



economic perspective

by Gene Steuerle

Do We Really Need More Stimulus?

Both the president and members of Congress have expressed strong political desire to appear to be “doing something” about the past recession and the current unemployment rate. This sentiment cuts across political parties and between the executive and congressional branches of government. In truth, however, few economists in the administration or in Congress, Republican or Democrat, have made much of a case that more stimulus — at least in terms of putting money in the economy — is needed or wanted at this time. *Why? As far as I can tell, never before in the nation’s history has so much fiscal stimulus been provided relative to the size of a downturn.*

While the typical change in fiscal position (or increase in deficit) might be 30 to 40 percent of the size of an economic downturn, this time it appears to be one to two times larger than the downturn itself! *That is, the government has absorbed more than the entire loss of income to the population. And that doesn’t count any new bill enacted this year.*

According to the Congressional Budget Office figures (soon to be updated), in fiscal 2003 alone, recently enacted tax bills have reduced collections by \$126 billion. Discretionary spending has been raised \$72 billion, and other changes (largely interest costs on other tax and spending changes) will raise legislative changes to \$238 billion.

In addition, we can approximate the direct impact of the economic slowdown on government activity simply by examining nonlegislative changes in es-

timates of the government’s deficit position. Here we find another \$286 billion, largely in lost revenues, due to reductions in such items as taxes on wages, capital gains realizations, and exercises of stock options. The natural reductions in the taxes people pay on their reduced income are the primary component of what is referred to as *automatic* fiscal policy, which is usually much larger than discretionary actions.

The total decline in fiscal posture for 2003 alone comes to around \$500 billion. Compare this to the size of the economic decline. So far the numbers indicate that the effect of the downturn on the economy was very mild. Real economic growth in 1998 was 4.3 percent, in 1999, 4.1 percent, in 2000, 3.8 percent, and in 2001, 0.3 percent. Then in the first three quarters of 2002, growth was 5.0 percent, 1.3 percent, and 4.0 percent, respectively, although it may be back around zero for the fourth quarter. Some economists believe that growth at the end of the 1990s was unusual and that the economy was operating above potential — indicating that some of the 2001 decline might have occurred even without a recession and brought the economy back toward potential.

Ignoring that argument, the total decline from the beginning of 2001 to the end of 2002 might be about 2 to 3 percentage points of GDP. With an economy of a little more than \$10 trillion, this implies that the nation’s income is about \$200 billion to \$300 billion below potential in 2003.

Next, compare the change in fiscal policy with the size of the recession. It turns out that the combination of revenue shortfalls due to the recession, new tax bills,

Table 1: How Much Stimulus Is There Already? (\$ billions)

Source	2003	2003-2007
Tax Reductions	126	607
Discretionary Spending Increases	72	392
Other	40	321
Total Legislative	238	1,320
Economic	130	501
Technical (including unanticipated capital gains changes)	156	725
Total Economic & Technical	286	1,226
Total	524	2,546

*Based on the change in Congressional Budget Office estimates of the size of the deficit for fiscal 2003 in August 2002 versus January 2001. New estimates will be coming soon. Technical changes include many economic changes, such as declines in capital gains realizations, that were not expected but still put cash in the form of lower taxes back in the economy.

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Size of:	2003	2003-2007
Economic Stimulus So Far	500	2,500
New Proposals	50 to 100	500
Economic Decline	200 to 300	0, 1,500, other?

*Numbers, especially for 2003 to 2007, are only approximate and are based on the recovery displayed in CBO August 2002 estimates. Economic growth in 2001 was 0.3 percent, versus 3.8 percent in 2000 and 5.0, 1.3, and 4.0 percent for the first three quarters of 2002. Reduced output in 2003 was estimated at 2 to 3 percentage points of GDP below potential. The ultimate decline for 2003-2007 could be as low as zero (if strong recovery) or continually fall behind by \$300 billion per annum. Note that the size of the five-year economic stimulus will rise or fall depending on whether the economy does worse or better than expected.

and new discretionary expenditures are on the order of one to two times the size of the decline so far. Of course, there are different ways to estimate this change in fiscal posture, and one may not want to count all the items listed here (for example, additional interest on the additional debt) as stimulus. On the other hand, the numbers are understated by the extent to which there has been a decline in revenues and increased spending at the state and local level.

The situation may not change if one looks at five-year estimates for 2003 to 2007. Much depends in the future on just what happens to the economy. One can interpret CBO's figures as claiming that there will be around \$2.5 trillion in discretionary and automatic fiscal policy stimulus over the five years. Yet it is still possible that, given a good economic recovery, there will be little or no decline from potential over the entire cycle (of course, the estimate of the stimulus would also change). On

the other hand, if another slowdown occurs or if the possible slowdown in the fourth quarter of 2002 GDP extends to 2003, then revenues will fall even further, and the size of the five-year economic stimulus will be well in excess of the \$2.5 billion, even in absence of any new tax bill.

Given all this money floating around, it is hard to argue that the nation needs additional stimulus — at least if by stimulus one means more fiscal deficits to put cash in the economy. One might argue that there are useful changes in structural tax or expenditure policy that would increase the nation's output and efficiency. That is a different debate and, really, the one that we ought to be having. As long as politicians need to prove they are stimulating the economy and putting money into it, however, the debate will remain confused as to whether this structural reform is a stimulus or not, and financing the change by deficit spending will be hard to resist.