Killing Two Birds with One Stone

HARDER THAN YOU THINK

Ron Haskins

The bipartisan stimulus package enacted in February 2008 was, like most stimulus packages, a straightforward application of Keynesian fiscal policy: Spend your way out of recession. To the extent that recessions involve declines in consumption, convincing people to spend more money might prevent a recession or make a recession shorter and shallower than it might otherwise have been. Given that consumer spending comprises 70 percent of the nation's GDP, stimulating consumer spending as an antidote to recession has face validity.

Thus, policymakers have long responded to evidence of an approaching recession by increasing government spending in ways designed to increase consumer spending. In fact, programs like unemployment insurance, food stamps, cash welfare, and a number of others are said to be automatically countercyclical because as a recession sets in people lose jobs and qualify for unemployment insurance and welfare. As a result, they have more money than they would have had without the government benefits and they are—given their financial condition—likely to spend it, thereby achieving the desired end of increasing economic activity.

On those unfortunate occasions when Congress is looking for ways to spend additional money to stimulate the economy and avoid recession, advocates concerned with the rise of inequality in America over the past two or three decades might wonder whether it would be possible to design a stimulus package that would also have the long-term effect of reducing inequality or—the other side of the same coin—increasing economic mobility. Personally, I'm skeptical about whether a stimulus package, even the stimulus package passed on a bipartisan basis in February, will achieve its major goal of getting the economy back on track, let alone killing two birds with one stone by simultaneously having an impact on inequality. Sending a $150 billion stimulus package out to boost a $14 trillion economy strikes me as tantamount to sending a tugboat into a hurricane to rescue an ocean liner. Even so, let's ignore whether a stimulus package might actually stimulate something other than the federal deficit, and reflect on how stimulus packages differ from reforms designed to reduce inequality and promote mobility.

According to Doug Elmendorf and Jason Furman of the Brookings Institution, there is substantial agreement among economists that a good stimulus plan must be timely, targeted, and temporary. Timeliness is difficult to gauge. Policymakers want to boost the economy just as it is about to nosedive by boosting spending and consumption. But if we think we're entering a recession and we're not, stimulating the economy is inflationary. So the emergency spending both adds to the deficit and boosts inflation. But if policymakers wait too long, the spending package could come after the recession is already well under way or nearing its end. In either case, policymakers' attempt to help the economy could increase both inflation and the deficit without producing much good.

Even if the timing is right, and Congress acts in timely fashion as it did earlier this year, the money must arrive quickly in the hands of people who will spend it. As Elmendorf and Furman put it, the targeting must be right. If the money—$1,200 for couples and $600 for individuals in the current case—is sent to middle class households, as more than half of it was under the current plan, the households may save a substantial fraction of the money or use it to pay off debt, thereby defeating the purpose of the stimulus. Similarly, the provision in the package allowing rapid expensing of equipment and thereby increasing the cash available to businesses does not come with a guarantee that businesses will spend the funds on new equipment or new hires. In large part, the economy is in the doldrums because of excessive borrowing for lousy investments, so there may be reason to question whether individuals or businesses will suddenly make sound investments—especially given that good investments are relatively difficult to find during a recession. Still, it must be granted, if many of the credit-constrained businesses use their savings to hire or make productive investments in equipment, there will be some economic boost.

Finally, a good stimulus package must be temporary. Historically, the American economy has been the most innovative and productive in the world, characteristics that most economists believe result in part from low taxes and decisions by risk-taking individuals and corporations who operate without major government interference. If a stimulus package gets the economy back on track, it is important to quickly restore the level of government spending and government interference in the economy to the status quo ante. In fact, under Keynesian theory, after the economy recovers the government should tax more than it spends to maintain fiscal balance. In any case, by sending out one-time checks, making income from the stimulus checks that is spent within two months tax free, and allowing one-time expensing of equipment, most of the spending in the stimulus package meets the criterion of being temporary.

Tallying the score of the stimulus package on the three criteria of timely, targeted, and temporary, the package earns high marks—with the possible exception of being well targeted. The payments do have the effect of helping some families struggling with unemployment, but better-off families are less likely to spend their money. Certainly they are less likely to spend it than other groups that might have been targeted—such as unemployed workers, poor and low-income workers, and welfare recipients.

As a number of critics have observed, it is curious that Congress and the president did not spend more of the stimulus package money on the unemployed or on the poor and near-poor by sending money to households receiving food stamps or the earned income tax credit (EITC). There is good evidence that unemployed workers would spend most of any such money.

Studies show that the consumption of households drawing unemployment insurance falls by only about a third of the dip in consumption experienced by similar households that do not receive unemployment payments. Especially if the money were given as a one-time bonus to all recipients of unemployment benefits, it seems likely that most of the money would be spent quickly. This type of targeting would not only stimulate the economy, which is the prime goal of any stimulus package, but is additionally attractive because it gives money to people who need it to achieve at least some relief from the problems caused by the very recession policymakers are trying to fight.

As with unemployment insurance, providing a one-time payment to food stamp and EITC households would result in poor and low-income families receiving additional money. These households are likely to be even worse off on average than households receiving unemployment insurance and therefore all the more likely to spend most or all of the money as soon as they get it. Yet Congress and the president are sending checks worth $120 billion or so to around 130 million Americans, many of them richer and in less need of cash than the households drawing unemployment insurance, food stamps, or EITC payments. These wealthier households need the money less and will almost surely be less likely to spend it quickly.

We ought not, however, exaggerate the inequality-reducing effect of such targeting. After all, using the stimulus to boost payments to the unemployed or to EITC and food stamp recipients would not address long-term inequality; it is temporary relief of hardship—worthy policy in its own right, but not necessarily a useful step in reducing long-term inequality. Now, as compared with the three criteria of a good stimulus package, consider the major characteristic of a good program to promote mobility and reduce inequality in a more enduring way. The foremost criterion for a program to promote economic mobility is investment in human capital. The American economy, and the economies of most modern nations, feature many jobs that pay well and provide good benefits, such as health insurance and retirement savings. However, these same economies, especially the American economy, also generate jobs that pay poor wages with few or no benefits. Oversimplifying somewhat, the good jobs require post-secondary education or long-term, structured training and work experience; the low-wage jobs require a high school education or less. In the last three decades the returns to post-secondary education have increased, while the economic situation of school dropouts and high school graduates have stagnated or declined. It follows that if a greater share of Americans were to attend post-secondary institutions, more young people would qualify for decent jobs, and economic mobility would rise while inequality falls. There will always be workers at and near the bottom of the wage distribution, but if they have greater skills they can command higher wages. More skilled workers at the bottom, in other words, would boost the entire bottom of the wage distribution.

It is not necessary to attend a four-year college to realize a sizeable boost in skills and earnings. Harry Holzer and Robert Lerman of the Urban Institute in Washington, D.C., have recently called attention to what they label "middle-skill jobs" that include clerical, sales, construction, installation/repair, production, and transportation/material moving positions. About half the jobs in the American economy fall into this middle-skill category. Equally important, the Bureau of Labor Statistics projects that about 45 percent of all job openings over the next decade will be in these middle-skill categories. Overall, occupations requiring a postsecondary vocational award or an associate degree are projected to grow by over 20 percent in the next 10 years, and many of these middle-skill jobs fall into this category. Furthermore, wages for many of these middle-skill occupations, such as registered nurses, speech and respiratory therapists, radiological technicians, and electricians, have improved over the past decade and can be expected to continue improving in the years ahead.

Government has done a great deal to enhance the economic well-being of those at the bottom of the income scale. Workers who take jobs at wages of around $8 per hour would earn perhaps $12,000 per year if they average 30 hours a week for 50 weeks. But these families do not live by earnings alone. A single mother with two children earning that $12,000 would be eligible for about $1,500 in food stamps and a payment of nearly $4,500 from the EITC. Although wages at the bottom of the distribution have stagnated for three decades, government policy has not. Workers at the bottom are better off as a result, but most of them remain in low-wage jobs and do not advance to better jobs. The stagnation of this group of Americans and their wages is the principle reason the nation has only modest economic mobility compared with many other nations with modern economies. Government subsidies for low-wage workers can improve their economic circumstances and help them avoid poverty, but subsidies do little to increase economic mobility. Similarly, if an economic stimulus package gives more money to this group, they will in all likelihood spend it quickly, but their economic mobility will not increase. Directing money from a stimulus package to families at the bottom (or headed in that direction), as Congress could have done in the 2008 stimulus package by expanding payments to families receiving unemployment insurance, food stamps, or the EITC, would provide them with a temporary boost that would only slightly reduce income inequality. Even so, as soon as the temporary program ends, so would the already slight reduction in economic inequality.

The two key differences between a good economic stimulus policy and a good mobility policy are timeliness and permanency. Stimulating the economy requires an immediate spending boost that ends quickly; increasing economic mobility requires investments in human capital that must be more or less permanent features of public policy and that require at least two years to mature. There is no short-term fix to increase economic mobility. The nation needs a long-term strategy to increase economic mobility—a strategy that focuses primarily on investing in human capital. Policy that boosts human capital cannot and should not be enacted or implemented on the fly.

Ron Haskins is the co-director of the Brookings Center on Children and Families at the Brookings Institution.