LEGISLATIVE ALERT

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THE AMERICAN RECOVERY AND REINVESTMENT ACT

'STIMULUS,' OR JUST BORROW AND SPEND?

H.R. 1

27 January 2009

OVERVIEW

No one doubts the U.S. economy is undergoing a severe downturn characterized by an unprecedented combination of elements: plummeting home values, a freeze-up in credit markets, declines in business investment and consumer spending, and a dropoff in exports due to significant weakness in the economies of the United States' main trading partners.

But the heart of the problem has been too much spending with borrowed money. As described by Alice M. Rivlin, former Clinton administration budget director: "Before the current crisis Americans were consuming and borrowing too much, while saving too little. We had become an over-mortgaged, over-leveraged society dependent on the inflow of foreign credit. If recovery from this recession is to be solid and sustainable, we must stop living beyond our means. We must transform ourselves into a society that consumes less, saves more and finances a larger fraction of its investment with domestic saving, rather than foreign borrowing."[1]

The Majority's so-called economic "stimulus" plan does just the opposite: it is a borrow-and-spend plan that will have doubtful benefits for the economy, and may well leave the U.S. economy worse off. With the current-year budget deficit already estimated at $1.2 trillion, this bill would add more than $1 trillion more to U.S. debt, raising borrowing costs, stoking demand for continued higher spending, and creating intense pressure for raising taxes. Even *The Washington Post* editorial page questioned the package, saying: "The stimulus plan has something for everyone – and a lot that's not stimulus." (See the appendix of this document.)

Here are some key points about the American Recovery and Reinvestment Act (H.R. 1).

KEY POINTS

Debt and Taxes

- The $816-billion package will be financed by borrowing, which will result in additional interest costs of $347 billion, according to the Congressional Budget Office [CBO].

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[1] Dr. Rivlin, testimony to the House Budget Committee, 27 January 2009.

When these interest costs are taken into account, the total cost of the package reaches $1.2 trillion.[2]

- The current year's budget deficit is already estimated at $1.2 trillion – 7 percent of gross domestic product [GDP] – and with the stimulus bill and other legislation likely to be enacted this year, the deficit could reach a staggering 10 percent of GDP, according to the CBO Director[3] (see Figure 1). This would be by far the largest budget deficit, as a share of the economy, since the end of World War II.

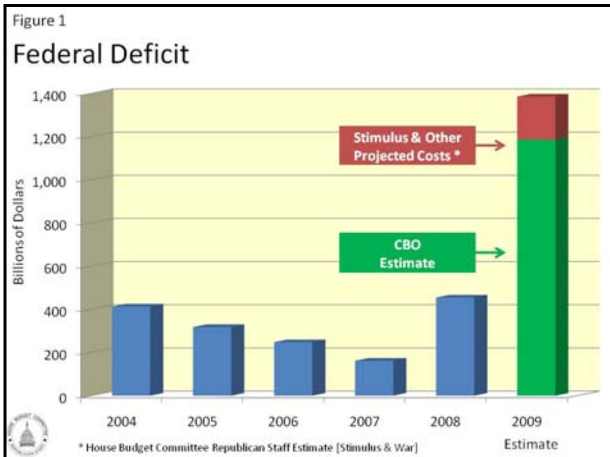


Figure 1
Federal Deficit

Figure 2
Tax Increases on the Horizon

	2010	2011
Tax Rates Move Higher:		
Ordinary Income...	35%	39.6%
Capital Gains...	15%	20%
Death...	0%	55%
Marriage Penalty...	$0	$1400
Child Tax Credit...	$1,000	$500
Lowest Tax Bracket...	10%	15%

- This additional debt will surely impede the economy's ability to rebound. It will also create heavy demands to continue the spending proposals in the bill well beyond the next 2 years, and will inevitably lead to calls for job-killing 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 (see Figure 2). 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.

Not So 'Timely' After All

- The President and others have said the economy needs immediate help. That is not what this bill does, according to CBO. Of the $358 billion in appropriations provided in the measure, only 8 percent will be spent in the first year, and just 40 percent in the first 2

[2] Letter from Douglas W. Elmendorf, Director of the Congressional Budget Office, 27 January 2009.

[3] Testimony of Director Elmendorf to the House Budget Committee, 27 January 2009.

years. Even including the measure's mandatory spending provisions, only 15 percent of the total spending will be spent in the first year, and only about half in the first 2 years.

- The Office of Management and Budget has claimed that at least 75 percent of the total bill will be spent in the first 2 years. Not true, says CBO. Considering all the bill's provisions, including revenue, the total budget impact is 64 percent in the first 2 years, according to CBO; and the nonpartisan agency notes in its cost estimate that spending tends to be slower than initially estimated.

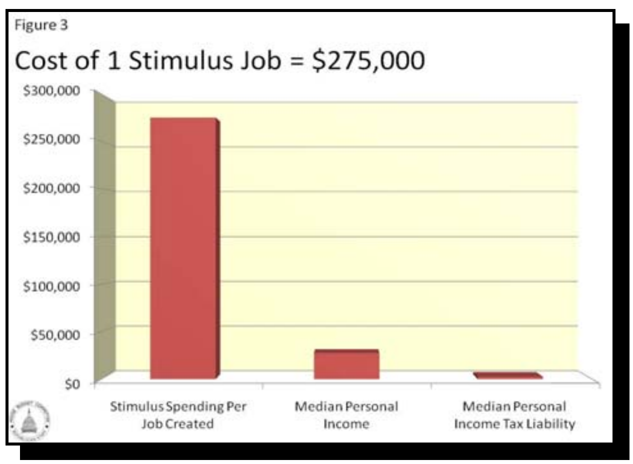
Table 1: H.R. 1 Spendout

	2009	2010	After 2010
Appropriated Spending (Outlays)	$29 billion	$116 billion	$211 billion
Percent of Total	8%	33%	59 percent
Mandatory Spending	$64 billion	$109 billion	$75 billion
Percent of Total	26%	44%	30%
Subtotal - All Spending	**$93 billion**	**$225 billion**	**$286 billion**
Percent of Total	**15%**	**37%**	**47%**
Revenue	$76 billion	$131 billion	$4 billion
Budget Impact	36%	$62%	2%
Total	**$170 billion[a]**	**$356 billion**	**$290 billion**
Total Spending/Budget Impact	**21%**	**44%**	**35%**

[a] May not add due to rounding.
Source: House Budget Committee Republican staff, based on Congressional Budget Office estimates.

Costly Job Creation

- The administration contends an $816-billion "stimulus" measure will "save or create" 3 million to 4 million jobs. Those predictions are questionable, but even if correct, they mean the government will spend nearly $275,000 for each job "created" (see Figure 3).



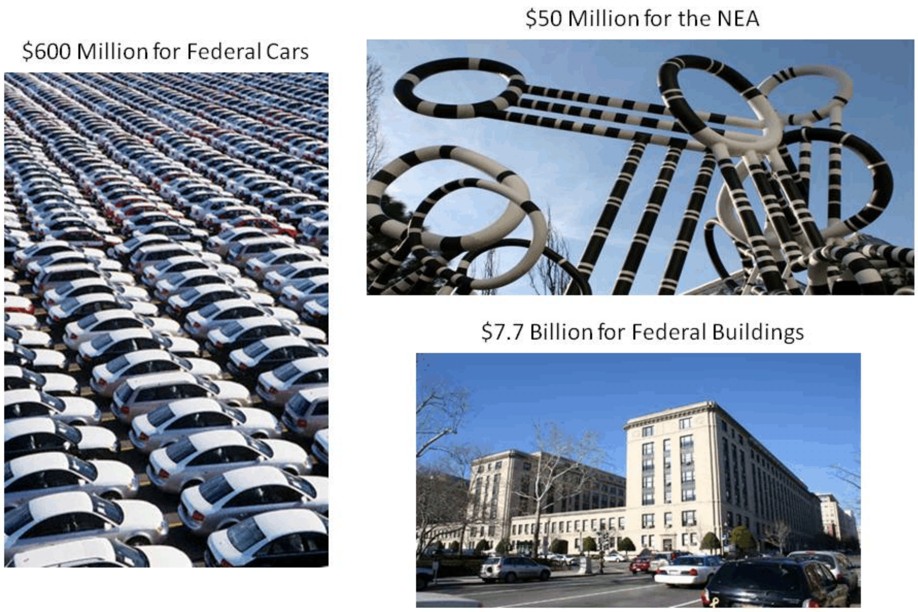
- More important, because this is government spending, it is money no longer available to the private sector, where real job creation and economic growth occur.

  - This allegedly "targeted" legislation provides spending in at least 150 different Federal programs. Examples include $7.7 billion for Federal buildings; $600 million for Federal cars; and $50 million for the National Endowment for the Arts. (See Figure 4 on the next page.)

- The bill also spends money on 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; and office furniture at the Public Health Service.

Figure 4

Is This Stimulus?



OTHER ELEMENTS

- 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, the principal Federal program to help low-income students; 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.

- Nearly 10 percent of the total cost of the bill ($89 billion) is spent on a program in dire need of reform: Medicaid. Last week, the Government Accountability Office released a report showing more than 10 percent of Medicaid payments were improper in 2007 ($32.7 billion in 1 year). But instead of reforming the program, Democrats insist on throwing money at the problem by increasing payments using a methodology based on the current payment formula – widely acknowledged as seriously flawed because it rewards States for driving up their health care costs. The bill increases States' Federal Medical Assistance Percentage [FMAP] by 4.9 percent regardless of unemployment rates. The bill also spends $20 billion creating a new health information technology program for health care providers, punishing those who have already adopted technology measures and refusing to acknowledge that no consensus has been reached on interoperability standards, the nucleus of any health information technology program.

- 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 2 below). 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 $43 billion of the $816-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.

Table 2: 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

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

APPENDIX

The Washington Post
AN INDEPENDENT NEWSPAPER
SUNDAY, JANUARY 25, 2009

Priming the Pump

The stimulus plan has something for everyone — and a lot that's not stimulus.

THERE IS much that makes sense in the $825 billion economic stimulus plan that the Democratic-controlled House of Representatives is developing, in close cooperation with President Obama's advisers. Several core features — increased food stamps and unemployment benefits; Medicaid money for state governments; increased infrastructure spending; a tax rebate to low- and moderate-income families — are either temporary measures that are well calculated to enable quick spending by families and businesses or that could be amended to become so.

However, some in Congress and the new administration apparently see the country's present recession as an opportunity to change the federal government's spending priorities more generally or simply to reward loyal political constituencies. This is understandable, given that the voters endorsed the Democratic Party and its priorities in November. But it's risky to make new, multiyear commitments in the middle of a crisis without debate over competing priorities — and without paying for them through some means other than borrowing.

Helping hire, equip and pay police, a $4 billion item under the bill, might be a good idea, but writing checks to individual households for the same amount would do more to stimulate the economy. Ditto for $16 billion in Pell Grants for college students, $2.1 billion for Head Start and $50 million for the National Endowment for the Arts. All of those ideas may have merit, but why do they belong in an emergency measure aimed to kick-start the economy? For sheer irrationality, it would be hard to top the $4.19 billion the bill would give to the Neighborhood Stabilization Program, on top of $4 billion authorized last year. This program gives local governments money to buy and rehabilitate homes that have been foreclosed on — thus giving lenders an incentive to foreclose on more houses.

Much of the stimulus bill does not really claim to deliver a short-term boost to the economy. Provisions to develop a "smart grid" for electricity and to enhance scientific research, alternative energy development and education seek to boost the economy's long-term efficiency, and, hence, its capacity to grow. We are sympathetic to the objective, and there might be much to recommend each of the various proposals. But given their cost, and the inherent difficulty of forecasting their impact, Congress should vet them through the normal legislative process, weigh them against other priorities and pay for them.

Fiscal stimulus is far from a sure-fire remedy. Economists disagree about the efficacy of every pump-priming effort from the New Deal to last year's tax rebates. In general, fiscal policy had fallen out of favor in economics; monetary policy, orchestrated by the Federal Reserve, is considered more efficient. Many economists note Japan's failed attempt to borrow and spend its way out of a recession during the 1990s. That country would have been better off, they say, if government had moved swiftly to recapitalize its banks instead of attempting repeated stimulus packages. As it is, Japan piled up a massive debt and recovered only modestly, leaving it vulnerable to today's downturn.

Fiscal policy is enjoying a political and intellectual comeback but in large part because the government is running out of alternatives; the Fed has already cut interest rates to zero and pumped its balance sheet up to more than $2 trillion. So legislators face a dilemma: They are being told that the stimulus package must be huge to work, but there may be no way to spend so much money quickly and effectively. Given the limitations, Congress and the administration would be well advised to trim the stimulus bill's more dubious spending, or reallocate it and focus on a definitive financial sector cleanup. Fiscal stimulus can be a part of the solution, but only if it is "targeted, timely and temporary." The efforts so far don't quite match that description.