



## 2008 SPRING SYMPOSIUM BUDGET POLICY AND ITS PEOPLE—AT THE CROSSROADS?

### SESSION SUMMARY

# The 2008 Economic Stimulus Package Good Politics or Good Policy?

Ashley Palmer, Reporter

As Americans anxiously await the arrival of their 2008 tax rebates, a panel discussed the anticipated effects on the economy during a morning session of the AABPA Spring 2008 Symposium. **George Krumbhaar**, Founder of USBudget.com and Senior Editor for the Federal Budget Observer, opened the discussion with the question, “Was this good politics and not good policy?” Respondents included **Douglas Hamilton** of the Congressional Budget Office, **Diane Lim Rogers** of the George Washington University and Chief Economist of the House Committee on the Budget, and **Alex Brill** of the President’s Council of Economic Advisers.

Mr. Hamilton began with an overview of the current state of our economy. He discussed several of the key indicators of our economy and noted that while the growth of employment has slowed, there has not been a sharp decline in employment which typically signals the beginning of a recession. He also discussed the uncertainty of the housing market and outlined the subprime mortgage crisis:

- Rising home prices encouraged borrowers to buy houses they could

not afford, and the standards for lending became more lax.

- Once the market began to fall, the prospect of losses pressured financial markets, and the value of securities backed by subprime mortgages began to fall sharply.

- Financial institutions that invest in subprime mortgages became leery of lending to one another out of concern for each other’s exposure to subprime mortgages and solvency.

- That concern spread to the market for interbank loans, which began to affect credit and spread to the rest of the economy. The subprime crisis also caused investors to become more risk-averse.

Hamilton went on to say that the current uncertainty in the housing and credit markets will cause the economy to continue its downward spiral. Currently, buyers are expecting housing prices to continue to fall, which causes them to hold off on buying and perpetuates the fall in prices. The farther housing prices fall, the more people will owe on their homes relative to the homes’ worth. This will increase the incentive to walk away and increase losses to lenders and to neighborhood

home values. There is also uncertainty regarding how large losses will be—estimates are between \$200 billion and half a trillion dollars—and how those losses will be distributed among borrowers, lenders and taxpayers.

Policy options will play a role in determining the magnitude of these losses. Mr. Hamilton said three main considerations should guide the policy options:

- Foreclosures—Foreclosures create large costs to the lender and external costs to the neighborhood. If foreclosures can be avoided, resources will be available to help curtail other problems in the economy.

- Moral hazard—There is a risk that government actions to prevent foreclosure can have the unintended consequence of causing some individuals to take more risk, believing that the government will bail them out if they get in trouble.

- Adverse selection—Investors may pawn off the worst assets to those who are the least informed and most vulnerable.

Mr. Hamilton concluded with an overview of the Economic Stimulus Act of 2008, which will provide re-

bates for households and incentives for business investment. He contended that this year's act will provide more stimulus than the 2001 rebates and will likely provide a kick to the economy in the second half of the year. The size of the rebate is three-quarters of a percent of GDP, and because it will be concentrated in the second half of the year, its effect on GDP could be as much as double that percentage. Studies of the 2001 rebate suggest that about two-thirds of the money will be spent, and that spending by consumers will have a multiplier effect. According to Mr. Hamilton, the net effect on GDP should range from .5 percent to 1.5 percent.

Ms. Rogers provided an overview of the House Budget Committee's role in passing this legislation and gave the audience a sense of the options available to promote long-term economic growth. She focused on tax reform rather than tax policy as a means of promoting such growth, emphasizing the need for policies

such as the Economic Stimulus Act of 2008 to be paid for in the years immediately following its passage. She contended that spending beyond our means reduces our national saving growth, which hurts long-term economic growth. She also commented on the political reasons that the bill was passed without a means to pay for it, highlighting the fact that it is an election year and an increase in taxes would have been unfavorable. Because this bill was not paid for, the budget committee and others in the House wanted to ensure that the bill was timely, targeted and temporary. They used this phrase to contain the bill's scope and minimize the fiscal irresponsibility associated with it, and they followed Federal Reserve Chairman Ben Bernanke's advice in keeping the scope of the bill around 1 percent of GDP.

Finally, Mr. Brill concluded with a discussion of the current tax code and a brief analysis of the Economic Stimulus Act of 2008. He

contended that the rebate checks are a relatively inefficient way to stimulate the economy because it is likely that people will save their rebate checks. He also questioned how temporary the tax cuts can be. Some people were removed from the income tax rolls as a result of this legislation, and Congress may not be interested in putting them back on. Mr. Brill posited that this legislation sets a precedent for tax cuts and unemployment benefits, and it reinforces negative ideas about the economy, which will cause people to be more conservative in the way that they choose to spend their money.

Mr. Brill discussed the distortionary nature of the current tax code and the way the code influences people's economic decisions. He believes that by broadening the tax base, we can reduce these distortions and enhance economic efficiency, which may lead to greater economic growth and promote efficient economic behavior.