on risk factors such as age and medical history and insurers often exclude people entirely.

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 form of individual coverage is made available to laid-off workers who previously had employer-based coverage. Similar requirements are part of current law, however, and some states comply with them simply by allowing individuals who otherwise are unable to secure coverage to purchase insurance through so-called "high-risk pools." These arrangements, often subsidized by insurers and states, are supposed to allow "uninsurable" individuals to purchase coverage.

Yet premiums for policies sold through high-risk pools can still be unaffordable, and the coverage provided can be very limited. In addition, some high-risk pools do not cover pre-existing conditions for some period of time, while others impose waiting lists or are closed to new enrollment. As a result, few individuals purchase health insurance through these pools. In addition, about half the states do not even operate high-risk pools.

To address these concerns, the House bill would make $100 million available to states. States could use the funds to establish high-risk pools if they have not already done so, or to

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[8] Workers who exhaust their unemployment insurance benefits would also be eligible.

further subsidize operation of these pools. Given the inadequacies of the high-risk pools, however, it is doubtful that these funds would be sufficient to significantly improve access, affordability, and quality for older and sicker unemployed workers who otherwise are unable to obtain coverage in the individual market.

Tax Credit Is Part of Long-Term Agenda To Weaken Employer-Based Coverage

The likely reason for inclusion of this tax credit in the House package is that supporters of this credit view its inclusion as an opening for the subsequent establishment of a broader individual tax credit for the purchase of health insurance, such as the proposal contained in the Administration's fiscal year 2003 budget. Rep. Bill Thomas, the chairman of the House Ways and Means Committee, has essentially said as much. If the tax credit in the House bill is enacted, subsequent efforts are likely to be made to broaden this credit into a general individual health insurance tax credit that could be used by employed as well as unemployed individuals to purchase insurance in the individual market.

Such a general individual health insurance credit could have deleterious effects:

- Such a credit likely 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. (Under the Administration's proposal, an employed individual could use the tax credit as long as he or she did not simultaneously participate in an employer-based plan or a public health insurance program.) 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. That could discourage still more employers from providing it. An analysis by M.I.T. economist Jonathan Gruber, one of the nation's leading experts on these matters, concludes that under the Administration's proposal, four million people would either lose or voluntarily opt out of their employer-based coverage, with 1.4 million of these individuals becoming uninsured.[9]

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[9] Jonathan Gruber, Testimony before the House Committee on Ways and Means , February 14, 2002. For an in-depth analysis of the Administration's tax credit proposal, see Edwin Park, "Health Insurance Proposals in Administration's Budget Could Weaken the Employer-Based Health Insurance System," revised February 5, 2002.

National Emergency Grants

The House package also would provide $3.9 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 is a small Labor Department program that operates in a limited number of areas. It currently is funded at about a $200 million annual level and provides grants for job training and related employment services in a modest number of areas where job dislocations have occurred because of a plant closing, natural disaster, or other such event.

This small employment program is not likely to provide an effective or expeditious way to provide health insurance to unemployed workers. It is designed to respond to needs for job training and employment services in a modest number of individual localities, not to provide health insurance to unemployed workers in every state in the nation.[10]

Furthermore, 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 would likely be over. CBO estimates that only $1.0 billion of the $3.9 billion in NEG grants that would be provided under the House bill — or about one-quarter of this funding — would be spent in fiscal year 2002.

Given these shortcomings, the health insurance proposals in the House bill are unlikely to provide adequate assistance to low- and moderate-income workers who lose their jobs. If Congress is determined to approve a broader economic stimulus package that includes measures to enable unemployed workers to obtain health insurance, a much sounder approach would be to couple a deeper COBRA subsidy — for example, a subsidy for 75 percent of COBRA premium costs — with an option for states to cover under Medicaid those low-income unemployed individuals who either do not have access to COBRA coverage or cannot afford their share of the COBRA premium even with a 75 percent subsidy. To encourage states to take up this option, states would be eligible for a higher federal Medicaid matching rate (say 90 percent). Such a COBRA-Medicaid proposal — which would be in effect for a period of no more than one year — would provide access to affordable quality health insurance through the employer-based system and Medicaid to low-income and less-healthy unemployed workers, not just to those with higher incomes and good health status.

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[10] 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.

Other Troubling Tax Provisions

Tax breaks for financial corporations with foreign operations

The House bill also includes a bevy of other troubling provisions. For example, it would extend for five years a tax break for multinational corporations engaged in banking, finance, and insurance activities overseas. This provision would benefit these multi-national financial corporations handsomely by allowing them to defer from taxation certain income earned overseas.[11] But it would do little to stimulate domestic investment. In its recent report, CBO concluded that allowing deferred taxation of this overseas income "would provide little stimulus (because it would primarily affect income from existing capital and foreign rather than domestic economic activity)."

Moreover, less than 4 percent of the $9.0 billion in tax cuts this measure would provide would come in fiscal year 2002. Over 96 percent of these tax benefits would come in years after that. This further diminishes any minor stimulative effect the measure might have.

In its original stimulus bill, the House proposed a permanent extension of this tax break. Although it since has shortened the extension to five years, this multi-year extension is still more favorable treatment than the two-year extension the bill provides for other expiring tax provisions.

Reduction in Employer Pension Contributions

The House plan also includes a provision that would allow firms to reduce pension contributions to pension funds for their employees. This provision was not considered in the Senate, nor was it in the original House-passed measure. It appeared for the first time in the stimulus bill the House passed in December.

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 to defined benefit plans have risen, balancing the lower contributions that many firms made when interest rates were high.

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[11] Under current law, U.S. firms are taxed on some types of income earned by foreign corporations 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, which expired at the end of 2001, exempted income earned in banking, finance, and insurance from these rules and therefore effectively provided a subsidy to income that is earned abroad and not distributed back to the United States.

The House bill 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.

Conclusion

By avoiding an up-or-down vote on the measure the Senate approved unanimously to provide additional weeks of unemployment benefits, the House leadership appears to be signaling an intention to hold benefits for unemployed workers hostage to its ideological preference for more multi-year and permanent tax cuts aimed primarily at business and upper-income households. The House has clung to tax-cut provisions that the Congressional Budget Office and other economists have concluded would be ineffective stimulus. These tax cuts would worsen an already deteriorating budget situation in years after the recession ends. Furthermore, while temporary in theory, these multi-year tax cuts appear to be designed so there would be considerable pressure to continue them on an ongoing basis when they were slated to expire, which would further aggravate the long-term squeeze on the budget.