



1226 Huron Road, Suite 300 Cleveland, Ohio 44115 (216) 781-2944 FAX (216) 781-2988
www.CommunitySolutions.com

Economic Stimulus Good, But More Needed

By Emily Campbell, Wendy Feinn, and Ericka Thoms

Economic Outlook for Ohio

The state of Ohio currently faces an economic downturn, which some are calling the beginning of a recession.¹ Governor Ted Strickland's office recently projected a shortfall between \$733 million and \$1.9 billion in the current budget, which ends June 30, 2009. While the projections anticipate most of the deficit to hit during state fiscal year 2009 (which starts July 1, 2008), the governor and economists recommend taking steps now to be more fiscally responsible and effective.

Ohio's unemployment rate was 5.6 percent in December, 2007, compared to a national average of 5.0 percent.² This was a slight decrease from November, but was still higher than one year earlier and shows no signs of improvement in the near future.³ The economic slowdown has been attributed to rising energy costs, the mortgage crisis and tightening of lending terms, declines in the housing market, and weakening of consumer confidence.

Federal Economic Stimulus as a Policy Tool

The growing concern that the U.S. economy may be headed for a recession has fueled recent discussions about the need for economic stimulus. The desire to reverse an economic downturn is not uncommon, but government policies aimed at boosting the economy must be carefully crafted to ensure they are effective.

Intended to inject money into the economy and encourage consumer spending, properly applied stimulus can rev up a lagging economic engine. It is hoped that additional funds

¹ The National Bureau of Economic Research defines an economic recession as "a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales." <http://www.nber.org/cycles/cyclesmain.html>

² Ohio Office of Budget and Management Monthly Financial Report, 10 January 2008.

³ Ibid.

flowing into the economy will cause consumers and businesses to spend more, preventing further economic slide into a recession or, at least, shortening a recession and reducing its impact.

There are many tools available to create an economic stimulus package, including direct government payments, state fiscal relief, and tax cuts. If properly applied, stimulus packages can achieve the goal of preventing a recession, but they often mean deficit spending. Therefore, they must be done effectively and efficiently in order to control long-term impact. One way to evaluate a stimulus package is by using the “Three T’s.” An effective stimulus must be *timely*, *targeted*, and *temporary*.

A stimulus package enacted too early could be an unnecessary expenditure if predictions of recession prove incorrect. Alternatively, if a package is not implemented quickly enough, its impact on any oncoming recession can be significantly diminished. Consequently, measures that promote spending as soon as possible are considered to be *timely* and, therefore, preferable.

Effective stimulus tools must be *targeted* toward those who are most likely to circulate additional funds back into the economy quickly. Economists across the political spectrum agree that stimulus measures geared toward low- and moderate-income Americans are preferable to those that go to people higher on the income scale. In testimony to the United States Senate Finance Committee, Peter Orszag, director of the Congressional Budget Office, cited a study on the 2001 tax rebate that found lower-income households and those with fewer liquid assets spent more of their refunds than higher-income households.⁴ He stated, “Lower-income households are...more likely to be among those with the highest propensity to spend. Therefore, policies aimed at lower-income households tend to have greater stimulative effects.”⁵

Finally, a strong stimulus package must be *temporary*. Once the economy moves out of recession, stimulus measures should end. If kept in place, these tools would further add to the deficit. In later years, such measures should be offset with deficit reduction tactics to ensure that providing short-term assistance to the economy does not add to a long-term deficit.

The Economic Stimulus Act of 2008 (H.R. 5140)

The declining housing market, consumer credit crunch, and worse economic indicators than expected prompted Congress and the White House to negotiate a fiscal stimulus package. With the goal of preventing the U.S. economy from slipping into a recession, the package includes tax breaks for individuals and businesses. It puts money back into

⁴ Statement of Peter R. Orszag, CBO Director, “Options for Responding to Short-Term Economic Weakness.” Before the Committee on Finance, United States Senate, 22 January 2008.

⁵ Ibid.

people's pockets, with the hope that sagging consumer confidence will receive a boost and demand will increase, thus avoiding a further economic slide.

The purpose of H.R. 5140—The Economic Stimulus Act of 2008—is “to provide economic stimulus through recovery rebates to individuals, incentives for business investment, and an increase in conforming FHA loan limits.” Comprised of a package negotiated by House leadership and administration officials, the bill passed the House on January 29 by a vote of 385-35. On February 7, the Senate voted 81-16 to pass a slightly amended version. President George W. Bush signed the final bill into law on February 13.

The version passed by the Senate and sent to the President contained some improvements from the original House bill. Because Social Security benefits and veterans' disability payments are included, thousands of seniors and disabled veterans are eligible to receive refunds. In order to win enough senators' support, it also included safeguards to ensure that illegal immigrants do not obtain rebates.

The final bill enacted by Congress is expected to cost approximately \$150 billion and has three major components:

1. *Individual Tax Provisions*: rebate checks to most Americans of up to \$600 for a single taxpayer and \$1,200 for a married couple. There is also a qualifying child credit of \$300 per child. Income eligibility is capped at \$75,000 for an individual and \$150,000 for a married couple.
2. *Business Tax Provisions*: enhanced expensing and depreciation for businesses buying equipment and placing it into service in 2008.
3. *Increase in FHA loan limits*: increase in the dollar amount of a mortgage the Federal Housing Authority can insure from a maximum of around \$417,000 to around \$730,000.

Effectiveness of H.R. 5140 as Economic Stimulus

Taken as a whole, The Economic Stimulus Act of 2008 presents a reasonable package. By including an income cap on eligibility, the individual tax rebates are *targeted* to those most impacted by economic downturn, and those most likely to spend extra funds they receive. It is *temporary*, with individual tax benefits being a one-time payment, and business incentives set to expire at the end of 2008. However, there will be a several-month lag before checks reach taxpayers' mailboxes. During this time, the economic landscape could change significantly, so the package is not very *timely*.

Although divided on the overall impact, most economists say that the package can help boost consumer and business spending, but additional stimulus may be necessary.

According to Ethan Harris, senior economist at Lehman Brothers, “In the rush to enact a timely package, politicians may have stopped a 2008 recession, but they have ignored a risky [economic] letdown,” which could result in the economy nearing recession again in early 2009.⁶

Based on inconsistent consumer reactions to past tax rebates, there is a great deal of uncertainty about how much economic activity will be generated by this stimulus package. In a recent Associated Press – Ipsos poll, only 19 percent of respondents stated they intend to spend a tax rebate if they receive one. The majority (45 percent), plan to use any refund to pay off bills; another 32 percent plan to save or invest the funds.⁷ Due to the lag between passage and implementation, we will not know whether congressional action has indeed prevented a possible recession until the second half of 2008.

Economic Stimulus in Ohio

Because of economic downturn, Ohio is facing budget shortfalls that the recently enacted federal stimulus package does nothing to address. In late-January, Governor Strickland announced budget cuts of approximately \$733 million based on the administration’s best-case scenario projection of the budget shortfall. His budget cuts include a reduction of 1,500 to 2,700 state jobs. The reduction would result from attrition and early retirement, with layoffs as a last resort. Most job cuts would occur in central administration rather than frontline workers. The departments of Corrections, Job and Family Services, and Mental Retardation and Developmental Disabilities would see the biggest job cuts.⁸ In addition, the plan would close psychiatric hospitals in Dayton and Cambridge. While cuts are never easy, particularly from an already lean budget, it is hoped that these cuts will have the least possible impact on services.

The budget reduction plan avoided several more difficult options. Governor Strickland’s plan does not include revising the 2005 tax reforms or the expansion of property homestead exemption to seniors. County funding will remain untouched by the budget cuts and continue to be held harmless for loss of the tangible personal property tax. Strickland did not tap the approximately \$1 billion Rainy Day Fund, leaving it as a future option.

In his State of the State address, the governor laid out his Building Ohio Jobs stimulus plan. His economic plan would invest \$1.7 billion to stimulate job growth through bonds.⁹ Implementation of the plan would not happen quickly because voters would

⁶ “Stimulus could provide short-term US recession relief: analysts.” *AFP* 11 February 2008.

⁷ Poll conducted by Ipsos Public Affairs, February 4-6, 2008, of 1,006 adults nationwide. MoE ±3.1

⁸ “Strickland Announces \$733 Million Budget Reduction Plan to Address Shortfall,” Office of the Governor Press Release, 31 January 2008.

⁹ Governor Strickland’s State of the State Address, 6 February 2008.

have to first approve it in November. But the strategies sound promising for long-term economic development. In response, House Speaker Jon Husted said the House probably will offer its own economic stimulus; he sounded unenthusiastic about borrowing to fund the governor's plan.¹⁰

Strickland also said he would continue to back his priorities for the current state budget, including early childhood education, expansion of children's health care, and the two-year freeze on college tuition. The plan includes investment in advanced and renewable energy, and infrastructure investment to support logistics and distribution, bioproducts from renewable sources, biomedicine, the Ohio Main Streets Renewable Initiative for downtown revitalization, and the Clean Ohio fund to clean and preserve our land. All of these investments are reputed as efficient uses of investment dollars.

If the governor remains intent on not raising taxes, it would be advisable for the state to find new sources of revenue to avoid additional program cuts. Strategies that other states are considering include postponing tax cuts, eliminating tax loopholes, and means-testing tax exemptions. The governor's proposal to add a Keno game to the Ohio Lottery to generate revenue estimated at \$73 million a year has stirred much debate, especially in light of previous opposition to legalized gambling in Ohio.¹¹

Impact of Federal Stimulus on Ohio

The federal stimulus could have inadvertent negative impacts on Ohio revenue. It includes a reduction in income taxes, which could reduce Ohio's income tax collections through depreciation since the state's tax collections are based on those of the Internal Revenue Code. However, if the federal tax reductions are structured in the same way as the last federal stimulus, Ohio statute spreads the depreciation over six years. In this case, the federal stimulus would have little, if any, impact on Ohio's revenue collections.¹²

Regardless of whether or not state aid comes from the federal budget, Ohio will probably need additional revenue to prevent further cuts to the very programs that become even more crucial and strained during economic downturns. Governor Strickland might consider utilizing the Rainy Day Fund for this purpose as use of the funds now may avoid more dire circumstances later, and our economic situation shows a justifiable need. Other possibilities include increasing revenues by postponing tax cuts, such as the phase-out of the corporate franchise tax. Many believe that spending cuts can be more harmful than tax increases to state economies during economic

¹⁰Mark Niquette. "Economy tops agenda; education close behind." *Columbus Dispatch*, 7 February 2008.

¹¹"Strickland Announces \$733 Million Budget Reduction Plan to Address Shortfall," Office of the Governor Press Release, 31 January 2008.

¹²Ohio Rev. Code. secs. 5747.01(A)(20-21) and 5733.04(I)(17-18).

downturns.¹³ While the Building Ohio Jobs stimulus seems promising, Ohio will probably need to spur economic growth much sooner.

Other Stimulus Options

While the enacted federal stimulus package is appropriate, there are other policies that could be more effective than tax rebates. In a letter to Senators George Voinovich and Sherrod Brown, Governor Strickland made an appeal for federal aid to states. His proposal is similar to that proposed by the National Governors Association. It would aid states with block grants, increase federal Medicaid match, an expansion of LIHEAP (Low Income Heating and Energy Assistance Program), emergency food assistance, unemployment insurance, and the Highway Trust Fund.¹⁴ The current federal economic stimulus package includes none of these options, and they should be considered in any future stimulus debates.

In testimony before the Senate Finance Committee, Peter Orszag stated, “The most effective fiscal stimulus polices share two common features: they focus on the time period when stimulus is most likely to be needed, and they are designed to increase economic activity as much as possible for a given budgetary cost.”¹⁵ He went on to cite food stamp increases and unemployment insurance extensions as the only two proposals currently being considered that are both fast-acting and highly effective.

According to the industry research firm Moody’s Economy.com, when measuring “bang for the buck,” or how much economic activity is generated by spending on certain policies, food stamps and unemployment insurance come out ahead. For every dollar spent on unemployment insurance, \$1.64 is generated throughout the economy in what economists call the ripple effect. For every dollar spent on food stamp benefits, \$1.73 is generated.¹⁶ Unlike tax rebates, which individuals may use to pay down debt or increase savings, recipients of food stamp benefits must spend them, quickly infusing money into the economy.

An increase in food stamp benefits and extension of unemployment insurance would have a significant impact on Ohio. Relative to other states, Ohio receives a large portion of total federal funds for these benefits, ranking seventh in food stamp benefits and 10th in unemployment insurance. In Fiscal Year 2007, federal expenditures on these two programs brought approximately \$2.4 billion in assistance to Ohio, resulting in over \$4.0

¹³ Statement of Peter R. Orszag, CBO Director, “Options for Responding to Short-Term Economic Weakness.” Before the Committee on Finance, United States Senate, 22 January 2008.

¹⁴ Governor Strickland letter to Senators Voinovich and Brown, 4 February 2008.

¹⁵ Statement of Peter R. Orszag, CBO Director, “Options for Responding to Short-Term Economic Weakness.” Before the Committee on Finance, United States Senate, 22 January 2008.

¹⁶ “Food stamps offer best stimulus – study.” CNN Money.com 29 January 2008.

billion dollars of economic activity.¹⁷ The economic activity resulting from just these two programs accounted for approximately 1 percent of the state's total Gross Domestic Product. As a result, it is likely that an increase in either, or both, of them would have a significant positive impact on Ohio.

Since structures for direct government payments through unemployment insurance and food stamps already exist, increases in these benefits would hit consumers' pockets in a matter of weeks rather than the months required for tax rebates. Should the economic outlook worsen, these two proposals should be given serious consideration due to their ability to meet the timely, targeted, and temporary criteria.

¹⁷ Data compiled from the *Unemployment Insurance Data Summary*, U.S. Department of Labor and *Food Stamp Program Annual Benefits*, U.S. Department of Agriculture. FY 2007 numbers for Food Stamps are preliminary.