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FISCAL STIMULUS: DO IT RIGHT OR DON'T DO IT AT ALL

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Congress appears poised to move forward with a fiscal stimulus package. In theory, a mixture of monetary and fiscal policy is generally most appropriate to help a slowing economy; in practice however, fiscal policy becomes politicized so easily that it is often ineffective, and is sometimes even counterproductive. Too often in the past, stimulus bills have been poorly timed, poorly targeted, and larded up with unrelated items.

If Congress moves forward with a stimulus package, the Committee for Responsible Federal Budget believes that:

Stimulus should be simple. Short-term stimulus should be the lone focus of any bill. Other economic agendas including making the tax cuts permanent, reforming unemployment insurance, expanding health insurance, increasing infrastructure spending, or altering Medicaid, should take a back seat to the goal of quickly crafting an effective stimulus that is unencumbered by unrelated agendas.

Stimulus should be targeted. To be effective, stimulus should maximize the size and speed of its effect on GDP. Stimulus should increase aggregate demand by encouraging spending by individuals, businesses, or government. The Congressional Budget Office has found some of the most cost-effective policies to include:

- Temporary tax cuts and rebates
- Temporarily extending or expanding unemployment benefits
- Temporarily increasing food stamps

The Committee also urges that fiscal stimulus policies not be targeted towards particular industries, including those that are hardest hit in the recession. Although the challenges in the housing industry are serious, for instance, these problems should be addressed separately, not as part of a stimulus package.

Stimulus should be timely and temporary. Mistimed fiscal policy can do more harm than good by adding to the national debt. Fiscal stimulus should be crafted to precede a sustained downturn, take effect as quickly as possible, and be temporary. If Congress waits too long to pass a plan, the economy could be growing just when the stimulus is passed, leading to an overheating of the economy rather than propping it up. We recommend that the stimulus take effect in calendar year 2008 and that none of it be permitted to significantly increase the deficit beyond a one-year window (barring other unforeseen deteriorations in the economy.)

Stimulus does not have to be paid for. We know, we know—as strong advocates of PAYGO, it might be expected that we would argue that all stimulus should be paid for. While we commend those who are concerned with creating a fiscally responsible stimulus package, the very point of stimulus is that it not be paid for so that it injects extra money into the economy and helps to drive higher levels of consumption. If a stimulus package were paid for in the out-years, we would certainly be pleased. However, we believe that such a requirement is likely to derail the process of trying to assemble an effective stimulus package. We would prefer to see stimulus separated from more generally fiscally responsible measures and treated as a one-time emergency measure that does not require offsets. If, however, there are any measures that extend beyond 2008, they should not be exempt from PAYGO.

The need for fiscal stimulus is a reminder of why we should keep our fiscal house in order. Although the Committee would accept using increased deficits as a tool to spur the economy in the short-run, we urge the President and the Congress to take the next important step: A long-term budget plan that addresses entitlements, tax reform, and spending restraint. The most important signal to send the economy is that the government intends to tighten fiscal policy, and run surpluses when the economy is doing well. Failure to deal with our dismal long-term fiscal outlook will eventually undermine the government's ability to use fiscal policy as a means to manage the economy or help protect Americans from recession.

At this point, a stimulus bill seems likely. We believe that a bad stimulus bill—one that comes too late, or contains special-interest, unrelated, or ineffective provisions—is worse than no stimulus at all, given the high costs of a bill (a cost that seems to be growing by tens of billions of dollars a day) and given the fiscal challenges already facing the country. If Congress fails to keep a bill simple, targeted, timely, and temporary, we would prefer to leave managing the economy to the Federal Reserve Board.

Major Stimulus Enacted in Past Recessions

Recession	Fiscal Stimulus
July 1953–May 1954	<ul style="list-style-type: none"> Temporarily eliminated the war time excess profits tax and personal and corporate income tax increases (\$1.1 billion)
August 1957–April 1958	<ul style="list-style-type: none"> Increased defense spending (\$1.3 billion) in January 1958 Increased public works (airports, hospitals, interstates spending) in mid-1958 Temporarily extended unemployment benefits in June 1958
April 1960–February 1961	<ul style="list-style-type: none"> Accelerated federal procurement and tax refunds between 1961-62 Increased transfer payments by \$2 billion between 1961–62 Temporarily extended unemployment compensation Adopted additional public works spending between 1961 and 1962 Implemented a permanent investment tax credit (ITC) in late 1962 Passed substantial, expansionary tax cuts in 1964 including increases in ITC
December 1969–November 1970	<ul style="list-style-type: none"> Temporarily extended unemployment benefits, using a 3-month unemployment number trigger Accelerating the elimination of the Vietnam surtax Permanently lowered taxes, including increasing the personal exemption and lowering excise taxes
November 1973–March 1975	<ul style="list-style-type: none"> Passed a temporary one-year, \$16 billion tax cut in March 1975 that included a rebate, a higher standard deduction, and a higher ITC (from 7% to 10%). Subsequent tax bills enacted over 1975-1977 temporarily extended these provisions. Legislated temporary Earned Income Tax Credit in 1975; made permanent in subsequent legislation Temporarily extended and expanded unemployment benefits Increased the Social Security COLA Passed \$8 billion in public works projects
January 1980–July 1980	<ul style="list-style-type: none"> Due to inflation fears, no fiscal stimulus or expansionary policies were enacted
July 1981–November 1982	<ul style="list-style-type: none"> Permanently and substantially lowered personal and corporate tax rates
July 1990–March 1991	<ul style="list-style-type: none"> Legislation was attempted, but no fiscal stimulus was passed
March 2001–November 2001	<ul style="list-style-type: none"> Issued income tax rebate checks in Fall of 2001 at \$300 for individuals and \$600 for couples Passed temporary bonus depreciation in 2002, extended in subsequent tax bills Issued child credit rebates in 2003 (up to \$400 per child)

Source: Christina D. Romer and David H. Romer 1994, *NBER Macroeconomics Annual*, Vol. 9 (1994) pp 13-57 (paper drew on historical government documents such as the *Economic Report of the President*); *Budgets of the United States Government FY 2002-04*; Douglas Elmendorf and Jason Furman, "If, When, How: A Primer on Fiscal Stimulus," *The Hamilton Project*, Washington, DC: The Brookings Institution, January 2008