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AN $825-BILLION 'STIMULUS'

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What the Majority calls a "targeted" plan to stimulate the economy has fast become an $825-billion omnibus spending bill for a vast array of programs that may or may not boost economic growth. The plan pours taxpayers' money into water projects, the health care industry, "green" technology, highway and bridge construction, and, of course, government jobs, along with myriad other activities – many of which may be worthy in themselves, but have little to do with "stimulating" the economy. Few of the plan's tax provisions are truly growth-oriented, and many are rebates or refundable credits – that is, they are spending that masquerades as tax relief.

In short, the American Recovery and Reinvestment Act is a kind of super-omnibus spending bill heaped together by a congressional Majority that could not pass its regular appropriations for the current fiscal year. It is fashioned under the colorful but unreliable notion of "priming the economic pump," which has never proved consistently successful in practice. But even if the theory did work, it is uncertain how much of this plan's spending will occur quickly enough to "jump-start" the economy as promised (to use another popular stimulus metaphor).

This document provides a critique of the $825-billion proposal. The Majority has provided details on $550 billion of the plan's spending provisions. The proposal also contains $275 billion in what it terms "tax provisions"; of this amount, however, $80 billion is for "refundable" credits, meaning payments from the government – an increase in government spending – rather than tax relief. So the proposal's true tax relief component totals $195 billion, or roughly 24 percent of the overall plan. Among the provisions is a refundable credit of $500 for individuals and $1,000 for families, which amounts to $10 a week for an individual, and $20 a week for a family.

THE DEMOCRATS' PROPOSAL

Here are some general observations about the plan Democrats have released:

- Little of the funding will be spent quickly. Based on a Congressional Budget Office [CBO] analysis of the $358 billion appropriated in this bill, just $26 billion (7 percent) will be spent in fiscal year 2009, and less than half – 38 percent – will be spent in the first 2 years. Hence, even assuming such fiscal measures can be effective, the vast majority of appropriated funds in this bill would be spent too late to stimulate the economy as intended.

- This allegedly “targeted” legislation provides spending in at least 150 different Federal programs, ranging from Amtrak – a government-owned company that has never made a profit – to the still-evolving Transportation Security Administration.

- The measure creates numerous funding “cliffs” in which programs will receive large sums of additional cash that will supposedly run out, creating immense pressure to maintain these inflated funding levels. For instance, the bill spends $15.6 billion to increase each student’s Pell Grant by $500. After 2 years, this extra funding vanishes, meaning a student attending school with the help of a Pell Grant will face a sudden and sharp decline in financial support. The bill also provides $13 billion to States over 2 years for Title 1, and allows States flexibility in how they use the funds. As a result, school districts are invited to hire teachers or start new programs for which Federal support will plummet after 2010 – leaving the schools scrambling to replenish the money.

- The plan spends about $54 billion on 19 programs that the Office of Management and Budget [OMB] has analyzed and described as “ineffective” or “results not demonstrated” (see Table 1 on page 3). In selecting his chief performance officer, President-elect Obama said: “We committed to change the way our government in Washington does business so that we’re no longer squandering billions of tax dollars on programs that have outlived their usefulness or exist solely because of the power of a lobbyist or interest group. We can no longer afford to sustain the old ways when we know there are new and more efficient ways of getting the job done.”

- Several programs receive added funding even though they still have cash on hand. For example, the Army Corps of Engineers’ water construction account’s unobligated balances – money that has been appropriated but not yet obligated – is projected to reach $3.2 billion by the end of this year, sharply higher than its $1.3-billion level at the end of fiscal year 2008. Instead of simply using these funds, the stimulus bill adds another $2 billion. Similarly, despite an unobligated balance of $1.5 billion in the Department of Housing and Urban Development’s homeless assistance program, the stimulus bill adds another $1.5 billion. In yet another instance, the General Services Administration has $3.3 billion in unobligated balances for Federal buildings, and yet would receive another $7.7 billion from the stimulus package.

- Democrats promised large amounts for improving roads and bridges, but only $44 billion of the $825-billion package (about 5 percent) is for transportation infrastructure, and of that, only $30 billion is for highways. There is little empirical evidence that such spending actually benefits the economy; and it clearly spends out far too slowly to provide a quick economic boost. Such projects usually spend only about 27 percent of their funding in the first year, and take about 7 years to spend all their funds.

- Tens of billions of dollars are spent mainly to protect or create government jobs. There is nearly $7.7 billion for renovations of Federal Government buildings, and $600 million for the government’s fleet of vehicles. In all, the bill proposes $16.4 billion for Federal agencies, including new computers and information technology “improvements” for the Social Security Administration, the Farm Service Agency, and the State Department; modernization at the Department of Agriculture; office furniture at the Public Health Service; and a $50-million boost for the National Endowment for the Arts. Again, however worthy such projects might be, it is unclear how they will boost the economy.

ECONOMIC "STIMULUS": THE THEORY AND THE REALITY

The entire notion of economic "stimulus" is based on a Keynesian theory, published 72 years ago, that maintains fiscal policy has a role in stabilizing economic output by temporarily boosting aggregate demand (via government spending) when the economy is stuck in a short-term, cyclical downturn.[1] But questions about the theory, and whether it works in practice, persist.

Application of the Theory

Stanford economist John B. Taylor has surveyed the U.S. experience with fiscal stimulus over the past half century, and has found that "there is little reliable empirical evidence that government spending is a way to end a recession or accelerate a recovery that rationalizes a revival of discretionary countercyclical fiscal policy."[2] The most recent example is the $168-billion fiscal package passed in early 2008, which gave temporary refundable tax rebates to households. Proponents believed recipients would spend most of the extra money, stimulating an economic rebound. Instead, the vast majority of recipients – having been warned repeatedly of a weak economy – saved the extra funds, or paid down bills. The tax package led to a small, one-quarter bump in consumer spending before consumption simply returned to its pre-stimulus trend.

A broader example comes from Japan's policy responses during its so-called "lost decade" of the 1990s. Early in that decade, Japan experienced a sharp economic slowdown resulting from the bursting of a real estate and stock market bubble. The Bank of Japan instituted an overly tight monetary policy, which eventually led to a serious deflationary crisis. But the country's fiscal policy errors were equally as important in triggering the decade of stagnation. For instance, Japan began to pursue an aggressive array of fiscal stimulus packages after 1993. The spending, which was mostly concentrated on public works, eventually pushed Japan's budget deficit to nearly 10 percent of gross domestic product by 1999, while total government debt increased to 130 percent of GDP. Japan's policy mistakes throughout the decade – which offer an important lesson for U.S. policymakers – would eventually lead to a protracted period of stagnation in which GDP grew by less than 1 percent, on average.

Table 1: Summary of Selected Provisions

	Number of Programs	Amount
Programs Rated by OMB as "Ineffective" or "Results Not Demonstrated"	19	$54 billion
Funds Not Available Immediately	15	$113 billion
Infrastructure Programs	75	$150 billion

Note: These figures are estimates by the House Budget Committee Republican staff based on available information.

The second question is how the proposed $825-billion package would operate in practice. Based on a rough review, about $150 billion is for infrastructure spending (see Table 1). As noted above, there is typically a lag with infrastructure spending, with only about 25 percent of it being

[1] John Maynard Keynes, *The General Theory of Employment, Interest and Money*, 1936.

[2] John B. Taylor, *The Lack of an Empirical Rationale for a Revival of Discretionary Fiscal Policy*, 4 January 2009.

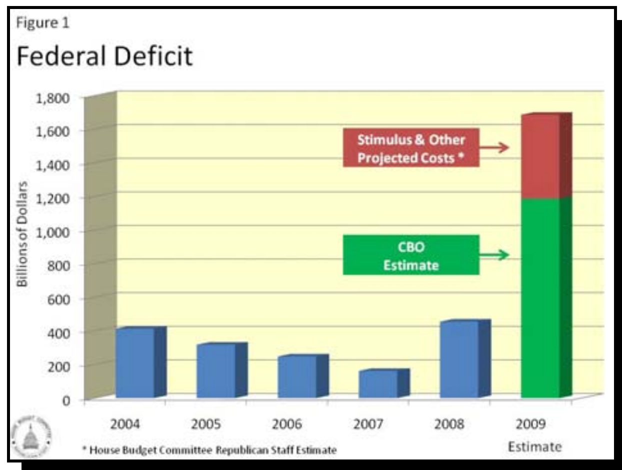
spent in the first year; hence, these provisions will have little immediate impact on the economy's weakness. About $200 billion of the package is in the form of transfer payments to States and individuals (not including tax rebates or refundable credits). The remainder of the plan's spending, about $200 billion, does not fit into the category of infrastructure or immediate transfer payments. Spending on education, for example, may be worthwhile, but it will not provide an immediate stimulative impact.

Finally, $113 billion in funding for 15 programs will not be available until a later date, diminishing the immediate stimulative impact (see Table 1).

The proposal also contains tax provisions supposedly aimed at encouraging private-sector investment. These provisions, however, total only about $22 billion, or roughly 2.7 percent of the overall $825-billion package.

Soaring Deficits, and the Risk of Future Tax Increases

The Congressional Budget Office has estimated this year's budget deficit will be $1.2 trillion, even before the effect of any stimulus bill (see Figure 1). The $825-billion cost of this package will add to that deficit, and will inevitably lead to calls for tax increases.



U.S. taxpayers already face a huge tax increase in less than 2 years, when taxes on families, workers, business, and investors are scheduled to rise dramatically. Just as these tax increases hit the economy, the Congressional Budget Office projects the unemployment rate will reach 8.5 percent. Even with the fiscal stimulus plan, the incoming administration's economic experts predict the unemployment rate will be close to 7 percent in early 2011. Allowing a tax hike to hit a still-weak economy would be sheer folly from a policy perspective.

This document was prepared by the Republican staff of the Committee on the Budget, U.S. House of Representatives. It has not been approved by the full committee and may not reflect the views of individual committee members.