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ATTACKS ON CONGRESSIONAL RECOVERY PACKAGE DON'T WITHSTAND SCRUTINY

By Chad Stone

The public debate over the economic recovery package working its way through Congress[1] has become more muddled and incoherent than the critics' caricature of the package itself. *New York Times* columnist David Brooks, for example, describes the package as a "sprawling, undisciplined smorgasbord."[2] Those words may be more appropriately applied to the case that he and others are trying to make against it.

A Focus on the Task at Hand

Congress, Brooks says, has abandoned what he sees as the case that Obama economic advisor Larry Summers built throughout 2008 for a "big but surgical stimulus package" that would be timely, targeted, and temporary. Congressional leaders abandoned the Summers parameters, Brooks says, and merged temporary stimulus measures with their permanent domestic agenda into a bill that tries to do everything at once and therefore does nothing well. This account mischaracterizes both Summers' position and the Congressional package.

First, Summers. He, like most mainstream economists, did begin 2008 arguing for a "timely, targeted, and temporary" stimulus equal to about one percent of GDP (roughly $150 billion). But when it became clear in late fall that economic conditions were worsening dramatically and the financial system was in an historic meltdown, he adjusted his prescription. Speaking at the *Wall Street Journal*'s CEO Council conference in November, he urged a plan that was "speedy, substantial and sustained over a several-year interval."[3] Summers was not alone among mainstream economists in recognizing that changed economic conditions warranted a much larger stimulus and recovery package than was originally anticipated.

How did Congressional leaders respond? The plan for the most part is well-designed to produce as much stimulus as possible as quickly as that can be done. It includes fast-spending, high "bang

[1] The American Recovery and Reinvestment Act of 2009.

[2] David Brooks, "Cleaner and Faster," *New York Times* Op-Ed, January 30 2009.

[3] "Summers's New View on Stimulus: Sustained Not Temporary," *Wall Street Journal* Real Time Economics, November 17, 2008.

for the buck" items such as expansions in Food Stamps and unemployment insurance — provisions that a broad range of economists and CBO have rated as the most highly stimulative types of spending. It also includes state fiscal relief, which is essential to moderate the depth of the budget cuts and tax increases that states otherwise will have to impose; such budget cuts and tax increases would withdraw demand from the economy and make the downturn deeper. In addition, the package includes infrastructure investments, which are highly stimulative once projects are underway but sometimes require significant lead time. Finally, the package includes tax cuts, some of which are targeted on low and moderate income households, making them more effective as stimulus, and some of which are less well-targeted and, according to CBO, likely to have far less of a stimulative effect.

But there is only so much money that usefully can be spent in the next few years in these areas and, thus, the authors of the package needed to cast a wider net and look for somewhat smaller programs that are meritorious and can usefully spend additional resources over the next couple of years. Economists from across the political spectrum have said that the total amount of stimulus that is needed falls in the $800 billion to $1 trillion range. It is simply impossible to develop an effective package of this size and include only infrastructure, safety net programs, state fiscal relief, and tax cuts. If one tried to craft such a package, programs that were included would get more money than they could usefully spend in the near term and programs that could spend money quickly and meritoriously would be left out.

The bottom line is that the cost estimates of the House and Senate bills by the Congressional Budget Office (CBO) and the Joint Committee on Taxation show that designers of the package largely succeeded in crafting a package that is well timed — more than five-sixths (85 percent) of the spending and tax cuts in the House bill, and 94 percent of those in the Senate bill (as introduced on the Senate floor) would occur over the next 2 $^{2}/_{3}$ years (i.e., during fiscal years 2009 – 2011).[4] Most economic forecasts, including CBO's, predict considerable economic slack in the economy over this entire period.

How the Recovery Package Creates Jobs

Effective economic stimulus and recovery measures work by increasing the demand for goods and services at a time when there is insufficient existing demand to keep businesses operating at full capacity and to generate full employment. Measures that increase demand stop the destruction of jobs and begin to put people back to work during times when business and consumer confidence is low and economic activity is spiraling downward. They continue to do so in the early stages of a recovery from a long and deep recession. Many criticisms of the Congressional package reflect a poor understanding of this process.

Some critics, for example, argue that spending on safety net programs like food stamps and unemployment insurance may be justified on humanitarian grounds but does not provide stimulus or create jobs in the way that reductions in, say, taxes for businesses would. In fact, this argument is completely backward in a recession. When the problem is that businesses have excess productive

[4] James R. Horney, "House, Senate Recovery Bills Allot Vast Share of Benefits During Downturn, New Official Estimates Show," Center on Budget and Policy Priorities, February 3, 2009.

capacity and can't sell everything they can make, the way to reduce pressure on them to lay off workers and to give them a greater incentive to expand is to give their customers more money to spend. When you increase benefits for unemployed workers or food stamp recipients, they spend the money quickly and the benefits spread through the economy. That's what creates incentives for businesses to preserve and create jobs in a recession. Whatever the merits of business tax cuts as a long-term strategy to promote economic growth, they are an ineffective policy when what is needed is to put more customers in the stores.

Some critics also argue that providing additional resources in areas such as child care, Pell Grants, or health services may be good long-run policy but will not help generate jobs. This, too, is mistaken. Programs that serve useful purposes and can spend additional resources relatively quickly boost demand and save or create jobs. Take child care, for example. If states can enroll more children who need child care while their parents are working, looking for work, or in school upgrading their skills, that will expand the number of teachers, aides, food service workers, and custodial staff employed in child care facilities around the country (many of which are small businesses that are so often talked about in the stimulus debate). More children in child care also translates into higher demand for classroom materials and transportation services. The teachers and others who have jobs as a result of the expansion in the child care program will have steady paychecks and be able to purchase more goods and services for their families.

Critics are similarly confused about fiscal relief measures for cash-strapped states. Here, too, some critics have mistakenly charged that such measures are not stimulus and do not create jobs. Brooks, for example, seems to think that such measures provide a boost to existing state budgets that exceeds what governors can absorb. The truth is quite different. In an economic downturn, states see their revenues fall off and their caseloads for social safety net programs like Medicaid increase. Unlike the federal government, states have balanced budget requirements for their operating budgets. As budget deficits begin to emerge, states must take actions to cut existing programs or raise new revenues.

Those actions translate into layoffs of state workers, cancellation of contracts with vendors, and a diminished response to the hardship that beneficiaries of safety net programs experience. Without help from the federal government, those state actions will reverberate through the economy, adding to the job losses and further weakening economic activity. States currently face budget shortfalls projected at more than $350 billion over the next 2½ years, a stunning amount that, in the absence of federal relief, would translate into budget cuts and tax increases that would make the recession longer and deeper. Far from exceeding what states can handle, the state fiscal relief provisions of the recovery package make up only a part (about half) of this gap.[5] State fiscal relief thus will reduce the job losses and reduction in economic activity that otherwise would take place, but will not prevent states from having to make tough budget choices to address the substantial budget gaps that remain.

One of the main provisions for providing fiscal relief to states is a temporary increase in the Federal Medical Assistance Percentage (FMAP), which increases the share of state Medicaid expenses that the federal government pays. Some critics may have this in mind when they criticize

[5] Iris Lav and Nicholas Johnson, "Funding for States in Senate Economic Recovery Package Would Close Less than Half of Projected State Deficits," Center on Budget and Policy Priorities, January 29, 2009.

the package for increasing entitlement spending rather than providing "real" stimulus. But that criticism is misplaced and reflects a misunderstanding of how the provision would work. By temporarily assuming some of the cost of Medicaid, the federal government allows states to continue to meet their Medicaid obligations without cutting other programs more deeply, avoiding the job losses and other adverse economic effects that would entail.

Properly understood, the bulk of the provisions in the recovery package contribute to job creation and preservation. In many cases, however, it will not be meaningful to try to trace a link between specific measures and specific jobs created. Money that is spent by food stamp or unemployment insurance recipients, by state employees who keep their jobs because of state fiscal relief, or by employees of firms doing business with the state who keep their jobs for the same reason – all of this creates additional demand for a wide variety of goods and services that preserves and protects jobs broadly through the economy. Using standard methods of analysis, Obama Administration economists estimate that more than half the jobs that a package similar to the Congressional recovery package would create would arise from these indirect effects, as the package's boost to demand multiplies through the economy.[6]

Recovery Package Is Temporary and Has Little Impact on Budget Deficits Going Forward

Some critics of the economic recovery package also argue that it is a large permanent expansion of government that will add to future deficits. Brooks, for example, worries that "there is no fiscal exit strategy." In fact, very little of the spending authority in the bill extends beyond 2011, and the evidence from past fiscal stimulus legislation is that Congress does allow temporary measures such as unemployment insurance and state fiscal relief to expire once the economy recovers. Indeed, this recovery package stands in marked contrast to the Bush tax cuts of 2001, in which Congress used an artificial and abrupt sunsetting to disguise the true cost and to create pressure to make them permanent, at high cost.

To be sure, the Making Work Pay Tax Cut was a centerpiece of President Obama's campaign, and the Administration has signaled that it would like to make it permanent. But if that happens, it will be in the context of the normal budget process, where budget enforcement procedures will be in place. And the Administration has said that if it seeks to extend tax cuts in the package, it will propose to fully offset the costs.

With respect to infrastructure, the recovery package provides a large one-time boost to spending authority, and the actual expenditures from that authority occur over a number of years. But, the amount diminishes rapidly after 2011. Maintaining higher levels of infrastructure spending over and above those amounts will require annual appropriations that Congress would have to enact under the normal budget process.

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[6] Christina Romer and Jared Bernstein, "The Job Impact of the American Recovery and Investment Plan," January 9, 2009.

Tax Cuts versus Spending

A persistent argument heard in the stimulus debate is that tax cuts are more effective stimulus than government spending. That is *not* the conclusion of mainstream macroeconomic theory or evidence. Table 1 shows Goldman-Sachs' assessment of various measures in the House version of the recovery package based on three criteria: how fast the measures can take effect, how much "bang-for-the-buck" they have (the fiscal multiplier), and how easy it is to control their duration and keep them from becoming permanent. Other assessments such as those of CBO and Moody's Economy.com differ in some details, but the general picture of what is effective stimulus and what is not are pretty uniform among these analysts.

The concern over federal spending on infrastructure is not how much it will boost demand and hence create and preserve jobs once the spending is out the door (and highway construction crews are getting paid and asphalt is getting laid), but rather how long it might take to get the money out the door. That is why Goldman Sachs scores infrastructure low on rapid impact. However, the Goldman Sachs analysis supports a point made earlier in this paper, arguing that "the fiscal program needs to remain large in 2010 and be withdrawn only gradually thereafter," which "puts a premium on measures that will provide stimulus for more than just a year, preferably several years."[7] Sound infrastructure investments that make sense on longer-term cost-benefit grounds fit that bill well.

Tax cuts are most effective as stimulus when they are targeted on low- and moderate-income households that will likely spend a high proportion of the benefits. Tax cuts are far less effective as stimulus when they go to high-income taxpayers who will likely save a large proportion of the tax benefits or, as discussed above, to businesses that will not likely spend the tax cuts on expansion when their sales are depressed and they are laying off workers.

The individual tax cuts in the package are fairly well targeted and thus score relatively well as stimulus. But many of the tax cuts that critics would replace them with tend to be more oriented

Table 1: Fiscal Impact of Measures in the House Proposal for Fiscal Stimulus

Category	Rapid Impact?	Approximate Multiplier	Duration Easy to Control?
Infrastructure			
Traditional: Transport	No	1.5	Easy
Traditional: Non-Transport	No	1.5	Easy
Non-Traditional	No	1.25	Easy
Benefit Programs	Yes	1.0-1.5	Medium
Direct Aid to States	Yes	1.25	Medium
Tax Cuts			
Individual	Yes	1.0	Hard
Corporate	Yes	0.25	Hard

Source: "Help Wanted! A Spender of Last Resort," Goldman Sachs Global Economics Paper No. 178, January 22, 2009, Table 3, p. 17.

[7] "Help Wanted! A Spender of Last Resort," Goldman Sachs Global Economics Paper No. 178, January 22, 2009, p.17.

toward more affluent households and businesses, which would spend less of their tax cuts now, and hence would be less potent as stimulus.

Conclusion

Contrary to what some critics say, the economic recovery package working its way through Congress by and large is focused on the task at hand, which is to provide a needed boost to an economy that is in the midst of a long and deep recession. Much of the criticism of the package reflects a misunderstanding of how stimulus works and why the measures in the package will be effective as stimulus. Ironically, these misunderstandings create the danger that Congress may cut back effective stimulative measures and replace them with other measures that would make the package less effective.