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DOWN-PAYMENT ON ECONOMIC RECOVERY

Why Temporary Payments to Social Security and Supplemental Security Income Recipients Are Effective Stimulus

BY JOSH BIVENS AND KATHRYN ANNE EDWARDS

The American Recovery and Reinvestment Act (ARRA) was passed in February 2009 in an attempt to boost the cratering economy. The Recovery Act has performed as advertised—the Congressional Budget Office (CBO 2010) has estimated that the ARRA has raised gross domestic product (GDP) by over \$600 billion by April of this year, saved or created up to 4.9 million full-time equivalent jobs, and kept unemployment up to 1.9 percentage points below what it would have been without the ARRA’s passage.

Yet the economy has not fully recovered and a crisis in the labor market persists. While the unemployment rate would have likely reached over 12% without the Recovery Act, even following the Act’s passage it stands today at an unacceptably high 9.7%. This lingering crisis is not a reflection of the effectiveness of the Recovery Act but of the growing magnitude of the crisis it was meant to address; that is, although the Recovery Act performed as advertised, the recession has been much worse than was expected. More help is needed to create jobs.

This brief argues that a clear success of the Recovery Act was the \$250 lump-sum payments that went to recipients of Social Security and Supplemental Security Income (SSI) benefits, and that further job-creation efforts should include another such payment. Repeating this \$250 payment would not, of course, constitute a sufficient response to the jobs crisis by itself. A response commensurate to the scale of the jobs crisis would be literally at least 20 times larger in simple dollar terms and would include further extensions to unemployment insurance and food stamps, significant fiscal relief to state and local governments, and more public investment projects that resulted in direct job creation. However, this lump-sum payment to Social Security and SSI beneficiaries should be part of a mix to maximize job creation—it is an effective job creator, and its effects would take hold faster than almost any other aspect of a new recovery package.

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Social Security and SSI payments in the Recovery Act

As part of the Recovery Act, all Social Security and SSI beneficiaries received a \$250 lump-sum payment. This payment accounted for roughly \$13 billion of the \$787 billion of the Recovery Act's estimated cost.

While its share of the overall Recovery Act spending was very small, this lump-sum payment was one of the quickest-acting components of the overall package—the majority of payments were received just months after the Act was passed (by the end of May 2009). This Social Security and SSI payment by itself likely boosted GDP by roughly 0.5% in the second quarter of 2009, which would roughly translate to about 125,000 jobs created or saved due to these payments.

Effective economic stimulus

Fiscal stimulus is simply an increase in the budget deficit brought about through policy decisions—either cutting taxes or increasing government spending. Both tax cuts and spending increases introduce extra purchasing power and demand for goods and services into an ailing economy. How effective different *kinds* of tax cuts and/or spending increases are as stimulus depends on essentially three things: the relevant *marginal tax rate* faced by those receiving the funds, the marginal propensity to consume out of current income, and the marginal propensity to consume *imports* rather than domestically produced goods.¹

Lower tax rates

Stimulus is more effective if it targets households that pay lower marginal tax rates, as an extra dollar of stimulus spending translates into more *disposable* income for these households than for those facing higher rates.

For example, if someone pays a 5% marginal rate and is given a dollar, their disposable income rises by 95 cents. If someone pays a 20% marginal rate and is given a dollar, their disposable income rises by only 80 cents. Since lower income households generally face lower marginal tax rates, stimulus spending should target them.

Similar to other programs, like Supplemental Nutrition Assistance (food stamps) and Temporary Assistance to Needy Families (welfare), SSI is means-tested, meaning that eligibility is determined by income. Hence, SSI recipients are very low-income households *by definition* and will therefore face lower-than-average marginal tax rates.

Further, while Social Security is not means-tested, there are several reasons for believing that Social Security beneficiaries also have lower incomes and/or face lower marginal tax rates than average. First, two-thirds of beneficiaries are retirees. While Social Security benefits are not directed *solely* toward retired persons (as is commonly thought), more than two-thirds of Social Security payments do go to those over the age of 62 to provide retirement income, and this group has lower average incomes than the rest of the population.

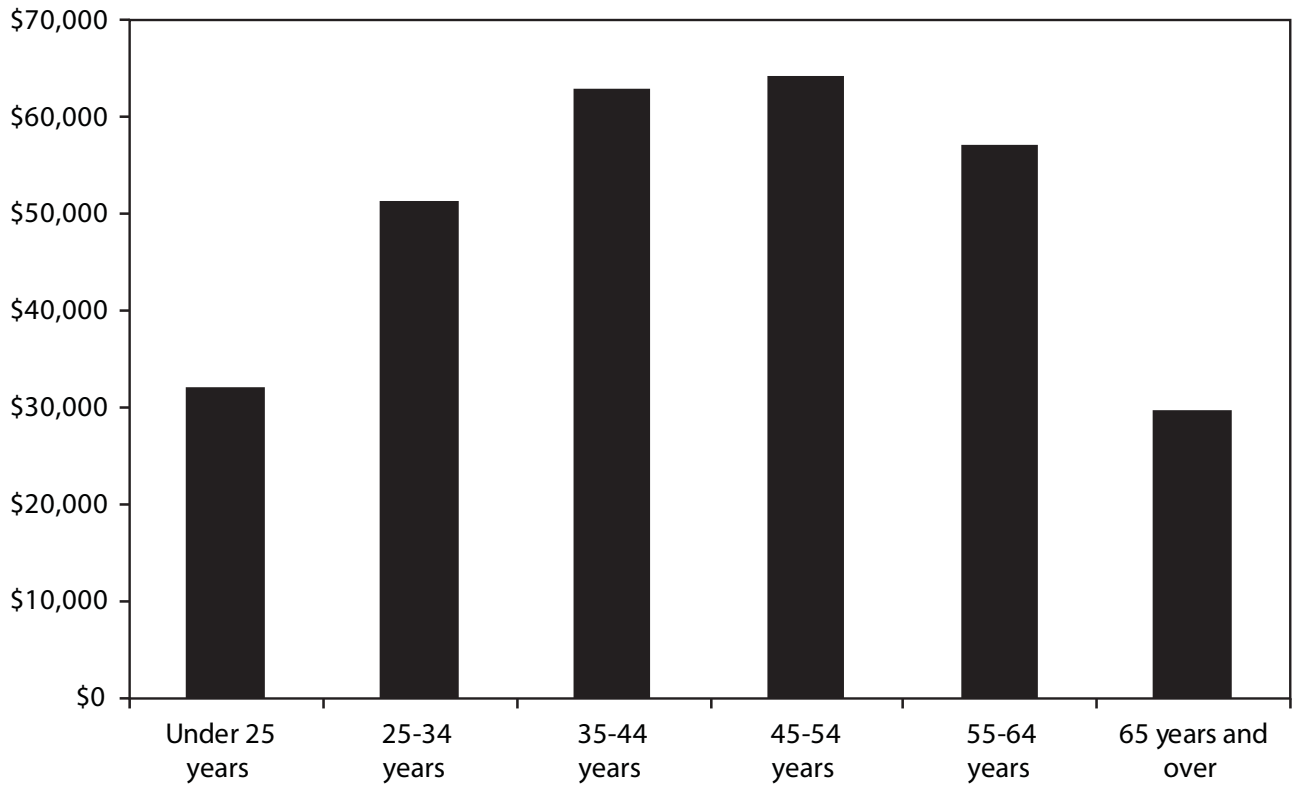
Figure A shows median family income by age of householder for different age groups. Besides families headed by very young (under 25) householders, families headed by those over 65 have lower median incomes than all other groups.

Second, Social Security payments account for a large portion of the income received by households headed by those over 65, and these payments (cash transfers from the government) tend to face lower marginal tax rates than most other forms of income. Most beneficiaries do not pay income tax.

Lastly, those Social Security payments that do not provide pure retirement income go to the disabled, families of the disabled, and families who have lost a worker. Data from the Census Bureau confirm that these are low-income households—in 2002, more than 85% of beneficiaries of disability income payments administered by Social Security lived in households earning less than \$20,000 annually.

FIGURE A

Median family income by age, 2008



SOURCE: U.S. Census Bureau, Historical tables, H-10.

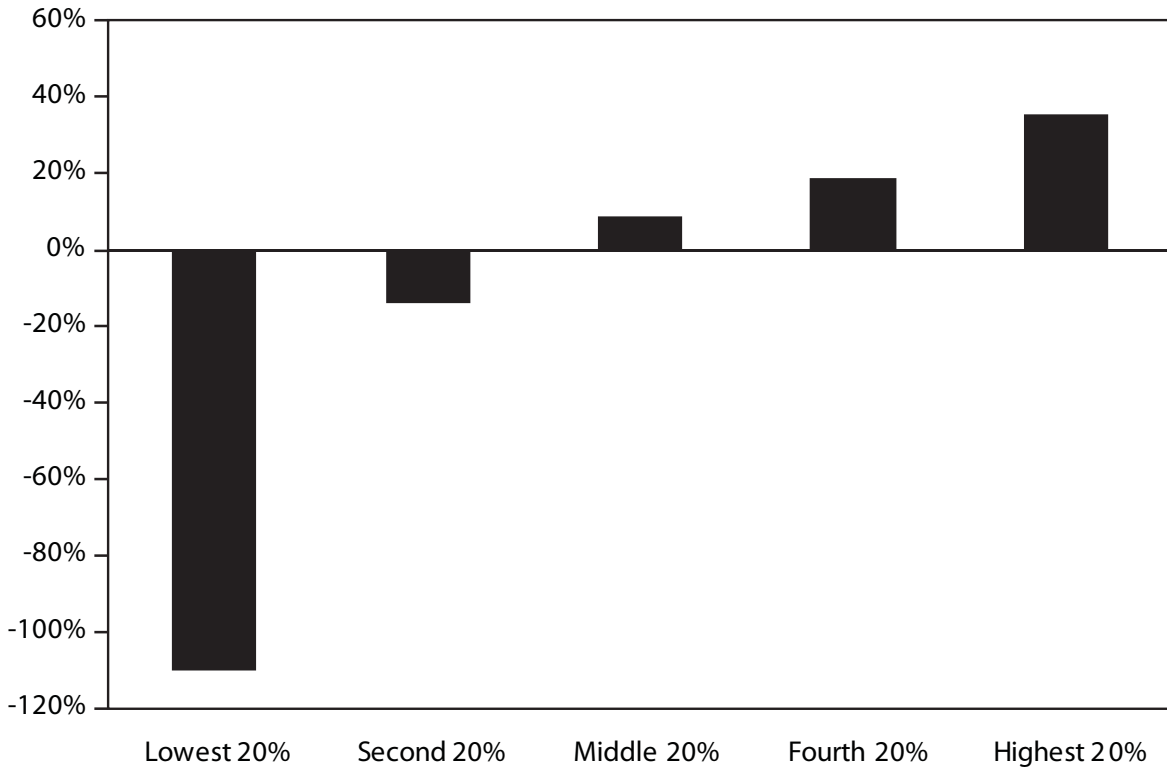
Higher marginal propensity to consume

A second metric for effective stimulus is a higher *marginal propensity to consume*. This metric indicates how much of an additional dollar of income given to a particular household is spent rather than saved. As the point of economic stimulus is to increase economy-wide demand for goods and services, stimulus efforts should be targeted to those households that are more likely to spend it, that is, those with a higher-than-average marginal propensity to consume.

Evidence strongly suggests that households receiving Social Security and SSI have higher-than-average marginal propensities to consume out of current income. For one, lower-income households generally consume a higher share of income than more affluent ones, and the preceding section demonstrated that recipients of these payments have lower-than-average incomes. **Figure B** confirms that savings rates of lower-income households are much lower than higher-income households.

FIGURE B

Savings rate by income quintile, 2008



NOTE: Savings rate calculated by subtracting average annual expenditures from after-tax income.

SOURCE: EPI analysis of Consumer Expenditure Survey, 2008, Table 1.

Payments to SSI recipients and Social Security disability and survivor's benefits are directed at lower-income households, so they should be expected from this evidence to have a higher propensity to consume. **Figure C** provides further evidence that this higher propensity to consume almost surely holds for Social Security retirement beneficiaries as well, confirming that older households have lower savings than all but the very young (again, those headed by under-25 householders).

Hence, we can assume that recipients of the lump-sum transfer are more likely to spend rather than save, either because they are low-income (SSI), elderly (Social Security), or both.

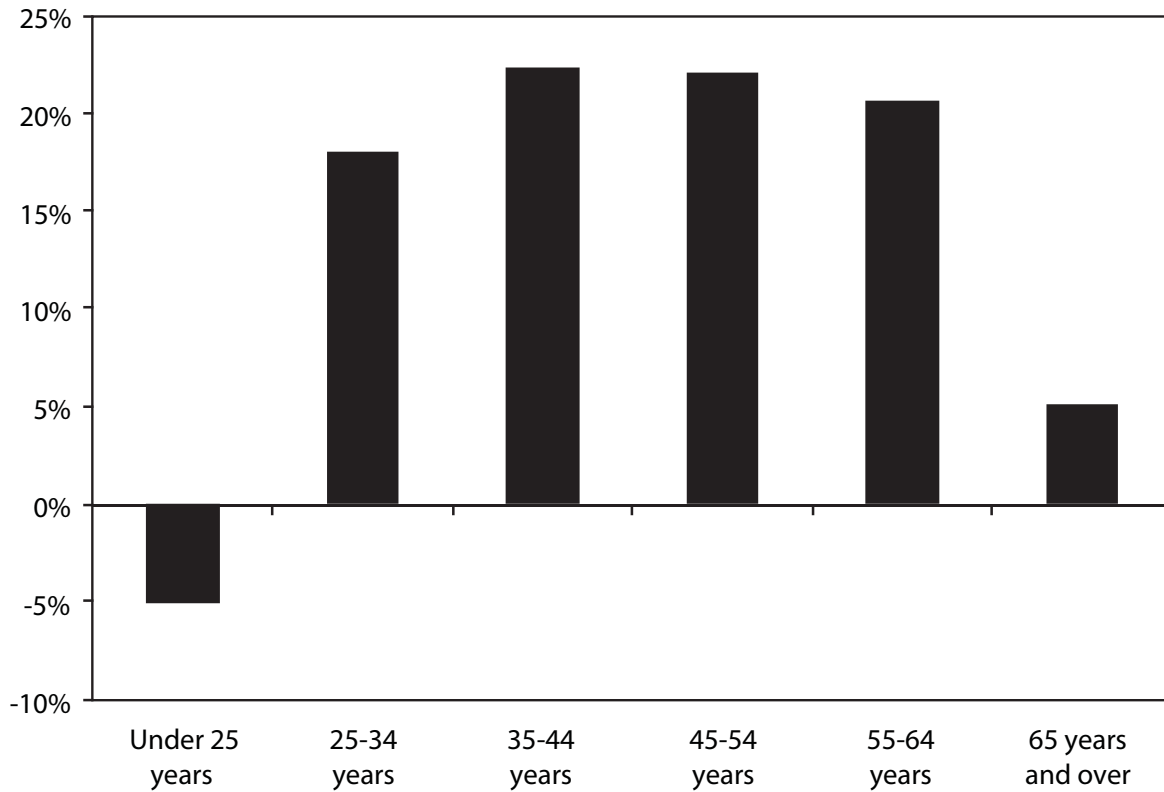
Lower marginal propensity to consume imports

A third measure of effective stimulus is the marginal propensity to consume imports, measuring how likely a household is to buy imports. The more likely stimulus recipients are to spend their additional income on imports rather than domestic products, the less effective this stimulus will be in spurring domestic growth in jobs and incomes.

There is little reason to think that the propensity to consume imports varies systematically by income-class, so on this count there is little reason to think that transfer payments to SSI recipients or recipients of Social Security disability and survivor's benefits score any worse, or better, than average based on income alone.

FIGURE C

Savings rate by age, 2008



NOTE: Savings rate calculated by subtracting average annual expenditures from after-tax income.

SOURCE: EPI analysis of Consumer Expenditure Survey, 2008, Table 3.

However, older households are less likely to consume goods and services that are imported. This is driven largely by the very high weight of health care services (a generally non-traded service) consumed by older households. **Figure D** shows the share of total expenditures accounted for by a range of categories that are very unlikely to have a high import share: shelter, household services, utilities, and health care. As can be seen, older households consume a much higher share of these non-traded services than other households. They also consume fewer goods that are likely to be imported, such as cars, clothes, or electronics. As such, transfer payments directed at these households are less likely to go toward imports and more likely to spur increased economic activity within the United States.

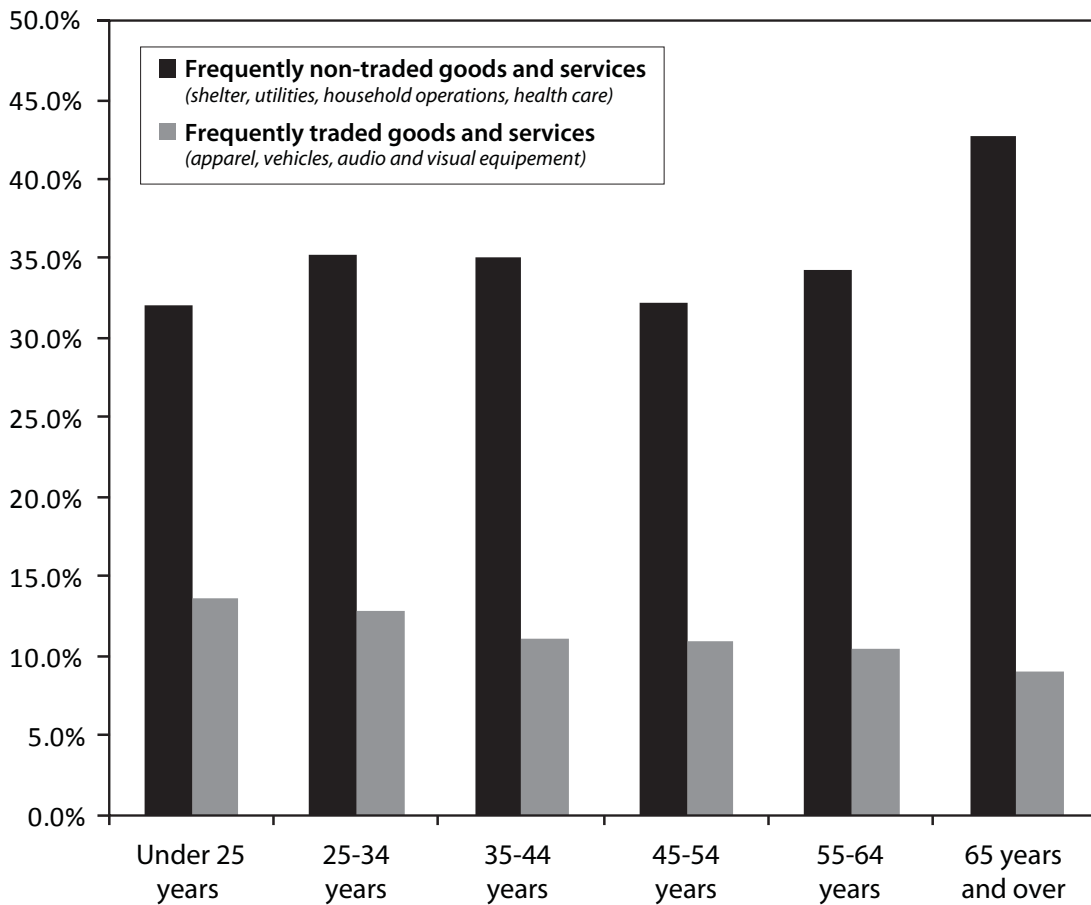
Lastly, while direct consumption data on the disabled do not exist, it seems fair to surmise that this is also a group that will see much higher medical expenditures on average than the general population. Given this, it seems a safe bet that the marginal propensity to consume imports is not higher (and may well be lower if health spending dominates their consumption bundle) than the population average.

Fair stimulus

While it is clear that the lump-sum payments to Social Security and SSI beneficiaries are *efficient* economic stimulus, some have argued that there is little rationale for providing these groups lump-sum cash payments instead of others based on principles of *fairness*.

FIGURE D

Share of expenditures on traded and non-traded goods



NOTE: Share of expenditures calculated by adding expenditures on specific items as a share of annual average expenditures.

SOURCE: EPI analysis of Consumer Expenditure Survey, 2008, Table 3.

That is not right, especially in the case of older households. These households depend far more on income generated from past savings—either through stocks and bonds or the implicit income of housing wealth—to maintain their living standards. Financial wealth has been devastated by the bursting of the housing bubble and the resulting chaos in the financial markets. Neither of these events are conceivably the fault of older households relying on accumulated wealth. While younger workers would gain from most aspects of economic stimulus simply through its beneficial effect on labor markets, older households who are no longer connected to labor markets would not get these benefits.²

Given this, and given that the economy needs substantial stimulus anyhow and lump-sum payments to Social Security and SSI beneficiaries clearly meet this criterion, it seems more than fair to help out this group on equity grounds.

Lastly, it should be reiterated that the primary criterion to grade measures aimed at job creation should be simply their overall effectiveness. Too much of the debate over job-creation measures centers on which interest group receives the first dollar of stimulus money. What matters more than who receives the first dollar is how quickly that dollar is put back into circulation and spurs greater demand for goods and services. On this count, the one that actually matters for effective job creation, payments to Social Security and SSI beneficiaries scores high.

Endnotes

1. For those interested in an Econ 101 refresher course, an autonomous increase in expenditures (either government spending or greater private spending made possible through, say, increased government transfers) is multiplied by the following expression to calculate its final effect on economic output: $1/1-[MPC(1-T)-MPM]$, where MPC is the marginal propensity to consume, T is the marginal tax rate, and MPM is the marginal propensity to import. As MPC rises, the overall multiplier rises as well, whereas when T and/or MPM rises, the overall multiplier falls.
2. Eggerston (2009) actually argues explicitly that tax cuts and transfers that do not provide incentives for people to supply more hours to the labor market are preferable to those (like income or payroll tax cuts) that do—arguing that “at a loose and intuitive level, policy should not be aimed at increasing the supply of goods [which would result if households began supplying more hours to the labor market] when the problem is that there are not enough buyers.”

References

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