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OPINION

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How About a Payroll Tax Stimulus?

For a similar amount of money, we could give workers $1,500.

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Congress and the Obama administration seem near to deciding the details of an economic stimulus package. Unlike the efforts of President Ronald Reagan and President George W. Bush, who also inherited declining stock markets and shrinking economies, this package is heavily weighted toward direct government spending, transfers to state and local governments, and tax changes that have virtually no effect on marginal tax rates.


AP

Christina Romer, chairman of the Council of Economic Advisers

Today the Reagan tax cuts are widely viewed as successful. Opinions on the longer-term effects of the Bush tax cuts are more diverse, but the short-term effects of the 2001 and 2003 cuts are generally credited as having been well-timed.

And what of the plan being put forward now? As crafted, it is unlikely to produce the desired results. For a similar amount of money, the government could essentially cut the payroll tax in half, taking three points off the rate for both the employer and the employee. This would put $1,500 into the pocket of a typical worker making $50,000, with a similar amount going to his or her employer. It would provide a powerful stimulus to the spending stream, as well as a significant, six percentage point reduction in the tax burden of employment for people making less than $100,000. The effects would be immediate.

By contrast, the stimulus now under consideration would suffer from the usual problems of government spending. The Congressional Budget Office and the Joint Committee on Taxation have calculated that only $170 billion, or about one-fifth of the $816 billion package will be spent in fiscal 2009. An additional $356 billion will be spent in 2010. That leaves $290 billion to be spent when even the most pessimistic forecasters think the economy will be in recovery mode.

Some of the longer-term investment projects proposed are quite worthy; some are not. Either way, they are not stimulus. The administration and the Democratic congressional leadership claim that the infrastructure projects, mainly carried out by state and local governments, are "shovel ready." In fact, the legislation gives states a full year to merely sign a contract to begin spending half the money, and another year to sign a contract to spend the second half. As anyone who has ever dealt with a contractor knows, the money tends to be spent months or years after the contract is signed.

The criticisms generated by the Congressional Budget Office analysis have been brushed aside by President Obama. As he correctly pointed out in a recent meeting with bipartisan congressional leaders, he won the election. His party has large majorities in both houses of Congress, and elections do and should have consequences.

Administration economists Christina Romer (chairman of the Council of Economic Advisers) and Jared Bernstein (Vice President Joe Biden's chief economic adviser) recently released a document that will allow us to benchmark those consequences. "The Job Impact of the American Recovery and Reinvestment Plan," issued on Jan. 9, lays out the course of the economy they expect if the administration's stimulus proposals are adopted, compared with what they expect if no stimulus is implemented.

Without a stimulus plan, the report predicts the unemployment rate will peak in the middle of 2010 at about 9%. With their plan, it estimates unemployment will peak at about 8% in the third quarter of this year. Longer term, they expect the unemployment rate to drop to roughly 5.5% by the end of 2012 with the recovery plan, compared with 6% without a plan.

This document provides a great service. We may know as early as the end of this year whether the spending approach now being undertaken is being successful, or whether it might be wiser to change course and focus on supply-side approaches that combine reductions in marginal rates and improved incentives with improved cash flow for the household and business sectors.

If, for example, the unemployment rate appears to be peaking at around 8% and shows some modest signs of declining by year's end, then the administration should take comfort that it took the right approach. But if the unemployment rate is over 8%, and more important, still appears to be climbing, then it might be advisable for the administration to propose tax cuts and less spending in its budget next year.

One other metric in the report should also be watched -- the composition of employment. Mr. Obama has stressed that he believes that his plan is essential to the revival of the private sector. This makes sense; merely expanding government would simply increase the burden on the private sector, but a larger private sector could easily cover the added costs of a larger government.

The administration's "Job Impact" report estimates that nearly 3.7 million jobs will have been either created or saved by the end of 2010. Of these, only 244,000 will be in government. Since the unemployment rate is estimated to be 1.5 percentage points lower at the end of 2010 as a result of the plan, this gives us a rough estimate of total jobs saved by the plan at 2.2 million. This means that the administration projects that the number of private-sector jobs will grow by about 1.25 million and the number of government jobs will grow by about a quarter million between now and 2010.

This ratio of roughly 5-to-1 of private sector versus government jobs roughly mirrors the current makeup of the job market. Thus, a second test of the stimulus package's effectiveness is that the mix of private-sector to public-sector jobs at the end of 2010 should be roughly what it is today. That would suggest to this administration and future policy makers that a stimulus bill oriented toward public-sector spending is an effective way of expanding the private economy, an essential ingredient toward sustainability of the higher level of spending.

Making the safe assumption that the stimulus bill is enacted, America will get a fair test of the spending approach to economic stimulus. The analysis of administration economists Ms. Romer and Mr. Bernstein provides a good framework for evaluating its success. Let's hope it succeeds. If it does not, next January we will find ourselves another year older and much deeper in debt.

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