EPI BRIEFING PAPER

ECONOMIC POLICY INSTITUTE • NOVEMBER 16, 2010 • BRIEFING PAPER #285

WHAT WOULD YOU DO WITH $67 BILLION?

Three alternatives to giving it to the rich

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A major item on the remaining agenda of the 111th Congress is the extension of some or all of the expiring Bush-era tax cuts. As Congress deliberates, unemployment remains high, job creation is weak, and revenues are scarce. At the same time, emergency federal unemployment benefits are set to expire on November 30, and an estimated 2 million Americans will lose benefits in December (Riordan et al. 2010).

If in the midst of these challenges Congress decides to extend the Bush tax cuts for the wealthy (individuals making above $200,000 or joint-filers making above $250,000 per year) for the next two years, it will be giving $66.8 billion to a group whose incomes have seen the strongest growth over recent decades and who will put relatively little of it back into the economy. At a time when millions are unemployed, revenues are tight, and the economy needs spending that will most improve the economic and budgetary outlook, there are better ways to invest $66.8 billion. Specifically:

- Enacting a stimulus package modeled after the American Recovery and Reinvestment Act would generate 296,000 jobs in 2011 and 339,000 in 2012, roughly 4.5 times as many as would be created by an extension of the upper-income tax cuts.[1]
- Continuing to provide emergency unemployment compensation would generate 531,000 jobs in 2011 and 172,000 in 2012, roughly 5.0 times as many as would be created by an extension of the upper-income tax cuts.
- Extending the Making Work Pay tax credit would generate 245,000 jobs in 2011 and 281,000 in 2012, roughly 2.7 times as many as would be created by an extension of the upper-income tax cuts.

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Employment should be job one

In September 2010 roughly five unemployed workers competed for each job opening. The Congressional Budget Office estimates that in calendar year 2012—five years after the start of the recession—the national unemployment rate will average 8.1%, more than three percentage points above the rate of unemployment when the economy is operating at potential (CBO 2010a). State budget cuts and the impending expiration of the Recovery Act will drag on growth over the next year unless Congress and the administration extend federal spending provisions.

What makes effective stimulus?

Depending upon how quickly the money circulates through the economy, various forms of fiscal stimulus range widely in their respective impact on economic activity.

Unemployment insurance

Unemployment insurance benefits perform better as cost effective stimulus than just about any form of federal spending, largely because the benefits are so well targeted. By providing unemployed workers with modest income support, unemployment benefits allow for necessary purchases such as groceries, rent, and utilities; the money

TABLE 1

Fiscal stimulus 'bang for the buck'

	GDP per dollar in tax cuts or spending
Tax cuts	
Nonrefundable lump-sum tax rebate	1.01
Refundable lump-sum tax rebate	1.22
Temporary tax cuts	
Payroll tax holiday	1.24
Job tax credit	1.30
Across-the-board tax cut	1.02
Accelerated depreciation	0.25
Loss carryback	0.22
Housing tax credit	0.90
Permanent tax cuts	
Extend alternative minimum tax patch	0.51
Make Bush income tax cuts permanent	0.32
Make dividend and capital gains tax cuts permanent	0.37
Cut corporate tax rate	0.32
Spending increases	
Extending unemployment insurance benefits	1.61
Temporary federal financing of work-share programs	1.69
Temporary increase in food stamps	1.74
General aid to state governments	1.41
Increased infrastructure spending	1.57
Low-Income Home Energy Assistance Program (LIHEAP)	1.13

NOTE: The "bang for the buck" is estimated by the one-year dollar change in GDP for a given dollar reduction in federal tax revenue or increase in spending.

SOURCE: Zandi (2010).

flows right back into the economy rather than being saved. Estimates by Zandi (2010) suggest that every dollar of federal spending on unemployment insurance generates $1.61 in economic activity (see **Table 1**).

Aid to states

Most state constitutions dictate balanced budgets, and so states nearly always have to cut spending when revenues plummet due to a recession (the bursting of the housing bubble has taken a particularly severe toll on state budgets because many states rely heavily on property taxes). By plugging budget shortfalls, federal relief for the states prevents mass layoffs of teachers, police, and firefighters. And because states face acute budget shortfalls, the money will be spent quickly and circulate through the economy; Zandi estimates that every dollar of federal spending on state fiscal relief generates $1.41 in economic activity.

Bush-era tax changes

Tax cuts generally yield a much smaller bang-per-buck than spending policies, but the tax cuts in question—permanent tax cuts for the well-off—perform much worse in stimulating the economy, according to independent forecasters. This is not surprising; these tax cuts are largely saved rather than spent on goods and services. Furthermore, the cost of these tax cuts balloons in the second half of the next decade, when the economy is projected to have mostly recovered. Making permanent the reduced top marginal rates, the unlimited personal exemption, and reduced capital gains and dividends rates would cost $629 billion in forgone revenue over 2011-20, but only $66.8 billion (10.6%) of this would be realized in the next two years (OMB 2010), when the economy most needs a boost.

Zandi estimates that every dollar spent on permanently extending the Bush income tax provisions yields just 32 cents in economic growth, only one-fifth the economic activity from aid to the unemployed per dollar spent.[2] No policy option for stimulating the economy is self-financing, but the eventual cost of stimulus hinges on its impact on the economy and the revenue base. Tax cuts for the wealthy are the most expensive form of stimulus per job created; they represent a lost opportunity that will exert pressure elsewhere in the budget or add to the public debt.

The funds now being considered for tax cuts for the wealthy could be used more effectively for other forms of job creation. The following sections detail three alternatives for spending $66.8 billion through 2012.

Option 1: A stimulus package modeled after the Recovery Act

Let's say that we used the $66.8 billion to create a mini-version of the American Recovery and Reinvestment Act, with appropriations and direct spending provisions proportional to their levels under the 2009 law. Despite its demonization during the midterm election campaign, the Recovery Act is a good model for job creation: CBO has estimated that by the second quarter of calendar year 2010 it had increased full-time-equivalent employment by between 2.0 million and 4.8 million jobs,[3] lowered the unemployment rate by between 0.7 and 1.8 percentage points, and boosted real gross domestic product by between 1.7% and 4.5% (CBO 2010b).

Investing $66.8 billion in a mini-Recovery Act would include $16.7 billion for state fiscal relief, $8.0 billion in refundable tax credits, $4.6 billion in unemployment compensation, $2.6 billion for COBRA health insurance premium subsidies, $3.2 billion for highway construction, $2.4 billion for health information technology, and $2.3 billion for the Supplemental Nutrition Assistance Program (SNAP), all over two years.[4]

Assigning Zandi's estimates for the economic activity created by each of these provisions, (see the appendix for details), we calculate that this stimulus package would boost GDP by $98.2 billion over 2011-12. This increased economic activity would translate to roughly 296,000 jobs in 2011 and 339,000 in 2012, or 4.5 times as many jobs as would be created by extending the Bush tax cuts for the rich (see **Table 2**).[5]

Option 2: Continue the Emergency Unemployment Compensation (EUC) program

The $33.9 billion continuation of EUC benefits approved this summer expires on November 30, 2010, and so a second option for using the resources required to extend the upper-income Bush tax cuts could be a package of additional

TABLE 2

Employment impact of a smaller Recovery Act stimulus package

	2011	2012	2011-12
Cost (equal to the Bush tax cuts for the wealthy)	$30,475	$36,339	$66,814
GDP impact of fiscal stimulus package	$44,800	$53,420	$98,219
Jobs impact of fiscal stimulus package	**295,737**	**338,878**	**634,615***
Additional jobs created by enacting fiscal stimulus (instead of cutting taxes for the wealthy)	**227,581**	**265,573**	**493,154***

* The sum of jobs created in 2011 and 2012 does not necessarily represent cumulative jobs created over 2011-12 because jobs created in 2011 might be double counted in 2012. To compare the cumulative employment impact of the three policy options relative to the Bush upper-income tax cuts, we compare total "job-years," a standard measure of job creation (representing one payroll job for one year) rather than averaging the ratio of jobs created in each year.

SOURCE: Author's calculations based on Zandi (2010).

TABLE 3

Employment impact of continuing unemployment insurance benefits

	2011	2012	2011-12
Cost of continuing unemployment insurance	$50,000	$16,814	$66,814
GDP impact of continuing unemployment insurance	$80,500	$27,071	$107,571
Jobs impact of continuing unemployment insurance	**531,409**	**171,727**	**703,135***
Cost of cutting taxes for the wealthy	$30,475	$36,339	$66,814
Additional jobs created by enacting fiscal stimulus (instead of cutting taxes for the wealthy)	**463,252**	**98,422**	**561,673***

* The sum of jobs created in 2011 and 2012 does not necessarily represent cumulative jobs created over 2011-12 because jobs created in 2011 might be double counted in 2012. To compare the cumulative employment impact of the three policy options relative to the Bush upper-income tax cuts, we compare total "job-years," a standard measure of job creation (representing one payroll job for one year) rather than averaging the ratio of jobs created in each year.

SOURCE: Author's calculations based on Zandi (2010).

aid for the unemployed. Continuing EUC unemployment benefits through the end of calendar year 2011 would cost around $65 billion, just under the cost of a two-year extension of the Bush tax cuts for the highest earners.[6]

Maintaining unemployment insurance is a highly effective way to keep Americans working and to create more jobs. Between the fourth quarter of 2007 and the first quarter of 2010, the expanded unemployment safety net is estimated to have created 1.7 million full-time-equivalent jobs (Mishel and Shierholz 2010).

The $66.8 billion of assistance to the unemployed would boost GDP by $80.5 billion in 2011 and $27.1 billion in 2012;[7] on net it would increase GDP by $107.6 billion over 2011-12. These gains translate into roughly 531,000 jobs in 2011 and 172,000 jobs in 2012, 5.0 times as many as would be created by extending the Bush tax cuts for the rich (see **Table 3**). This economic stimulus would spur job growth when it is most needed while minimally affecting the long-term fiscal outlook.

Option 3: Extend the *Making Work Pay* tax credit

A third option to use the $66.8 billion saved from eliminating the top-tier tax cuts would be to partially extend the Making Work Pay (MWP) refundable tax credit. Unlike a permanent tax cut for the wealthy, an extension of MWP would be better targeted to those most in need and who are more likely to spend the money. The president's budget

TABLE 4

Employment impact of extending *Making Work Pay*

	2011	2012	2011-12
Cost (equal to the Bush tax cuts for the wealthy)	$30,475	$36,339	$66,814
GDP impact of a extending Making Work Pay	$37,180	$44,334	$81,513
Jobs impact of extending Making Work Pay	**245,435**	**281,238**	**526,672***
Additional jobs created by enacting fiscal stimulus (instead of cutting taxes for the wealthy)	**177,279**	**207,933**	**385,211***

* The sum of jobs created in 2011 and 2012 does not necessarily represent cumulative jobs created over 2011-12 because jobs created in 2011 might be double counted in 2012. To compare the cumulative employment impact of the three policy options relative to the Bush upper-income tax cuts, we compare total "job-years," a standard measure of job creation (representing one payroll job for one year) rather than averaging the ratio of jobs created in each year.

SOURCE: Author's calculations based on Zandi (2010).

proposed a two-year extension of MWP at a cost of $60.1 billion—less than the two-year cost of the Bush tax cuts for the wealthy—but Congress has yet to take up an extension.

Devoting $66.8 billion to extend the Making Work Pay credit would boost GDP by $81.5 billion over 2011-12 and would translate to roughly 245,000 jobs in 2011 and 281,000 jobs in 2012, or 2.7 times as many as would be created by extending the Bush tax cuts for the rich (see **Table 4**).

These results are in line with economic theory; targeted refundable tax credits boost disposable income for the population most likely to spend the money quickly and thereby pump demand back into the economy. Not only would an extension of Making Work Pay do more to help working families adversely affected by the economic downturn, it would also do more to return the economy to potential than tax cuts for the wealthy.

The employment gains in this option are smaller relative to the gains from a stimulus package modeled after the Recovery Act or an extension of unemployment insurance because, in the latter two cases, direct spending is immediately channeled into the economy in the form of purchases and wages, with very little opportunity for savings.

Conclusion: Upper-income tax cuts are not good stimulus

Incremental fiscal stimulus is no substitute for a massive job creation program and long-term growth plan aimed at rebuilding the middles class, but the more we do to address the unemployment crisis, the better. At a time when fiscal stimulus is desperately needed, however, cost effectiveness is an obvious and prime consideration, both in terms of maximizing gains in employment and minimizing the impact on the long-term budget outlook. The policy options discussed in this paper are meant to illustrate effective ways to stimulate economic activity, but are simply not on the magnitude necessary to bring the economy back to full employment and are in no way mutually exclusive; we endorse enactment of all three policies on a larger scale.

Highly effective job creation measures include unemployment insurance, aid to state governments, and assistance for individuals with a high propensity to consume and thereby create demand. Each of these measures efficiently boosts the economy when it needs support most.

To those who assert that we can't afford any more spending because of current budget deficits, we would say that it is the long-term accumulation of debt—not this year's budget deficit—that requires the attention of Congress and the White House. While it is regrettable that our nation was running a structural deficit when the economy tumbled into recession, widening the deficit to absorb the shock of the severe downturn was the responsible course of action. Effective stimulus today supports long-term deficit reduction by increasing employment and boosting growth, thus expanding the revenue base.

Congress should spur job creation, but tax cuts for the wealthy are the worst way to achieve this goal. They will just make the rich richer while incomes for everyone else stagnate or fall. Devoting the cost of these tax-cuts for high-yielding public investments or safety net spending would be a proven, cost-effective step toward restoring full employment and output.

Appendix: How spending affects GDP and job growth

Our methodology translates spending on a variety of fiscal stimulus packages, as well as the forgone revenue from extending the upper-income Bush tax cuts, into increases in output (GDP), and then translates these changes into corresponding increases in payroll employment.

Constructing fiscal multipliers

Miniature Recovery Act

We first compile a fiscal multiplier for spending provisions in the Recovery Act. A breakdown of discretionary spending provisions (Division A) and direct spending provisions (Division B) is available from the cost estimate for the conference agreement (CBO 2009; see *http://www.cbo.gov/ftpdocs/99xx/doc9989/hr1conference.pdf).* These provisions were projected to cost $575.3 billion over 2009-19.[8] Each spending provision is then calculated as a fraction of total discretionary and direct spending provisions in the Recovery Act. A fiscal multiplier is assigned to each spending provision, and the multipliers are then weighted by each provision as a fraction of total spending. The sum of the weighted multipliers produces a multiplier for all of the spending provisions in the Recovery Act. Mark Zandi of Moody's Economy.com provides his firms' multipliers for various policies in recent House testimony (Zandi 2010, Table 1; see *http://budget.house.gov/hearings/2010/07.01.2010%20-%20zandi%20testimony.pdf).* Zandi explicitly provides multipliers for many Recovery Act provisions such as general aid to state governments, extension of unemployment benefits, and increased infrastructure spending. In Division A, Title I (SNAP) is assigned a multiplier of 1.74 (Temporary Increase in Food Stamps); Title II (State and Local Law Enforcement Assistance), Title VIII (Education for the Disadvantaged, Special Education), and Title XV (State Fiscal Stabilization Fund) are assigned a multiplier of 1.41 (General Aid to State Governments); Title XII (Public Housing Capital Fund) is assigned a multiplier of 1.13 (LIHEAP); and all other provisions are assigned a multiplier of 1.57 (Increased Infrastructure Spending). In Division B, Title I (Refundable Tax Credits) and Title II (Economic Recovery Payments, TANF, Child Supports) are assigned a multiplier of 1.22 (Refundable Lump-Sum Tax Rebate); Title I (Other) is assigned a multiplier of 1.01 (Nonrefundable Lump-Sum Tax Rebate); Title II (Unemployment Benefits) and Title III (COBRA) are assigned a multiplier of 1.61 (Extending Unemployment Insurance Benefits); Title IV (Health IT) is assigned a multiplier of 1.57 (Increased Infrastructure Spending); and Title V (State Fiscal Relief) is assigned a multiplier of 1.41 (General Aid to State Governments). Programs considered general government spending, such as increased funding for the National Science Foundation or the Department of Defense, are assigned the 1.57 multiplier for increased infrastructure spending, which is consistent with CBO's estimate of the impact on purchases of goods and services by the federal government. The CBO report "Estimated Impact of the American Recovery and Reinvestment Act on Employment and Economic Output From April 2010 Through June 2010" (CBO 2010b; see *http://www.cbo.gov/ftpdocs/117xx/doc11706/08-24-ARRA.pdf)* estimates that a dollar in general federal government purchases yields between $1.00 and $2.50 in economic activity, for an average multiplier of $1.75. Based on these designations, the weighted multiplier for discretionary and direct spending provisions in the Recovery Act is 1.47.

Continue the Emergency Unemployment Compensation (EUC) program

We assign the federal Emergency Unemployment Compensation program a multiplier of 1.61 (Extending Unemployment Insurance Benefits).

Making Work Pay (MWP) extension

We assign the Making Work Pay tax credit a multiplier of 1.22 (Refundable Lump-Sum Tax Rebate).

Upper-income tax cuts

The permanent extension of the reduced capital gains and dividends rate is assigned a multiplier of 0.37 (Make

Bush Income Tax Cuts Permanent), and the permanent extension of the reduced investment income tax rates is assigned a multiplier of 0.32 (Make Dividend and Capital Gains Tax Cuts Permanent).

Impact on gross domestic product

Each of the above multiplier effects is applied to the budgetary cost in each fiscal year for each stimulus option. For the options 1 and 3 ("A stimulus package modeled after the Recovery Act" and "Extend Making Work Pay tax credit"), the budgetary cost is assumed to be the cost of making the upper-income Bush tax cuts permanent, taken from the president's Budget Mid-Session Review, Summary Tables, S-9; see *http://www.whitehouse.gov/omb/assets/fy2011_msr/11msr.pdf)*. For option 2 ("Continue the Emergency Unemployment Compensation (EUC) program"), the cost of continuation is assumed to be fixed at $5 billion per month (Riordan et al. 2010), with the full FY2011-12 opportunity cost of the Bush tax cuts being used to fund an extension. Because EUC has been extended through November 2010, we assume a cost of $50 billion in FY2011 (which started October 1, 2010), and the remaining $16.8 billion goes to extending EUC for a little over three months in FY2012.

The fiscal multiplier times the budgetary cost equals the change in GDP associated with a stimulus package for a given year. Adding that GDP figure to the CBO projection for nominal GDP, we calculate a percentage change in GDP that would be associated with a particular stimulus package. The GDP projections are taken from CBO's August "Budget and Economic Outlook: An Update" (CBO 2010a; *see http://www.cbo.gov/ftpdocs/117xx/doc11705/EconomicProjections.pdf)*. The GDP impact of a miniature Recovery Act would be $44.8 billion (+0.30%) in 2011 and $53.4 billion in 2012 (+0.34%). The GDP impact of extending EUC benefits would be $80.5 billion (+0.53%) in 2011 and $27.1 (+0.17%) billion in 2012. The GDP impact of extending MWP is estimated at $37.2 billion (+0.25%) in 2011 and $44.3 billion in 2012 (+0.28%). As a basis for comparison, a permanent extension of the Bush upper-income tax provisions would boost GDP by only $10.3 billion (+0.07%) in 2011 and $11.6 billion (+0.07%) in 2012.

Impact on employment

Based on the annual percentage change in GDP associated with a particular stimulus package, we then calculate the impact on payroll employment in each year. We use the Bernstein-Romer (2009; see *http://www.politico.com/pdf/PPM116_obamadoc.pdf)* rule of thumb that a 1% increase in GDP increases payroll employment by one million additional jobs. The GDP impact of a miniature Recovery Act is estimated to generate 295,737 jobs in 2011 and 338,878 jobs in 2012. This is 493,154 more job-years than would be created by using the same funds for a two-year extension of the upper-income tax cuts. The GDP impact of maintaining EUC benefits is estimated to generate 531,409 jobs in 2011 and 171,727 jobs in 2012, which represents 561,674 more job-years than would be created by using the same funds for a two-year extension of the upper-income tax cuts. The GDP impact of extending Making Work Pay is estimated to generate 245,435 jobs in 2011 and 281,238 jobs in 2012, which represents 385,211 more job-years than would be created by using the same funds for a two-year extension of the upper-income tax cuts.

Endnotes

1. All years are fiscal unless otherwise noted.
2. This estimate pertains to a permanent extension of the Bush income tax provisions (excluding the AMT patch) for all earners, but the benefits of the 2001 and 2003 income tax modifications were very skewed toward top earners. A permanent extension of just the upper-income provisions would yield a lower fiscal multiplier.
3. A full-time equivalent job is equal to 40 hours of work for a full year.
4. Proportional Recovery Act estimates are a based on CBO's score of the conference report for H.R. 1 (http://www.cbo.gov/ftpdocs/99xx/doc9989/hr1conference.pdf). See the appendix for more detail.
5. The sum of jobs created in 2011 and 2012 does not necessarily represent cumulative jobs created over 2011-12 because jobs created in 2011 might be double counted in 2012. To compare the cumulative employment impact of the three policy options relative to the Bush upper-income tax cuts, we compare total "job-years," a standard measure of job creation (representing one payroll job for one year) rather than averaging the ratio of jobs created in each year.
6. An extension of current EUC benefits would cost approximately $5 billion per month (Riordan et al. 2010).
7. Note that these are fiscal years, not calendar years. This proposal would extend EUC benefits through calendar year 2011.
8. CBO has since revised upward the projected cost of the Recovery Act from $787 billion to $814 billion (largely because earlier economic assumptions underestimated the severity of the recession), but it has not released a detailed line-by-line revised score of the law. We assume the provisions of the Recovery Act have not changed as a proportion of total spending since the original score. Unemployment insurance expenditures have likely risen as a total fraction of expenditures, and this increase would generate a higher fiscal multiplier than our weighted Recovery Act multiplier, so our estimate for job creation is, if anything, on the conservative side.

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