Order Code RL34349

CRS Report for Congress

Economic Stimulus Proposals for 2008: An Analysis

February 1, 2008

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Congressional
Research
Service

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Summary

In response to fears of an economic downturn, legislators and the President have proposed economic stimulus packages. After negotiations with the Administration, the Recovery Rebates and Economic Stimulus for the American People Act of 2008 (H.R. 5140) was introduced and passed by the House on January 29. On January 30, the Senate Committee on Finance reported the Economic Stimulus Act of 2008, which contains provisions not included in the House bill, as well as elements that are similar. The Senate committee bill is set for consideration on the Senate floor.

The estimated budget cost of the House bill is $145.9 billion for FY2008 and $14.8 billion for FY2009, and $117.2 billion over 10 years. The Senate Finance Committee bill's estimated budget cost is $158.1 billion for FY2008 — about 8% higher than H.R. 5140 — and $155.7 billion over 10 years. The largest provisions in both bills (in terms of budgetary cost) are a tax rebate for individuals and business tax provisions. Both bills contain these provisions, but differ in their details. In the House bill, the rebate would equal up to $600 for single and $1,200 for married households that are eligible. In the Senate committee bill, it would equal up to $500 for single and $1,000 for married households, but more households would be eligible (including more retirees). The business tax provisions include bonus depreciation and expensing for small businesses. The Senate committee bill also includes an extension in unemployment compensation benefits up to 26 weeks and expiring energy tax provisions, while the House bill includes an increase in the conforming loan limit for mortgages from $417,000 up to $729,750 in high-cost areas.

The need for fiscal stimulus depends, by definition, on the state of the economy. While the economy is not officially in a recession at present, there are signs that economic activity may be slowing. Some economists are predicting a recession in the near term based on the downturn in the housing market, its spillover into financial markets, and the rise in energy prices. In the absence of fiscal stimulus, some economists believe that the Fed's recent decision to significantly reduce interest rates and natural market adjustment would be enough to avoid recession.

Fiscal policy generally stimulates the economy through an increase in the budget deficit. In the case of deficit-financed spending increases, the increase in total spending is direct. In the case of deficit-financed tax cuts, the economy is stimulated via the increase in spending by the tax cuts' recipients. Any increase in spending as a result of fiscal stimulus is strictly temporary — in the long run, the economy naturally adjusts to set spending equal to output. Economists have debated which policy proposals would be most stimulative. There is a consensus that proposals that result in more spending, can be implemented quickly, and leave no long-term effect on the budget deficit would increase the benefits and reduce the costs of fiscal stimulus. That being said, there is little consensus on which policy proposals best meet these criteria. Economists generally agree that spending proposals are somewhat more stimulative than tax cuts since part of a tax cut will be saved by the recipient. The most important determinant of stimulative fiscal policy's effect on the economy is its size. Both bills would increase the deficit by about 1% of GDP.

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Economic Stimulus Proposals for 2008: An Analysis

Recent economic indicators suggest that economic growth is slowing and the economy may be headed for — or already in — a recession. In response to weaker economic growth, legislators and the Administration have proposed economic stimulus packages. After negotiations with the Administration, the Recovery Rebates and Economic Stimulus for the American People Act of 2008 (H.R. 5140) was introduced by Speaker Pelosi and passed by the House on January 29. On January 30, the Senate Committee on Finance reported the Economic Stimulus Act of 2008, which contains provisions not included in the House bill. The Senate committee bill is set for consideration on the Senate floor. The two stimulus packages differ somewhat, and this report briefly describes those differences. In addition, the state of the economy, the need for a stimulus package, and the macroeconomic effects of the proposals are discussed.

The Current State of the Economy[1]

The need for fiscal stimulus depends, by definition, on the state of the economy. The U.S. economy is not officially in a recession at present, according to the National Bureau of Economic Research (NBER), the official arbiter of the business cycle. It defines a recession as a "significant decline in economic activity spread across the economy, lasting more than a few months" based on a number of economic indicators, with an emphasis on trends in employment and income.[2] According to the latest available data, neither employment nor income is currently experiencing a lasting or significant decline.[3] But because a recession is defined as a lasting decline, the NBER typically does not declare a recession until it is well under way. For example, the recession that began in March 2001 was not declared by the NBER until

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[1] This section was prepared by Marc Labonte, Government and Finance Division.

[2] National Bureau of Economic Research, *The NBER's Recession Dating Procedure*, January 7, 2008.

[3] There are two major official employment series kept by the Bureau of Labor Statistics, the Current Employment Series (known as the "payroll" series) and the Current Population Series (known as the "household" series). The NBER, and most other economists, favor the payroll series because it has a larger and more robust sample. According to the payroll series, employment fell in January 2008 but increased, albeit slowly, each month in 2007. At times the series diverge, however. In October and December 2007, the household series diverged from the payroll series and measured a slight decline in employment. The unemployment rate is calculated from the household series, and has risen in the second half of 2007. If this trend were to continue, it would be consistent with a recession.

November 2001, the same month in which the NBER later declared the recession to have ended.

Nor are professional economic forecasters convinced that the economy is heading toward a recession. According to the firm *Blue Chip*, 50 professional forecasters predict, on average, a 38% chance of a recession in 2008.[4] There are signs that, if they were to persist, suggest the economy is slowing. After two strong quarters, economic growth fell to 0.6% in the fourth quarter of 2007, but remained positive. (Although negative growth is not an official prerequisite for a recession, all historical recessions have featured it.) Nevertheless, some economists fear that the likelihood of a recession is high because of recent developments.

After a long and unprecedented housing boom, the median house price of existing homes fell by 1.8% in 2007 — possibly the first year of falling prices since the Great Depression, according to the organization which compiles the data.[5] And the decline appears to be worsening over time: prices fell 6.5% in December 2007 compared to the previous December. Other housing data fell even further — existing home sales fell by 22% in the twelve months since December 2007, and residential investment (house building) fell by 18% in the four quarters ending in the fourth quarter of 2007. The decline in residential investment has acted as a drag on overall GDP growth, while the other components of GDP have grown at more healthy rates. Many economists argued that the housing boom was not fully caused by improvements in economic fundamentals (such as rising incomes and lower mortgage rates), and instead represented a housing *bubble* — a situation where prices were being pushed up by "irrational exuberance."[6]

Most economists believe that a housing downturn alone would not be enough to singlehandedly cause a recession.[7] But in August 2007, the housing downturn spilled over to widespread financial turmoil.[8] Triggered by a dramatic decline in the price of subprime mortgage-backed securities and collateralized debt obligations, large losses and a decline in liquidity spread throughout the financial system. The Federal Reserve was forced to create unusually large amounts of liquidity to keep short-term interest rates from rising in August, and has since reduced interest rates significantly. To date, financial markets remain volatile and new losses continue to be announced at major financial institutions. A reduction in lending by financial institutions in response to uncertainty or financial losses is another channel through which the economy could enter a recession.

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[4] Blue Chip, *Economic Indicators*, vol. 33, no. 1, January 10, 2008.

[5] Michael Grynbaum, "Home Prices Sank in 2007, and Buyers Hid," *New York Times*, January 25, 2008. Prices are compiled by the National Association of Realtors.

[6] For more information, see CRS Report RL34244, *Would a Housing Crash Cause a Recession?*, by Marc Labonte.

[7] See, for example, Frederic Mishkin, "Housing and the Monetary Transmission Mechanism," working paper presented at the Federal Reserve Bank of Kansas City symposium, August 2007.

[8] See CRS Report RL34182, *Financial Crisis? The Liquidity Crunch of August 2007*, by Darryl Getter et al.

At the same time as the economy and financial sector has been grappling with the housing downturn, energy prices have risen significantly, from $48 per barrel in January 2007 to $88 per barrel in the first three weeks of January 2008. Most recessions since World War II, including the most recent, have been preceded by an increase in energy prices.[9] Energy prices have gone up almost continuously in the current expansion, however, without causing a recession so far, which may point to the relative decline in importance of energy consumption to production. While a housing downturn or an energy shock might not be enough to cause a recession in isolation, the combination could be sufficient.

Is Fiscal Stimulus Needed?

The economy naturally experiences a boom and bust pattern that is called the business cycle. A recession can be characterized as a situation where total spending in the economy (*aggregate demand*) is too low to match the economy's potential output (*aggregate supply*). As a result, some of the economy's labor and capital resources lay idle, causing unemployment and a low capacity utilization rate, respectively. Recessions are short-term in nature — eventually, markets adjust and bring spending and output back in line, even in the absence of policy intervention.[10]

Policymakers may prefer to use stimulative policy to attempt to hasten that adjustment process, in order to avoid the detrimental effects of cyclical unemployment. By definition, a stimulus proposal can be judged by its effectiveness at boosting total spending in the economy. Total spending includes personal consumption, business investment in plant and equipment, residential investment, net exports (exports less imports), and government spending. Effective stimulus could boost spending in any of these categories.

Fiscal stimulus can take the form of higher government spending (direct spending or transfer payments) or tax reductions, but generally it can boost spending only through a larger budget deficit. A deficit-financed increase in government spending directly boosts spending by borrowing to finance higher government spending or transfer payments to households. A deficit-financed tax cut indirectly boosts spending if the recipient uses the tax cut to increase his spending. If an increase in spending or a tax cut is financed through a decrease in other spending or increase in other taxes, the economy would not be stimulated since the deficit-increasing and deficit-decreasing provisions would cancel each other out.

Since total spending can be boosted only temporarily, stimulus has no long-term benefits, and may have long-term costs. Most notably, the increase in the budget deficit "crowds out" private investment spending because both must be financed out of the same finite pool of national saving, with the greater demand for saving pushing

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[9] For more information, see CRS Report RL31608, *The Effects of Oil Shocks on the Economy*, by Marc Labonte.

[10] For more information, see CRS Report RL34072, *Economic Growth and the Business Cycle*, by Marc Labonte.

up interest rates.[11] To the extent that private investment is crowded out by a larger deficit, it would reduce the future size of the economy since the economy would operate with a smaller capital stock in the long run. In recent years, the U.S. economy has become highly dependent on foreign capital to finance business investment and budget deficits.[12] Since foreign capital can come to the United States only in the form of a trade deficit, a higher budget deficit could result in a higher trade deficit, in which case the higher trade deficit could dissipated the boost in spending. Indeed, conventional economic theory predicts that fiscal policy has no stimulative effect in an economy with perfectly mobile capital flows.[13] Some economists argue that these costs outweigh the benefits of fiscal stimulus.

The most important determinant of a stimulus' macroeconomic effect is its size. Both the House and Senate committee stimulus packages would increase the budget deficit by about 1% of gross domestic product (GDP). In a healthy year, GDP grows about 3%. In the moderate recessions that the U.S. experienced in 1990-1991 and 2001, GDP contracted in some quarters by 0.5% to 3%. (The U.S. economy has not experienced contraction in a full calendar year since 1991.) Thus, a swing from expansion to recession would result in a change in GDP growth equal to at least 3.5 percentage points. A stimulus package of 1% of GDP could be expected to increase total spending by about 1%.[14] To the extent that spending begets new spending, there could be a multiplier effect that makes the total increase in spending larger than the increase in the deficit. Offsetting the multiplier effect, the increase in spending could be neutralized if it results in crowding out of investment spending, a larger trade deficit, or higher inflation. The extent to which the increase in spending would be offset by these three factors depends on how quickly the economy is growing at the time of the stimulus — an increase in the budget deficit would lead to less of an increase in spending if the economy were growing faster.

Since the economy is not currently in a recession to the best of our knowledge, it is uncertain whether stimulus is needed. Economic forecasts are notoriously inaccurate due to the highly complex nature of the economy. If the economy enters a recession, then fiscal stimulus could mitigate the decline in GDP growth and bring idle labor and capital resources back into use. If the economy experiences solid growth, then a boost in spending could be largely inflationary — since there would be no idle resources to bring back into production when spending is boosted, the boost would instead bid up the prices of those resources, eventually causing all prices to rise.

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[11] Crowding out is likely to be less of a concern if the economy enters a recession since recessions are typically characterized by falling business investment.

[12] If foreign borrowing prevents crowding out, the future size of the economy will not decrease but capital income will accrue to foreigners instead of Americans.

[13] For more information, see CRS Report RS21409, *The Budget Deficit and the Trade Deficit: What Is Their Relationship?*, by Marc Labonte and Gail E. Makinen.

[14] See, for example, "Options for Responding to Short-term Economic Weakness," Testimony of CBO Director Peter Orszag before the Committee on Finance, January 22, 2008.

In judging the need for a stimulus package, policymakers might also consider that stimulus is already being delivered from two other sources. First, the federal budget has *automatic stabilizers* that cause the budget deficit to automatically increase (and thereby stimulate the economy) during a downturn in the absence of policy changes. When the economy slows, entitlement spending on programs such as unemployment compensation benefits automatically increases as program participation rates rise and the growth in tax revenues automatically declines as the recession causes the growth in taxable income to decline. The Congressional Budget Office projects that under current policy, which excludes a stimulus package, the budget deficit will increase by $56 billion in 2008 compared to 2007. If supplemental military spending to maintain current troop levels overseas and an alternative minimum tax patch are enacted, and expiring tax provisions are extended, CBO estimates the 2008 deficit could increase by $98 billion in total compared to 2007, in the absence of stimulus legislation.

Second, the Federal Reserve has already delivered a large monetary stimulus. As of the end of January 2008, the Fed had already reduced overnight interest rates to 3% from 5.25% in September. Lower interest rates stimulate the economy by increasing the demand for interest-sensitive spending, which includes investment spending, residential housing, and consumer durables. In addition, lower interest rates would stimulate the economy by reducing the value of the dollar, all else equal, which would lead to higher exports and lower imports.[15]

Presumably, the Federal Reserve has chosen a monetary policy that it believes will best avoid a recession in the absence of fiscal stimulus. If it has chosen that policy correctly, an argument can be made that fiscal stimulus is unnecessary since the economy is already receiving the correct boost in spending through lower interest rates. In this light, fiscal policy would be useful only if monetary policy is unable to adequately boost spending — either because the Fed has chosen an incorrect policy or because the Fed cannot boost spending enough through lower interest rates to avoid a recession.[16]

Stimulus Proposals

Both the House and Senate Finance Committee versions of an economic stimulus package are briefly described below. The House version is the Recovery Rebate and Economic Stimulus for the American People Act of 2008 (H.R. 5140). The estimated budget cost of H.R. 5140 is $145.9 billion for FY2008 and $14.8 billion for FY2009 (see **Table 1**). The 10-year cost is estimated to be $117.2 billion.

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[15] For more information, see CRS Report RL30354, *Monetary Policy and the Federal Reserve*, by Marc Labonte and Gail E. Makinen.

[16] Fed Chairman Ben Bernanke may have hinted at the latter case when he testified that "fiscal action could be helpful in principle, as fiscal and monetary stimulus together may provide broader support for the economy than monetary policy actions alone." Quoted in Ben Bernanke, "The Economic Outlook," testimony before the House Committee on the Budget, January 17, 2008.

Table 1. Estimated Budget Cost of H.R. 5140
(billions of dollars)

Provision	FY2008	FY2009	FY2008-2018
Rebates for Individuals	-101.1	-8.6	-109.7
Increase Sec. 179 Expensing and Phaseout Amounts for 2008	-0.9	-0.6	-0.1
50% Bonus Depreciation	-43.9	-5.6	-7.4
Total	**-145.9**	**-14.8**	**-117.2**

Source: Joint Committee on Taxation, JCX-6-08, Jan. 28, 2008.

The bill reported by the Senate Committee on Finance, the Economic Stimulus Act of 2008, includes additional provisions, such as energy provisions and extended unemployment insurance benefits, but excludes changes to the conforming loan limits for mortgages. There are some differences in the provisions that both bills share as well, which will be discussed below. Its estimated budget cost for FY2008 is $158.1 billion — about 8% higher than H.R. 5140 (see **Table 2**). The 10-year budget cost is estimated to be $155.7 billion.

Table 2. Estimated Budget Cost for the Economic Stimulus Act of 2008 as Reported by the Senate Committee on Finance
(billions of dollars)

Provision	FY2008	FY2009	FY2008-2018
Stimulus Rebate	-115.1	-11.2	-126.4
Business Stimulus Incentives	-32.3	-28.9	-11.9
Extensions of Energy Provisions	-0.7	-1.1	-5.7
Expansion of Qualified Mortgage Bonds	—	-0.1	-1.7
Extension of Unemployment Insurance	-10.1	-4.4	-9.9
Total	**-158.1**	**-45.7**	**-155.7**

Source: Joint Committee on Taxation, JCX-13-08, Jan. 30, 2008.

Tax Rebates[17]

The centerpiece of both the House bill (H.R. 5140) and the Senate committee proposal is the tax rebate for individuals. Unlike the 2001 rebate, both rebates have elements of refundability, although the Senate committee proposal's refundability is

[17] This section was prepared by Jane Gravelle, Government and Finance Division.

greater than in the House proposal. The House proposal, H.R. 5140, would provide $109.7 billion in rebates, while the Senate committee proposal would provide $126.3 billion.[18] The rebate is technically a credit for 2008, but payments would be mailed in 2008 based on 2007 returns. If taxpayers qualify for a higher credit based on their 2008 circumstances, they could claim the excess on their 2008 returns.

There are five elements of the rebate proposals that are outlined in Table 3. The first is the basic nature of the rebate. The House proposal effectively suspends part of the 10% income tax bracket, allowing a reduction in tax liability of 10% of the first $6,000 of taxable income for single individuals and 10% of the first $12,000 of taxable income for married couples. Absent any other provisions, the benefit would increase gradually until a maximum benefit was reached at $600 for single individuals and $1,200 for married couples. The Senate committee plan allows a flat rebate of $500 for single individuals and $1,000 for couples.

Table 3. Comparative Provisions of the Rebate

Provision	House Bill	Senate Committee Bill
General Rebate Proposal	10% of the first $6,000 of taxable income ($12,000 for couples), to extent of tax liability (maximum $600/$1,200)	Flat rebate of $500, $1,000 for couples
Refundability Provisions	$300 rebate ($600 for couples) available if earned income is at least $3,000	Full rebate allowed if earned income plus Social Security benefits are at least $3,000 or taxable income is at least $1.
High Income Phase-out Provisions	Phased out at 5% of income over $75,000 for single individuals, $150,000 for couples	Phased out at 5% of income over $150,000 for single individuals, $300,000 for couples.
Child Provisions	$300 per qualifying child if eligible for any other rebate	$300 per qualifying child if eligible for any other rebate
Other Features	None	Expands rebates to veterans receiving disability; disallows the rebate to illegal immigrants.

Source: CRS.

The second element is the basic refundability feature, which extends benefits to lower income households without tax liability. In the House bill, individuals without tax liability but with earnings of at least $3,000 can receive a minimum rebate of $300 for singles and $600 for married couples. (Households with earnings under $3,000 would not receive a rebate.) In the Senate committee proposal, the full flat amount can be received for households with at least $3,000 in combined earnings and Social Security benefits. This inclusion of Social Security benefits would extend the rebate to a large group of retired individuals who do not have taxable income.

[18] Joint Committee on Taxation, See JCX-6-08 and JCX-9-08,[http://www.house.gov/jct/].

The third element is the treatment of high income taxpayers. In both bills, the benefit is phased out at higher incomes; the phaseout points are higher in the Senate committee proposal.

The fourth element is the child rebate, which in both plans is set at $300 per child and allowed if a basic or refundable rebate is received.

The fifth element (present only in the Senate committee proposal) limits and expands the scope of the rebates by extending them to veterans on disability and denying them to illegal immigrants by requiring the taxpayer identification number to be a social security number.

Compared to the experience with a rebate in 2001, the proposed rebates are more favorable to lower income individuals because of their refundability provisions. For a non-refundable credit, about 37% of taxpayers would not receive a credit because of lower incomes; in the House bill, 20% would not receive a credit and in the Senate committee proposal, 6.5% would not.[19] The increase in coverage in the Senate committee proposal is due to coverage of the elderly. The House bill is more progressive (i.e., relatively more favorable to lower income households) than a non-refundable rebate, and the Senate committee bill is more progressive than the House bill (except at the top of the income distribution).

Although some rebates in the past appeared to be relatively ineffective in increasing spending, there is some evidence the 2001 rebate was spent.[20] In general, economic analysis suggests that benefits that go more heavily to low income individuals are likely to be more effective, per dollar of payment, than those with smaller benefits because lower income households are more likely to spend the rebate, and spending is necessary to produce a stimulus. The extension of rebates to those with Social Security payments could be quite complex administratively, since it would require filing and processing up to an additional 18 million tax returns.[21]

Business Tax Incentives[22]

The House bill includes two business provisions. The first is bonus depreciation, allowing 50% of investment with a life of less than 20 years (which applies mostly to equipment) to be deducted when purchased. The second addresses a provision that allows small businesses to deduct all equipment investment when purchased, by increasing the ceiling on eligible equipment and phasing out the benefit more slowly. The Senate committee proposal has these same provisions,

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[19] See CRS Report RL34341, *Tax Rebate Refundability: Issues and Effects*, by Jane G. Gravelle.

[20] See CRS Report RS22970, *Tax Cuts for Short Run Economic Stimulus: Recent Experiences*, by Jane G. Gravelle.

[21] According to the Tax Policy Center, 18 million households over the age of 65 would receive no rebate under the House bill. See Tax Policy Center, Table T08-0030, at [http://www.taxpolicycenter.org/numbers/displayatab.cfm?Docid=1742&DocTypeID=4].

[22] This section was prepared by Jane Gravelle, Government and Finance Division.

although it modifies bonus depreciation by allowing a deduction over two years instead of one. It also adds a provision that would allow companies to increase the period of time in the past that they can use to offset current net operating losses (NOLs) against past positive taxable income from two years to five, for losses generated in 2006 or 2007. The Senate committee proposal would allow businesses to use only one of the three provisions. The Senate committee proposal also includes the extension of some energy provisions that largely relate to businesses. These provisions are compared in **Table 4**.

Table 4. Business Tax Provisions of the House and Senate Committee Plans

	House Bill (H.R. 5140)	Senate Committee Bill
Bonus Depreciation	For 2008, allows 50% of eligible investment (generally equipment) to be deducted when incurred	For 2008, elect to allow 50% of investment to be deducted equally over the first two years
Small Business Expensing	For 2008, increases the amount of eligible investment (generally equipment) expensing from $128,000 to $250,000; begin phaseout at $800,000 instead of $510,000.	For 2008, elect to increase the amount of eligible investment (generally equipment) expensing from $128,000 to $250,000; begin phaseout out at $800,000 instead of $510,000.
Net Operating Loss (NOL) Carryback	None	Elect to increase NOL carryback from two years to five years for losses generated from 2006 to 2008; and suspends provision that NOL cannot exceed 90% of alternative minimum taxable income.
Other Features	None	Taxpayer may elect only one of the three business benefits above; extends through 2009 of expired or expiring energy incentives; expands tax exempt mortgage and rental housing bonds.

Source: CRS.

The bonus depreciation provisions are the most costly of the business provisions, amounting to $43.9 billion in FY2008 and $5.4 billion in FY2009 for the House bill and $16.4 billion in FY2008 and $20.2 billion in FY2009 for the Senate committee proposal. (Apparently the election provision significantly reduces the cost of bonus depreciation in the first two years.) As with all of the provisions, which largely involve timing, revenue is gained in future years as regular depreciation deductions fall. Over 10 years, the cost is $7.4 billion in the House bill and $6.7 billion in the Senate committee proposal.[23]

[23] Revenue estimates are from the Joint Committee on Taxation, See JCX-6-08 and JCX-9-08,[http://www.house.gov/jct/]

The small business expensing provision, in both plans, costs $0.9 billion in FY2008 and $0.6 billion in FY2009, with the 10-year cost $0.1 billion. The net operating loss (NOL) provision in the Senate committee proposal loses $15.4 billion in FY2008, and $8.1 billion in FY2009, and then gains revenue, with the ten-year cost $5.1 billion.

Because these benefits arise from timing, neither the initial cost nor the 10-year cost provide a good reflection of the value to the firm. For the benefit of bonus depreciation to the firm, the discounted values (using an 8% nominal interest rate) would be about $18 billion for the House bill and about $14 billion for the Senate committee proposal.

Overall, it is unlikely that these provisions would provide significant short-term stimulus. Investment incentives are attractive, if they work, because increasing investment does not trade off short term stimulus benefits for a reduction in capital formation, as do provisions stimulating consumption. Nevertheless, most evidence does not suggest these provisions work very well to induce short-term spending.[24] This lack of effectiveness may occur because of planning lags or because stimulus is generally provided during economic slowdowns when excess capacity may already exist.

Of business tax provisions, investment subsidies are more effective than rate cuts, but there is little evidence to support much stimulus effect. Temporary bonus depreciation is likely to be most effective in stimulating investment, more effective than a much costlier permanent investment incentive because it encourages the speed-up of investment. Although there is some dispute, most evidence on bonus depreciation enacted in 2002 nevertheless suggests that it had little effect in stimulating investment and that even if the effects were pronounced, the benefit was too small to have an appreciable effect on the economy.

The likelihood of the remaining provisions having much of an incentive effect is even smaller. Firms may, for example, benefit from the small business expensing, but it actually discourages investment in the (expanded) phase out range. The NOL provision, since it largely relates to events that have occurred in the past and therefore the effect is only a cash flow effect, is unlikely to have much incentive effect.

The energy provisions provide an extension through 2009 of provisions that expired at the end of 2007 or will expire at the end of 2008.[25] Their overall cost is

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[24] See CRS Report RL31134, *Using Business Tax Cuts to Stimulate the Economy*, and CRS Report RS22970, *Tax Cuts for Short Run Economic Stimulus: Recent Experiences*, by Jane G. Gravelle.

[25] The provisions include the credit for energy efficient appliances, the credit for certain non-business energy property, the suspension of the net income limit for marginal oil and gas properties, the 30% credit for residential investments in solar and fuel cells, the placed-in-service date for the tax credit for electricity produced from renewable resources, the credit for construction of energy efficient homes, the section 48 business credit, clean

(continued...)

$5.7 billion and they are unlikely to have a stimulative effect of importance, not only because of their size and because investment incentives are unlikely to be effective, but also because market participants may already be acting under the expectation that they will be extended in any case. Finally the Senate committee proposal provides an extension of tax exempt bonds for housing, that costs $1.7 billion and, similarly, would be unlikely to provide a significant short-term stimulus.

Housing Provisions[26]

The House bill would allow the housing government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, to purchase qualifying mortgages originated between July 1, 2007, and December 31, 2008, up to a value of $729,750 in high cost areas. This would be an increase above the current conforming loan limit of $417,000. The limit for any area would be the greater of (1) the 2008 conforming loan limit ($417,000) or (2) 125% of the area median house price, and no higher than (3) 175% of the 2008 conforming loan limit ($729,750, which is 175% of $417,000).

It would grant the Federal Housing Administration (FHA) temporary authority to insure mortgages in high cost areas up to this $729,750 limit. The authority would expire December 31, 2008. Currently the FHA limit ranges from $200,160 to $362,790 in high-cost areas.[27]

The Secretary of the Department of Housing and Urban Development (HUD) would be required to publish the increased GSE and FHA limits. None of these provisions were included in the bill reported by the Senate Finance Committee.

Many of those supporting the increases believe they would provide a needed stimulus to housing and mortgage markets.[28]

The immediate impact of the changes affecting Fannie Mae and Freddie Mac, however, is unclear. The Office of Federal Housing Enterprise Oversight (OFHEO), an independent office within HUD, which oversees the safety and soundness of the GSEs, has announced that it is "disappointed" that increasing the limit was not part of general regulatory reform, and that the GSEs should subject the higher priced mortgages to rigorous new product development, risk management, and capital reserves.[29] This suggests that HUD might require the GSEs to submit their plan to

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[25] (...continued)
renewable energy bonds, and the energy efficient commercial property deduction.

[26] This section was prepared by Eric Weiss, Government and Finance Division.

[27] FHA limits are available from HUD's website at [https://entp.hud.gov/idapp/html/hicost1.cfm].

[28] James R. Haggerty and Damian Paletta, "Details Lacking on Mortgage-Relief Plan," *Wall Street Journal*, January 26, 2008, p. A6.

[29] James Lockhart, *Statement of OFHEO Director James B. Lockhart on Conforming Loan Limit Increase*, January 24, 2008, available at [http://www.ofheo.gov/NewsRoom_Print.aspx?ID=410].

purchase the larger mortgages for regulatory review.[30] Unlike the GSEs, FHA (part of HUD) is not under independent regulatory authority.

Given these delays and the limited lives of the programs, it is not clear how much use the GSEs or FHA would make of their temporary authority. As stockholder-owned companies, the GSEs would balance their fiduciary responsibility to earn profits with the requirements in their Congressional charters to assist housing markets. FHA would probably consider the risk to the financial soundness of their insurance fund against temporary assistance to parts of the housing market.

Other factors tending to limit the impact of the increased mortgage limits are as follows:

- Existing loan-to-value limits would continue to apply. This would prevent homeowners who owe more on a house than its appraised value from participating in the program.

- Existing credit worthiness and debt-to-income requirements would apply. This would prevent anyone not current on their mortgage from refinancing.

- The GSEs currently are close to the maximum retained portfolios that they can have without raising additional capital. The GSEs could, however, follow the suggestion in H.R. 5140 to package these mortgages, add their guarantees, and sell mortgage-backed securities (MBS) to large investors.

These housing-related provisions of H.R. 5140 would narrow or eliminate the spread between loans above today's loan limit (but under proposed limits) and conforming loans already eligible for purchase. Recently, this spread has been in the range of 0.90% to 1.10%, as compared to a "normal" spread of approximately 0.20%. The provisions, and subsequent reduction in the spread, would

- Help homebuyers with good credit obtain lower interest rates on loans above the current loan limits and below the temporarily higher ones. The monthly payments on a 30-year fixed-rate $600,000 mortgage could fall from $3,824 to $3,377, saving $447 per month.[31] FHA's guidelines state that mortgage payments, insurance, and taxes should not exceed 29% of monthly income. According to the guidelines, a combined monthly housing expense of $3,377 would require a minimum annual household income of $140,000;

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[30] The Secretary of the Department of Housing and Urban Development has new program approval authority. See 12 U.S.C. 4542.

[31] Interest rates are based on mortgage rates reported by Bankrate.Com at [http://www.bankrate.com/brm/graphs/graph_trend.asp?tf=91&ct=Line&prods=1,325&gs=275,250&st=zz&c3d=False&web=brm&cc=1&prodtype=M&bgcolor=&topgap=&bottomgap=&rightgap=&leftgap=&seriescolor=].

- Primarily help home buyers in areas with high home prices such as California, New York City and its suburbs, the Boston area, the Seattle area, and the Washington, D.C. area. Most other parts of the nation have home prices that would not cause their ceiling to increase;

- The provision raising the limit on home prices to 125% of the area median house price would raise the loan ceiling in areas with a median house price of more than $336,000. For example, in Barnstable, MA the median existing home price in the third quarter of 2007 was $400,600. A mortgage there presently is capped at $417,000, but would increase to $500,750 (125% of $400,600 is $500,750);

- Likely have little impact in areas and houses where the current conforming loan limit would still apply;

- Not count mortgages purchased by the GSEs as a result of the higher loan limit for the purpose of low- and moderate-income housing goals and underserved areas goals. HUD establishes numeric goals based on the Housing and Community Development Act of 1992;[32] and

- Help FHA compete against private sector lenders and possibly open homeownership to borrowers who, for one reason or another, could not qualify for a conforming mortgage to purchase a more expensive home.[33]

Extending Unemployment Benefits[34]

Originally, the intent of the Unemployment Compensation (UC) program was, among other things, to help counter economic fluctuations such as recessions.[35] This intent is reflected in the current UC program's funding and benefit structure. UC is financed by federal payroll taxes under the Federal Unemployment Tax Act (FUTA) and by state payroll taxes under the State Unemployment Tax Acts (SUTA). When the economy grows, UC program revenue rises through increased tax revenues, while UC program spending falls as fewer workers are unemployed. The effect of collecting more taxes than are spent is to dampen demand in the economy. This also creates a surplus of funds or a "cushion" of available funds for the UC program to

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[32] 12 U.S.C. 4562-4564 and 4566.

[33] For more information on FHA, see CRS Report RS22662, *H.R. 1852 and Revisiting the FHA Premium Pricing Structure: Proposed Legislation in the 110th Congress*, by Darryl E. Getter and CRS Report RS20530, *FHA Loan Insurance Program: An Overview,* by Bruce E. Foote and Meredith Peterson.

[34] This section was prepared by Julie M. Whittaker, Domestic Social Policy Division.

[35] See, for example, President Franklin Roosevelt's remarks at the signing of the Social Security Act [http://www.ssa.gov/history/fdrstmts.html#signing].

draw upon during a recession. In a recession, UC tax revenue falls and UC program spending rises as more workers lose their jobs and receive UC benefits. The increased amount of UC payments to unemployed workers dampens the economic effect of earnings losses by injecting additional funds into the economy.[36]

The limited duration of UC benefits (generally no more than 26 weeks) results in some unemployed individuals exhausting their UC benefits before finding work or voluntarily leaving the labor force for other activities such as retirement, disability, family care, or education. The Extended Benefit (EB) program, established by P.L. 91-373 (26 U.S.C. 3304, note), may extend UC benefits at the state level if certain economic situations exist within the state. Although the EB program is not currently active in any state, it — like the UC program — is permanently authorized. The EB program is triggered when a state's insured unemployment rate (IUR)[37] or total unemployment rate (TUR)[38] reaches certain levels. States must pay up to 13 weeks of EB if the IUR for the previous 13 weeks is at least 5% and is 120% of the average of the rates for the same 13-week period in each of the 2 previous years. There are two other optional thresholds that states may choose. (They may choose one, two, or none.) If the state has chosen the option, it would provide the following:

- Option 1: an additional 13 weeks of benefits if the state's IUR is at least 6%, regardless of previous years' averages.
- Option 2: an additional 13 weeks of benefits if the state's TUR is at least 6.5% and is at least 110% of the state's average TUR for the same 13-weeks in either of the previous two years; an additional 20 weeks of benefits if the TUR is at least 8%.

During some economic recessions, Congress has created federal temporary programs of extended unemployment compensation. Congress acted seven times — in 1958, 1961, 1971, 1974, 1982, 1991, and 2002 — to establish these temporary programs of extended UC benefits. These programs extended the time an individual might claim UC benefits (ranging from an additional 6 to 33 weeks) and had expiration dates. Some extensions took into account state economic conditions; many temporary programs considered the state's TUR and/or the state's insured unemployment rate (IUR).

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[36] For a detailed examination of how the federal government has extended UC benefits during recessions see CRS Report RL34340, *Extending Unemployment Compensation Benefits During Recessions*, by Julie M. Whittaker.

[37] The IUR is substantially different than the TUR because it excludes several important groups: self-employed workers, unpaid family workers, workers in certain not-for-profit organizations, and several other, primarily seasonal, categories of workers. In addition to those unemployed workers whose last jobs were in the excluded employment category, the insured unemployed rate excludes the following: those who have exhausted their UC benefits; new entrants or reentrants to the labor force; disqualified workers whose unemployment is considered to have resulted from their own actions rather than from economic conditions; and, eligible unemployed persons who do not file for benefits.

[38] The TUR is essentially a weekly version of the unemployment rate published by the Bureau of Labor Statistics. That is, the ratio of the total number of unemployed persons divided by the total number of employed and unemployed persons.

Recently, congressional and popular debate has examined the relative efficacy of the expansion of UC benefits and duration compared to other potential economic stimuli. In his January 22, 2008 congressional testimony, the Director of the Congressional Budget Office (CBO) stated that increasing the value or duration of UC benefits may be one of the more effective economic stimulus plans.[39] This is because many of the unemployed are severely cash constrained and would be expected to rapidly spend any increase in benefits that they may receive.[40]

Others point out that increasing either the value or length of UC benefits may, however, discourage recipients from searching for work or from accepting less desirable jobs.[41] A rationale for making an extension in UC benefits only temporary is to mitigate disincentives to work, since the extension would expire once the economy improves and cyclical unemployment declines.

A vigorous debate on how to determine when the federal government should extend unemployment benefits has been active for decades. Generally, this debate has examined the efficacy of using the IUR or TUR as triggers for extending benefits. The debate also has examined whether the intervention should be at a national or state level. Recently, serious consideration of alternative labor market measures has become increasingly common. In particular, the increase in the number of unemployed from the previous year has emerged in several proposals as a new trigger for a nation-wide extension in unemployment benefits.

Senate Committee Proposal. The bill, as passed by the Senate Finance Committee on January 30, 2008, would create a new temporary extension of UC that would entitle certain unemployed individuals to unemployment benefits that are not available under current law. (The House bill contained no provisions relating to unemployment benefits.) Individuals who had exhausted all rights to regular UC benefits under the state or federal law with respect to a benefit year (excluding any benefit year that ended before February 1, 2007) would be eligible for these additional benefits. The amount of the benefit would be the equivalent of the individual's weekly regular UC benefit (including any dependents' allowances). The temporary extension would be financed 100% by the federal government.

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[39] See CBO Testimony of Peter Orszag on Options for Responding to Short-Term Economic Weakness before the Committee on Finance United States Senate on January 22, 2008, [http://www.cbo.gov/ftpdocs/89xx/doc8932/01-22-TestimonyEconStimulus.pdf].

[40] For another paper that takes this position see the following: Elmendorf, Douglas W. and Jason Furman, *If, When, How: A Primer on Fiscal Stimulus*, January 2008, [http://www.brookings.edu/papers/2008/0110_fiscal_stimulus_elmendorf_furman.aspx].

[41] For example, Shrek, James and Patrick Tyrell, *Unemployment Insurance Does Not Stimulate the Economy*, Webmemo #1777, January 2008, [http://www.heritage.org/Research/Economy/wm1777.cfm#_ftn1]. Martin Feldstein in testimony before the Senate Committee on Finance on January 24, 2008 stated that "(w)hile raising unemployment benefits or extending the duration of benefits beyond weeks would help some individuals ... it would also create undesirable incentives for individuals to delay returning to work. That would lower earnings and total spending." [http://www.senate.gov/~finance/hearings/testimony/2008test/012408mftest.pdf]

The number of weeks an individual would be eligible for these temporary extended UC benefits would be the lesser of 50% of the total regular UC eligibility or 13 weeks. Under a special rule, if the state is in an EB period (which has a special definition for purposes of this temporary extension), the amount of temporary extended UC benefits would be augmented by an additional amount that is equivalent to the temporary UC benefit. Thus, in those "high-unemployment" states where the EB program was triggered, temporary benefits of up to 26 weeks would be possible.[42] As of this writing, both Michigan and Puerto Rico would qualify for the additional "high-unemployment" benefits.

Governors of the states would be able to pay the temporary extended UC benefit in lieu of the Extended Benefit (EB) payment (if state law permits). Thus, once the regular UC benefit was exhausted, a state would be able to opt for the individual to receive the temporary extended UC benefit (100% federal funding) rather than receiving the EB benefit (50% federal funding and 50% state funding).

The program would terminate on December 31, 2008. Unemployed individuals who had qualified for the temporary extended UC benefit or had qualified for the additional "high-unemployment" provision would continue to receive payments for the number of weeks they were deemed eligible. However, if the unemployed individual has not exhausted the first temporary extension of UC benefits by December 31, 2008, regardless of state economic conditions, the individual would not be eligible for an additional "high-unemployment" extension of the temporary UC benefit. If an individual exhausts his or her regular UC benefits after December 31, 2008, the individual would not be eligible for any temporary extended UC benefit. No such benefits would be payable for any week beginning after March 31, 2009.

Comparing the Macroeconomic Effects of Various Proposals[43]

The relative effectiveness of different proposals in stimulating the economy has been evaluated along a number of lines that will be discussed in this section.[44]

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[42] The bill would temporarily change the definition of an EB period only for the purposes of the bill. Regardless of whether a state had opted for section 203(f) of the Federal-State Extended Unemployment Compensation Act of 1970, an EB period would be in effect for such state in determining the level of temporary extended UC benefits in the state. The bill would temporarily change that trigger by removing the requirement that the TUR be at least 110% of the state's average TUR for the same 13-weeks in either of the previous two years. The bill would also change the base EB trigger described in section 203(d) only for purposes of the bill, reducing it from an IUR of 5% to an IUR of 4%.

[43] This section was prepared by Marc Labonte, Government and Finance Division.

[44] For a more detailed analysis, see Congressional Budget Office, *Options for Responding to Short-Term Economic Weakness*, January 2008.

Bang for the Buck. In terms of first-order effects, any stimulus proposal that is deficit financed would increase total spending in the economy.[45] For second-order effects, different proposals could get modestly more "bang for the buck" than others if they result in more total spending. If the goal of stimulus is to maximize the boost to total spending while minimizing the increase in the budget deficit (in order to minimize the deleterious effects of "crowding out"), then maximum bang for the buck would be desirable. The primary way to achieve the most bang for the buck is by choosing policies that result in spending, not saving.[46] Direct government spending on goods and services would therefore lead to the most bang for the buck since none of it would be saved. The largest categories of direct federal spending are national defense, health, infrastructure, public order and safety, and natural resources.[47]

Higher government transfer payments, such as extended unemployment compensation benefits or increased food stamps, or tax cuts could theoretically be spent or saved by their recipients.[48] While there is no way to be certain how to target a stimulus package toward recipients who would spend it, many economists have reasoned that higher income recipients would save more than lower income recipients since U.S. saving is highly correlated with income. For example, two-thirds of families in the bottom 20% of the income distribution did not save at all in 2004, whereas only one-fifth of families in the top 10% of the income distribution did not save.[49] Presumably, recipients in economic distress, such as those receiving unemployment benefits, would be even more likely to spend a transfer or tax cut than a typical family. As discussed previously, business tax incentives can be crafted so that they can be claimed only in response to higher investment spending, but businesses may be unwilling to increase their investment spending when faced with a cyclically-induced decline in demand for their products.[50]

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[45] There may be a few proposals that would not increase spending. For example, increasing tax incentives to save would probably not increase spending significantly. These examples are arguably exceptions that prove the rule.

[46] Policies that result in more bang for the buck also result in more crowding out of investment spending, which could reduce the long-term size of the economy (unless the policy change increases public investment or induces private investment).

[47] For the purpose of this discussion, government transfer payments, such as entitlement benefits, are not classified as government spending.

[48] Food stamps cannot be directly saved since they can only be used on qualifying purchases, but a recipient could theoretically keep their overall consumption constant by increase their other saving.

[49] Brian Bucks et al, "Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances," *Federal Reserve Bulletin*, vol. 92, February 2006, pp. A1-A38.

[50] For more information, see CRS Report RS21136, *Government Spending or Tax Reduction: Which Might Add More Stimulus to the Economy?*, by Marc Labonte.

Mark Zandi of *Moody's Economy.com* has estimated multiplier effects for several different policy options, as shown in **Table 5**.[51] The multiplier estimates the increase in total spending in the economy that would result from a dollar spent on a given policy option. Zandi does not explain how these multipliers were estimated, other than to say that they were calculated using his firm's macroeconomic model. Therefore, it is difficult to offer a thorough analysis of the estimates. In general, many of the assumptions that would be needed to calculate these estimates are widely disputed (notably, the difference in marginal propensity to consume among different recipients and the size of multipliers in general), and no macroeconomic model has a highly successful track record predicting economic activity. Thus, the range of values that other economists would assign to these estimates is probably large. Qualitatively, most economists would likely agree with the general thrust of his estimates, however — spending provisions have higher multipliers because tax cuts are partially saved, and some types of tax cuts are more likely to be saved by their recipients than others.

Table 5. Zandi's Estimates of the Multiplier Effect for Various Policy Proposals

Policy Proposal	One year change in real GDP for a given policy change per dollar
Tax Provisions	
Non-refundable rebate	1.02
Refundable rebate	1.26
Payroll tax holiday	1.29
Across the board tax cut	1.03
Accelerated depreciation	0.27
Extend alternative minimum patch	0.48
Make income tax cuts expiring in 2010 permanent	0.29
Make expiring dividend and capital gains tax cuts permanent	0.37
Reduce corporate tax rates	0.30
Spending Provisions	
Extend unemployment compensation benefits	1.64
Temporary increase in food stamps	1.73
Revenue transfers to state governments	1.36
Increase infrastructure spending	1.59

Source: Mark Zandi, *Moody's Economy.com*.

[51] Mark Zandi, "Washington Throws the Economy a Rope," *Dismal Scientist*, Moody's Economy.com, January 22, 2008.

Timeliness. Timeliness is another criterion by which different stimulus proposals have been evaluated. There are lags before a policy change affects spending. As a result, stimulus could be delivered after the economy has already entered a recession or a recession has already ended. First, there is a legislative process lag that applies to all policy proposals — a stimulus package cannot take effect until bills are passed by the House and Senate, both chambers can reconcile differences between their bills, and the President signs the bill. Many bills get delayed at some step in this process. As seen in **Table 6**, many past stimulus bills have not become law until a recession was already underway or finished.

Table 6. Timing of Past Recessions and Stimulus Legislation

Beginning of Recession	End of Recession	Stimulus Legislation Enacted
Nov. 1948	Oct. 1949	Oct. 1949
Aug. 1957	Apr. 1958	Apr. 1958, July 1958
Apr. 1960	Feb. 1961	May 1961, Sep. 1962
Dec. 1969	Nov. 1970	Aug. 1971
Nov. 1973	Mar. 1975	Mar. 1975, July 1976, May 1977
July 1981	Nov. 1982	Jan. 1983, Mar. 1983
July 1990	Mar. 1991	Dec. 1991, Apr. 1993
Mar. 2001	Nov. 2001	June 2001

Source: Bruce Bartlett, "Maybe Too Little, Always Too Late," *New York Times*, Jan. 23, 2008.

Second, there is an administrative delay between the enactment of legislation and the implementation of the policy change. For example, Treasury Secretary Henry Paulson has stated that if legislation were enacted quickly, rebate checks would be sent out between May and July.[52] When unemployment benefits were extended in March 2002, there was about a three week lag between enactment and the adjustment of benefits.[53] Many economists have argued that new government spending on infrastructure could not be implemented quickly enough to stimulate the economy in time since infrastructure projects require significant planning. (Others have argued that this problem has been exaggerated because existing plans or routine maintenance could be implemented more quickly.) Others have argued that although federal spending cannot be implemented quickly enough, fiscal transfers to state and local governments would be spent quickly because many states currently face budgetary shortfalls, and fiscal transfers would allow them to avoid cutting spending.[54]

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[52] Associated Press, "You Could Get Your Tax Rebate by May," January 24, 2008.

[53] The administrative lag could be longer in this case because the legislative lag to date was longer in 2002, so the Department of Labor had longer to prepare. Unemployment benefits were extended in the Job Creation and Worker Assistance Act of 2002 (P.L. 107-147).

[54] Transfers to state and local governments could be less stimulative than direct federal

(continued...)

Finally, there is a behavioral lag, since time elapses before the recipient of a transfer or tax cut increases their spending. It is unclear how to target recipients that would spend most quickly, although presumably liquidity-constrained households (i.e., those with limited access to credit) would spend more quickly than others. In this regard, the advantage to direct government spending is that there is no analogous lag. While monetary policy changes have no legislative or administrative lags, research suggests they do face longer behavioral lags than fiscal policy changes because households and business generally respond more slowly to interest rate changes than tax or transfer changes.

Long-term Effects. As discussed above, while a deficit-financed policy change can stimulate short-term spending, it can also reduce the size of the economy in the long run through the crowding out effect on private investment. Stimulus proposals can minimize the crowding out effect by lasting only temporarily — an increase in the budget deficit for one year would lead to significantly less crowding out over time than a permanent increase in the deficit. Among policy options, increases in public investment spending would minimize any negative effects on long-run GDP since decreases in the private capital stock would be offset by additions to the public capital stock. Also, tax incentives to increase business investment would offset the crowding out effect since the spending increase was occurring via business investment.

Should Stimulus be Targeted? As discussed above, there is uncertainty concerning whether the economy is headed for a recession. If it is not, a stimulus package aimed at increasing total spending could be ineffective or even counterproductive because of its effects on inflation, interest rates, and the trade deficit. Even in the absence of a recession, it is clear that housing and financial markets have already experienced sharp deterioration. In the absence of evidence that there is an economy-wide recession, some economists have argued that stimulus should be targeted at these depressed sectors, both to stabilize them and to prevent the downturn from spreading to other sectors. Other economists argue that if the current housing bust is being caused by the unwinding of a bubble, then it could be detrimental for the government to interfere with natural market adjustment which is bringing those markets back to equilibrium that, in the long run, is both necessary and unavoidable. And some would argue that the best way to help a troubled sector is by boosting overall demand. Besides the change in the GSE and FHA loan limits, housing-focused legislation is likely to be considered separately from the stimulus package.[55]

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[54] (...continued)
spending because state and local governments could, in theory, increase their total spending by less than the amount of the transfer. (For example, some of the money that would have been spent in the absence of the transfer could now be diverted to the state's budget reserves.) But if states are facing budgetary shortfalls, many would argue that in practice spending would increase by as much as the transfer.

[55] See CRS Report RL33879, *Major Housing Issues in the 110th Congress*, by Libby Perl et al.