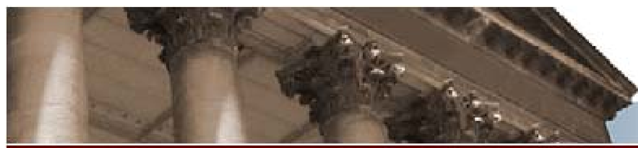

JOINT ECONOMIC COMMITTEE
SENATE REPUBLICANS

SENATOR SAM BROWNBACK, SENIOR REPUBLICAN SENATOR

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OVERVIEW OF ALTERNATIVE STIMULUS OPTIONS

There have been a number of different stimulus options offered up by various individuals and agencies, leaving room for debate on the most effective stimulus options. The purpose of a stimulus is to increase demand as much as possible, as quickly as possible, for as little cost as possible. Below is a chart that outlines the policy options available, a range of likely (estimated) costs for specified purposes, and the potential benefits and consequences of each option:

Action	Cost	Purpose	Benefits	Consequences
Extend Unemployment Benefits	$4-8 billion	To extend unemployment benefits for an additional 13 weeks for a period of 6-12 months.	Relatively large percentage of the money would be spent because the unemployed are likely to be cash-constrained.	Encourages longer periods of unemployment by reducing incentives for individuals to look for new jobs.
Increase Food Stamp Payments	$4 billion	To increase monthly amount per person by $25 for 6 months.	Most of the money given out would be spent, and would likely be spent quickly (food stamps cannot be saved or used to pay down debt).	Demand might not increase dollar-for-dollar if families use more of their non-food budgets to pay off debt, which mutes the effect of the stimulus.
Low-Income Home Energy Assistance	$7 billion	To provide 37 million families with checks of about $200 to help pay home heating and energy bills.	Targeted to low income families and could allow families to increase other spending.	Assistance would not be received until the summer when heating is no longer needed; Could increase demand for energy, much of which comes from foreign sources; Families could devote more of their non-energy budgets to paying off debt.
Temporary Marginal Rate Reduction and Tax Prebates	$40 billion	To provide $300 and $600 rebates, similar to what was done in 2001.	Rate reductions reward work; Money could be put into consumers hands by the summer; Cash benefits allow for efficient distribution of increased demand as consumers allocate the "prebates" to goods and services they deem most valuable.	Only about 1/3 of all money sent out would be spent in the near term and a good portion could be spent on foreign products; Those with no income-tax liability may not benefit.
Payroll tax holiday	$45 billion	To provide $250 payroll tax rebates to all workers.	All workers would receive the benefit*; Relatively quick implementation possible; There is evidence that people consume a greater portion of a paycheck increase than a lump-sum payment.	Although the propensity to consume might be slightly higher than rebate checks, demand would still only increase by a fraction of the expenditure; Unemployed would not benefit.

Action	Cost	Purpose	Benefits	Consequences
Business Investment Incentives	$35 billion	To provide an additional 30%-50% bonus deductions for capital purchased and put to use in 2008 as was done in 2002 (the $35 billion cost declines over the longer term).	Encourages businesses to make capital purchases in the near term and to hire more employees; Short term cost is partially offset by increased future receipts.	There is a lag between capital purchases and when the capital has a positive impact on the economy; Making only certain types of investments eligible could lead to complexity.
Cut corporate tax rates	$35 billion	Cut the top corporate tax rate from 35% to 30.5% for one year.	Could encourage hiring (prevent firing) and/or investment.	Results are ambiguous and it could take a while for positive impact to be felt.
Increase infrastructure spending	$80 billion	To make 5% of all infrastructure repairs needed.	Infrastructure improvements provide valuable social capital; People laid off in the construction industry could fill the new jobs.	Significant implementation and impact lags—Action, in the form of hiring and beginning of work, would likely begin too late to help.
Provide Aid to States	$20 billion	$10 billion to increase the federal Medicaid match rate by about 3 percentage points for approximately 4 quarters, and $10 billion to help states maintain services and/or comply with federal mandates.	May help states cope with decreasing property tax revenues and allows states to provide benefits without increasing taxes in a time of potential economic downturn.	States might not use aid to provide services with the biggest "bang for the buck;" There is no guarantee that states will not still increase taxes.

*individuals who have already earned the taxable payroll cap of $102,000 would not receive any benefit.

An economic stimulus involves an increase in government spending and/or a reduction in government revenues, which can be implemented through a variety of policies. According to traditional Keynesian arguments, utilizing policies that have the greatest impact on demand is crucial to crafting a meaningful stimulus that will improve our current economic situation without spending so much as to disproportionately harm future economic growth. While it is not clear that there is a need for fiscal stimulus in the current economic environment, and while there is no strong evidence that Keynesian-style fiscal stimulus measures have been effective in combating recessionary headwinds in the past, the debate seems to have rapidly proceeded to, at least, a need to analyze alternative possible stimulus measures. The economic stimulus packages passed and implemented between 2001 and 2003 provide some degree of evidence about the effectiveness of various types of stimulus measures.

The 2001 tax rebate checks that households received in the amount of either $300 or $600 were actually advance rebates, or "prebates", provided as part of the long-term reduction in tax rates. The $300 and $600 checks represented the rebate that taxpayers would have been entitled to at the end of the year as a result of the creation of the new 10% tax bracket (applying to part of income previously taxed at 15%), and thus simply accelerated tax cuts forward. The rebate checks that have been talked about as part of most proposals for a current economic stimulus package would be one-time tax cuts, as opposed to the longer-term marginal rate reductions that occurred in 2001 (of which, the 2001 prebate checks were a part). Thus, if individuals appropriately distinguish between the long-term nature of the 2001 rebates and the short-term nature of the possible 2008 rebates, their spending responses would likely be more muted in response to the currently proposed purely temporary measures.

Studies from the 2001 tax rebates suggest that, on average, consumers' short-term spending increased by about one-third of the size of their rebate. However, consumers with low liquid assets, low income, and credit constraints increased their spending by 100% or more of the rebate amount within 3 months, while consumers with high liquid assets, high income, and no credit constraints increased their spending by about 20% of the rebate amount. While this provides a general guideline for how we might expect consumers to respond to a tax rebate today, the short-term nature of such a rebate would likely mean more muted responses. Because most proposed rebates are to be temporary, there is a higher likelihood that households would use the funds to pay down debt or save than what was observed surrounding the 2001 measures. If the government increases its debt to provide stimulus and households simultaneously use their stimulus receipts to increase their savings then, on balance, national savings will not have changed and there would be no reason to expect an economic stimulus.

Stimulus aimed at businesses can take the form of reduced marginal tax rates, one-time tax cuts (rebates), or increased investment incentives. Businesses are receptive to tax incentives that lower their cost of investment. Because businesses' future plans include certain capital purchases (both to replace current capital and to add new plant and equipment), a significant and temporary decrease in the effective cost capital can be very effective at stimulating business investment in the near term. The economic stimulus packages of 2002 and 2003 provided firms with bonus depreciation of 30% and then 50% of the cost of capital purchased and put to use by the end of 2004. As a result, there was a marked increase in capital purchases immediately following enactment of the incentives through to the end of 2004.

It is likely that the relatively long period of time—nearly three years—over which businesses could take advantage of the bonus depreciation lessened the short-term "stimulus" impact of the 2002 and 2003 business investment incentives. In light of the purported current need for an immediate and temporary boost in demand, it might be advantageous to limit business investment incentives to a shorter period of time than was allowed in the 2002 and 2003 legislation.

In addition to reducing taxes for individuals and businesses, the 2001-2003 economic stimulus packages also included increased government spending on transfer programs (unemployment insurance and food stamps) as well as aid to the states. Evidence suggests that spending on transfer programs has a relatively stronger effect on demand than rebates for all taxpayers because transfer spending is targeted at low-income and often credit-constrained consumers who are most likely to spend all of the additional benefits and to spend them immediately.

In providing additional aid to states, we cannot accurately predict what the states would do with the money or how effective state aid might be. Because most states are forced to maintain balanced budgets, they often have to reduce spending and benefits or increase taxes in times of economic downturn. Federal aid could help states confronted with falling revenues to maintain current spending without increasing taxes, but it is unclear how states would use the money. If state aid is given out and put to use quickly, and if states use the aid to maintain crucial benefits to citizens most impacted by a potential downturn without increasing taxes, the effectiveness of state aid could be somewhat high. However, if states simply use the money to shift spending around or to create new, perhaps non-essential spending, or if they nonetheless raise taxes, the effectiveness could be very minimal. It is possible to try to increase the effectiveness of state aid by specifying the use

of the aid, such as providing an increase in the federal share of Medicaid costs, or requiring that the aid be used for essential transfer benefits. While specified aid would likely improve the overall effectiveness of spending on state aid, it could limit states flexibility in delivering needed services, and even targeted aid would provide states with more discretionary revenue than before, with which they could either spend on effective or ineffective uses.

Providing federal aid for infrastructure projects, whether to the states or through direct funding, would likely provide little short-term economic relief. Although infrastructure spending is appealing because it could provide jobs to people hurt by the housing downturn and because it would initiate possibly socially valuable improvements, there would be a significant lag between enactment of legislation and the commencement of hiring and building. Actual economic effects of increased infrastructure spending could take many years, at which point the economy would likely already have recovered.

The series of economic stimulus packages passed between 2001 and 2003 provide some evidence about the effectiveness of potential stimulus packages being discussed today. However, many factors of our economy are very different today than they were at the end of 2001 (when a declining economy was further weakened by the tragedy of September 11th), and the types of stimulus measures being discussed today are in many ways different than the combination of short and long-term stimulus measures enacted in 2001-2003