Center on Budget and Policy Priorities

CBPP STATEMENT

For Immediate Release:
Thursday, January 24, 2008

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STATEMENT BY ROBERT GREENSTEIN, EXECUTIVE DIRECTOR

REPORTED STIMULUS PACKAGE WOULD PROVIDE LITTLE IMMEDIATE BOOST DUE TO REMOVAL OF MOST EFFECTIVE PROVISIONS

Changes reportedly made last night in the stimulus package would reduce its effectiveness as stimulus. Although the package includes a reasonably designed tax rebate, the two most targeted and economically effective measures under consideration — a temporary extension of unemployment benefits and a temporary boost in food stamp benefits — were zeroed out, apparently at the insistence of House Republican leaders.

The two respected institutions that have rated stimulus options in recent days — the Congressional Budget Office and Moody's Economy.com — both give their two highest ratings for effectiveness as stimulus to the two measures that were dropped.

- Of all tax and spending stimulus options that CBO examined, the only two that it found would have a large "bang-for-the-buck" as effective stimulus *and* act fast to boost the economy are the unemployment insurance and food stamp provisions. Both could start injecting more consumer purchasing power into the economy within one to two months. The planned tax rebate checks, in contrast, are not likely to be sent out until June.

- Economy.com found that for each dollar spent on extended UI benefits, $1.64 in increased economic activity would be generated. For each dollar in increased food stamp benefits, $1.73 in new economic activity would be generated. *No other options* rated as high.

- In contrast, Economy.com found that for each dollar in "accelerated depreciation" — the main business tax cut in the package — only 27 cents of increased economic activity would be generated. CBO and a Federal Reserve study in 2006 found that the business tax cuts adopted in the last recession, which closely resemble those in the current package, had only modest stimulative effects. Despite this evidence, the package apparently contains at least $50 billion in business tax cuts while excluding unemployment insurance — the single measure most focused on the people hardest hit by the downturn — and food stamps.

- The business tax cuts also would cause states to lose at least $4 billion in *state* revenue, due to linkages between federal and state tax codes. The package contains no fiscal relief for states, not even to offset this loss. As a result, many states will have to enact deeper and more painful budget cuts, likely hitting areas from health care and education to aid to local governments. Those state budget cuts will also act as a drag on the economy.

The unemployment insurance and food stamp provisions apparently were rejected by House Republican leaders, who reportedly said that the inclusion of spending measures would be unacceptable to the House Republican Caucus and would derail the package. Such a stance reflects the elevation of ideology over sound economic reasoning. As Nobel laureate Joseph Stiglitz and now-CBO director Peter Orszag wrote in late 2001, "Basic economic analysis indicates that increased government expenditures can indeed be stimulative, and, in fact, are often more effective as stimulus measures than tax cuts."[1] This is because a significant portion of most tax cuts is saved rather than spent.

Rebates Are Reasonably Designed

The package does contain reasonably designed tax rebates. The rebate component is vastly superior to the rebate proposal that the Administration developed last week, under which more than 25 million low- and moderate-income working families would have been shut out. Most of those families would get a substantial rebate under the new package.

(Even so, the rebates will not be fully as effective as stimulus as they could have been, since the rebates for working-poor families will apparently be smaller than those for middle- and upper-middle-income families. Since the working poor are the people who will spend — rather than save — the largest share of their rebate dollars, the optimal design would be one under which working-poor families do not receive smaller rebates than people at higher income levels do.)

In the bipartisan negotiations over the stimulus package, an appropriate trade would have been to include the sizable (but not especially effective) business tax cuts in return for a rebate that extended to the working poor, but *not* to drop the unemployment insurance and food stamp provisions. It is unfortunate that those two provisions — the most targeted and effective measures under consideration — were removed, and that states facing deficits will be driven deeper into deficit and thus have to cut services or raise taxes more, rather than being provided some fiscal relief.

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[1] 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, http://www.cbpp.org/11-27-01tax.htm.