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Special Series: **Economic Recovery Watch**

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HOUSE, SENATE RECOVERY BILLS ALLOT VAST SHARE OF BENEFITS DURING DOWNTURN, NEW OFFICIAL ESTIMATES SHOW

Senate Bill: 94% of Effects in 2009-11; House Bill: 85% of Effects in 2009-11

By James Horney

Despite charges to the contrary, the House-passed economic recovery package and the one that the Senate plans to consider this week each would provide a timely boost to the struggling economy.

Charges that much of each bill's new spending and tax cuts would take place after the economy has largely recovered are inaccurate. In fact, the official cost estimates of the Congressional Budget Office and Joint Committee on Taxation show that more than five-sixths (85 percent) of the effects of the House bill, and 94 percent of the effects of the Senate bill, would occur during the 2009 – 2011 period — when the CBO says the nation's economic output will be far below its potential and fiscal stimulus thus would be beneficial.[1]

Criticism Does Not Reflect Impact of Complete Bill

The criticism that the bills would take effect too late is misguided for two reasons. First, it stems partly from claims about the timing of spending in the House bill that were based on preliminary estimates of only one portion of the bill. Relying on an initial CBO estimate of just the Appropriations Committee's part of the House recovery package, critics suggested that less than half of the spending would take place in the first two fiscal years covered by the bill.[2]

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[1] Figures in this paper for the House bill are based on CBO's estimate of the bill (H.R. 1) passed by the House on January 28, 2009. Figures for the Senate bill are based on CBO estimates of the amendment in the nature of a substitute to H.R. 1 introduced on January 31 by Senate Finance Committee Chairman Max Baucus and Senate Appropriations Committee Chairman Daniel Inouye and do not include the effect of a provision extending relief from the Alternative Minimum Tax.

[2] The first two years covered are fiscal year 2009 (which ends September 30, 2009) and fiscal year 2010 (which begins October 1, 2009). Since a recovery package is unlikely to be enacted until at least the middle of February, almost halfway through fiscal year 2009, spending and tax cuts attributed to those two years really represent effects over a little more than a year and a half rather than two full years.

When *all* of the spending increases and tax cuts in the House and Senate bills are considered, the shares of the bills' effects that would occur in the next few years are much higher. CBO and the Joint Committee on Taxation estimate that 64 percent of the impact of the full House bill, and 75 percent of the impact of the full Senate bill, would be felt in 2009 and 2010.[3]

Longer Stimulus Appropriate for Longer Recession

Second, the criticism reflects a misunderstanding of the current economic situation. Since this downturn is expected to be much longer and deeper, and the recovery from it slower, than has been typical of post-World War II recessions, providing stimulus over a longer period than seemed appropriate in the past is a sound idea.

CBO estimates the magnitude of an economic downturn by the gap between actual (or expected) Gross Domestic Product and CBO's estimate of what GDP would be if the nation's labor and capital resources were fully utilized. Testifying before the House Budget Committee on January 27, CBO Director Douglas Elmendorf said CBO expects that, without enactment of the stimulus package, the GDP gap will equal 7.4 percent of GDP in the last quarter of 2009 and 6.3 percent of GDP in the last quarter of 2010 — the equivalent of more than $1 trillion in lost output each year.[4] CBO also projects that the GDP gap will still remain very large (4.1 percent of GDP) in the last quarter of *2011*.[5] Thus, spending increases and tax cuts occurring in 2011 would come when the economy is still far below its potential and would benefit from such stimulus.

CBO Director Elmendorf explicitly addressed the desirability of providing stimulus that will be effective over a number of years in his House testimony:

> Because most periods of economic weakness are fairly short-lived, it is generally preferable that stimulus policies be short-lived. Currently, however, CBO projects that economic output will remain significantly below its potential for several more years, so policies that provide stimulus for an extended period of time may be appropriate. Indeed, a fiscal stimulus that ends before the economy has started to regain its footing runs the risk of exacerbating economic weakness when the stimulus ends.[6]

Well-designed spending increases or tax cuts that occur in 2011 would provide welcome support for a still-lagging economy.

[3] It is important to note that a package that has a larger share of a given amount of spending and tax cuts in the first two or three years is not necessarily providing more effective stimulus in that period than a bill that has a somewhat smaller share of the effects in those years. If the share of the effects is higher in the former case because the package includes more measures that can take effect quickly but provide little stimulus — such as a reduction in corporate tax rates — that package may be less effective in stimulating the economy in that period.

[4] Congressional Budge Office Director Douglas W. Elmendorf, "The State of the Economy and Issues in Developing an Effective Policy Response," Testimony before the House Committee on the Budget, January 27, 2009.

[5] Even with the stimulus effect provided by the House bill, CBO estimates that the GDP gap at the end of 2011 would remain high, between 2.7 percent and 3.6 percent of GDP.

[6] Elmendorf, page 20.