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Stimulus Gone Bad
By Paul Krugman
The New York Times

Friday 25 January 2008

House Democrats and the White House have reached an agreement on an economic stimulus plan. Unfortunately, the plan - which essentially consists of nothing but tax cuts and gives most of those tax cuts to people in fairly good financial shape - looks like a lemon.

Specifically, the Democrats appear to have buckled in the face of the Bush administration's ideological rigidity, dropping demands for provisions that would have helped those most in need. And those happen to be the same provisions that might actually have made the stimulus plan effective.

Those are harsh words, so let me explain what's going on.

Aside from business tax breaks - which are an unhappy story for another column - the plan gives each worker making less than $75,000 a $300 check, plus additional amounts to people who make enough to pay substantial sums in income tax. This ensures that the bulk of the money would go to people who are doing O.K. financially - which misses the whole point.

The goal of a stimulus plan should be to support overall spending, so as to avert or limit the depth of a recession. If the money the government lays out doesn't get spent - if it just gets added to people's bank accounts or used to pay off debts - the plan will have failed.

And sending checks to people in good financial shape does little or nothing to increase overall spending. People who have good incomes, good credit and secure employment make spending decisions based on their long-term earning power rather than the size of their latest paycheck. Give such people a few hundred extra dollars, and they'll just put it in the bank.

In fact, that appears to be what mainly happened to the tax rebates affluent Americans received during the last recession in 2001.

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On the other hand, money delivered to people who aren't in good financial shape - who are short on cash and living check to check - does double duty: it alleviates hardship and also pumps up consumer spending.

That's why many of the stimulus proposals we were hearing just a few days ago focused in the first place on expanding programs that specifically help people who have fallen on hard times, especially unemployment insurance and food stamps. And these were the stimulus ideas that received the highest grades in a recent analysis by the nonpartisan Congressional Budget Office.

There was also some talk among Democrats about providing temporary aid to state and local governments, whose finances are being pummeled by the weakening economy. Like help for the unemployed, this would have done double duty, averting hardship and heading off spending cuts that could worsen the downturn.

But the Bush administration has apparently succeeded in killing all of these ideas, in favor of a plan that mainly gives money to those least likely to spend it.

Why would the administration want to do this? It has nothing to do with economic efficacy: no economic theory or evidence I know of says that upper-middle-class families are more likely to spend rebate checks than the poor and unemployed. Instead, what seems to be happening is that the Bush administration refuses to sign on to anything that it can't call a "tax cut."

Behind that refusal, in turn, lies the administration's commitment to slashing tax rates on the affluent while blocking aid for families in trouble - a commitment that requires maintaining the pretense that government spending is always bad. And the result is a plan that not only fails to deliver help where it's most needed, but is likely to fail as an economic measure.

The words of Franklin Delano Roosevelt come to mind: "We have always known that heedless self-interest was bad morals; we know now that it is bad economics."

And the worst of it is that the Democrats, who should have been in a strong position - does this administration have any credibility left on economic policy? - appear to have caved in almost completely.

Yes, they extracted some concessions, increasing rebates for people with low income while reducing giveaways to the affluent. But basically they allowed themselves to be bullied into doing things the Bush administration's way.

And that could turn out to be a very bad thing.

We don't know for sure how deep the coming slump will be, or even whether it will meet the technical definition of a recession. But there's a real chance not just that it will be a major downturn, but that the usual response to recession - interest rate cuts by the Federal Reserve - won't be sufficient to turn the economy around. (For more on this, see my blog at krugman.blogs.nytimes.com.)

And if that happens, we'll deeply regret the fact that the Bush administration insisted on, and Democrats accepted, a so-called stimulus plan that just won't do the job.

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Critiques of Spending Plan Retrace Old Debate
By Peter S. Goodman and Louis Uchitelle
The New York Times

Friday 25 January 2008

Useful, but flawed and probably not enough: that, in general terms, was the verdict pronounced on the $150 billion emergency spending plan agreed to by the White House and Congressional leaders on Thursday in a bid to stimulate the suddenly sputtering economy.

Most economists praised the deal as a necessary effort that by increasing the public debt to put cash swiftly into the hands of ordinary consumers, could limit the severity and duration of a recession and very likely spare some jobs.

Nonetheless, economists of nearly every ideological stripe also found substantial fault with the plan: liberals, because it does not expand unemployment benefits or food stamps; conservatives, because it fails to lock in President Bush's tax cuts beyond their planned expiration in 2010.

Few economists thought the stimulus plan alone would be adequate to keep the economy clear of a recession. Yet many portrayed the package as a significant psychological boost for anxious markets around the world, a sign that the Washington overseers of the American economy are seriously engaged in finding a fix.

"It is a much needed and very constructive step," said Lawrence H. Summers, the Treasury secretary in the Clinton administration who has recently called for specific and temporary tax cuts. "It will provide some confidence. But policy-making will need to be on standby, because more may be needed."

The plan was a result of intensive horse-trading between Democrats and the Bush administration, bringing to the fore fundamentally competing notions about economic policy. But the basic goal was shared and simple - keeping the economy growing at a time when millions of Americans are losing confidence and cutting back in the face of falling home prices, mounting debt and rising joblessness.

At the center of the plan is an effort to spur consumers, whose spending makes up 70 percent of the American economy. The plan leans heavily on cash payments for all but the wealthiest Americans, assuming that money put in pockets will swiftly find its way into cash registers, generating jobs at restaurants, retail outlets and banks and on the factory floor.

The most fervent proponents of free markets criticized the plan as a damaging intrusion by government that incurs public debt for dubious subsidies.

"The economy is working these things out," said David R. Henderson, a libertarian economist at the Hoover Institution at Stanford. "We've got the housing crisis and the subprime, and all these things take a while to settle. The government just doesn't have the discipline to kind of let things work out."

But in recent weeks, mainstream economists from across the political spectrum have come to the conclusion that growing economic turmoil demands that significant public money be poured into limiting the pain of a downturn.

Still, the way the deal was cut left many bemoaning the compromises.

Democrats had sought the extension of unemployment benefits and an increase in food stamps. Research shows these measures deliver the largest increases in spending, because poor people are prone to buy what they need when given the chance. Wealthy people, by contrast, tend to save more when taxes are cut.

The Bush administration insisted on rebates alone, and House Democrats relented in exchange for adding payments to people who do not pay income taxes.

"They gave up pieces of the package that were more effective," said Jared Bernstein, senior economist at the labor-oriented Economic Policy Institute in Washington, who blamed the Bush administration for blocking the expansion of benefits. "It's a political choice, and a bad one. It's an ideology that says, 'I can get a lot more credit for tax cuts than I can for expanding unemployment insurance.' "

Unemployment among blacks and Hispanics has been rising at triple the rate for whites, while the time it takes for people to find new jobs has been lengthening, according to government data. Some experts argue that by failing to expand unemployment benefits, the plan leaves minority groups most vulnerable to a recession.

"It's way inadequate," said William Spriggs, an economist at Howard University in Washington. "It doesn't fix the problems we have with the safety net."

Seven years ago, the last time the government handed out rebate checks in a downturn, recipients spent two-thirds of the money within six months, according to Mark Zandi, chief economist at Moody's Economy.com.

This time, unlike the last, some of the money is going to people who do not pay taxes, so an even bigger surge of spending is likely, he said.

"This is a very positive, big step," Mr. Zandi said.

But much has changed in recent years. Given that a lot of Americans are so deeply in debt, some economists said, many may use the money to pay off bills rather than to buy new goods and services. "People are already behind on mortgages and credit cards," said Gary A. Hoover, an economist at the University of Alabama.

Another big factor is that an increasing share of goods sold in the United States are made overseas. During the 2001 recession, 18 percent of what Americans spent on food and manufactured goods was imported, according to the Commerce Department. By 2006, the share had risen to 21 percent.

"A great deal of any stimulus is going to be sent overseas," said Alan Tonelson, a research fellow at the United States Business and Industry Council, a trade association of small manufacturers that lobbies to limit imports.

Other analysts argued that the best way to ensure that dollars do not leak abroad would be to spend them on state-financed public works projects employing large numbers of people - repairing levees and dams, fixing bridges or building schools.

The money could also be directed to states that face shrinking tax revenues as the economy contracts. An infusion of federal money would allow them to sustain construction programs and social services for the poor.

"The first people to go in this squeeze are social workers, and that should not be," said Paul A. David, an economic historian at Stanford. "When people are short of money or unemployed, they have trouble at home and need help."

Debate over the stimulus plan also tripped one of the key fault lines in American economic policy - argument about the merits of tax breaks.

The Bush administration championed tax cuts for businesses, arguing that this would coax companies to expand. But many economists question that assumption, asserting that if consumers lack money to spend, then businesses will stand pat or even cut back and fire people, whatever the tax rate.

"Breaks in taxes for corporations are unlikely to make a difference," said Desmond Lachman, an economist at the American Enterprise Institute. "There's waste in it."

But conservatives who expound the supply-side view expressed disappointment with the plan because it focused on temporary tax cuts rather than improving economic incentives through lower rates, which tend to benefit the wealthy the most.

Over the last quarter-century, Republicans have generally argued that the economy grows when money is freed up through lower taxes for all, businesses especially. Some argue that the prospect that a new administration will take office next year and increase taxes is damping investment now, stifling the creation of new jobs.

"One of the factors that's currently souring this economy is the prospect that taxes are going to be rising in the future," said William W. Beach, a senior fellow at the conservative Heritage Foundation in Washington. "I'm concerned about the bang for the buck."

Mark Landler contributed reporting from Davos, Switzerland.

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Strains on the IRS Could Delay Rebate Checks for Months
By David Cay Johnston
The New York Times

Friday 25 January 2008

The checks will be in the mail - eventually.

But President Bush's plan to send payments to 117 million households to stimulate the economy would impose major strains on the Internal Revenue Service, delays in answering calls to the agency and require a host of technical rules to determine who ultimately collects the benefits, officials said Thursday.

The deal between the administration and House leaders calls for checks to be issued 60 days after the president signs a law authorizing the one-time payments. That may be in as few as four or five weeks if the full House and the Senate come to terms on the details quickly.

In theory, the first checks may arrive in early May, if nothing goes wrong.

Even as the negotiators crunched the numbers, the Congressional Joint Committee on Taxation warned that the tax-filing season could be disrupted and hinted that it might be June before checks were issued.

I.R.S. computer and other systems "are today fully engaged in processing 2007 tax returns," the committee said Monday in a report. "As a result, it is not practical to contemplate distributing cash rebates until the peak filing season is completed, which in past years has been the very end of May."

At the very least, the agency needs to have in hand the annual returns for last year to know who is married and who has dependent children, information that often changes.

The size of the checks will also depend on incomes and other factors. For example, individuals would not qualify for the $300 payments if they earned less than $3,000, unless they paid taxes on unearned income like pensions and interest.

Although many people who owe no income tax will receive checks, none will be sent to people who pay their taxes through withholding but do not file returns, said Anthony DeSouza, a spokesman for the Treasury Department. Because the withholding tables typically collect slightly more tax than is owed, those nonfilers are seldom pursued.

The prospect of collecting the stimulus payments may spur some of those taxpayers to file returns, after all, adding to the logistical strain and increasing the drain on the Treasury, which would have otherwise kept their money.

Determining who is eligible and for how much money will require major reprogramming of an outdated computer system that relies on technology long since abandoned by business. The software changes will have to be made as an estimated 135 million individual income tax returns arrive between now and April 15.

The agency has already rushed to adjust its computers because of a temporary patch to reduce the effects of the alternative minimum tax that was not agreed on until just before lawmakers left Washington in December. More than two million taxpayers affected by the alternative tax cannot file until at least Feb. 11.

Treasury Secretary Henry M. Paulson Jr. told reporters on Thursday that he did not believe the tax patch would affect the new checks. Agency officials who would not speak on the record because they were not authorized were not so sanguine and pointed to the Congressional joint committee report's warnings about adding to the workload in the big filing season.

Nobody has authorized the agency to hire extra workers to reprogram computers, enter new data, issue checks and answer calls. The agency will divert resources from serving taxpayers and enforcing tax laws.

A surge in calls accompanied the rebates that Mr. Bush sponsored in 2001, straining the ability to answer calls from people with tax problems and causing other logistical problems.

Charles O. Rossotti, the executive who was the internal revenue commissioner in 2001, warned amid that rush to issue rebate checks that "compression of analysis, testing and production of complex programs poses very high risks of errors in issuing these refunds such as taxpayers receiving incorrect amounts or notices with incorrect information."

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