IRET *Congressional Advisory*

INSTITUTE FOR RESEARCH ON THE ECONOMICS OF TAXATION

IRET is a non-profit 501(c)(3) economic policy research and educational organization devoted to informing the public about policies that will promote growth and efficient operation of the market economy.

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A STIMULUS ALTERNATIVE

A far simpler, smaller, and better-focused stimulus package could do more for the economy than the bloated bill now making its way through the Senate, at a fraction of the cost. Even at $780 billion, the trimmed down bill is still far too big and riddled with ineffective and wasteful provisions. The entire bill, tax and spending provisions alike, should be pulled and replaced with a few simple provisions that would address the needs of the unemployed and get investment and GDP growing moving again.

A simple, effective substitute for the package:

- The unemployment extension provision from the package.
- The Alternative Minimum Tax "patch" from the package.
- Extension of the 2008 bonus expensing provision and small business expensing provision in the package, but make it permanent, or at least for four years.
- A reduction in the depreciation life for structures from 39 years to 25. (It would also help small businesses if you reclassify "built-ins" such as lunch counters and shelving and heating and cooling systems as equipment rather than parts of the structure so they can be written off quickly.)

These provisions would:

- Help people pay their bills until they find new private sector jobs. (The provision should be moderate and temporary to avoid prolonging job search.)
- Do the necessary AMT patch for the year to keep millions of middle class taxpayers from being dragged into the AMT.
- Encourage investment in equipment by large and small businesses, putting some of the saving being done by discouraged consumers to work in a useful way (not wasting it on pork).
- Spur the construction of new commercial and office buildings, which would also put saving to work and pick up some of the slack from the depressed home-building sector, not to mention putting a floor under that end of the real estate market to prevent the securities market contagion from spreading. Note that the bonus expensing provision is for equipment only, not structures (except specialty structures of 20 years or less). Yet structures, with their very long asset life, are the most discriminated against and over-taxed asset class.

People are saving more, which is actually a good thing. But that saving has to be put to work via the credit markets. If private businesses are not borrowing to invest in useful capital, because it is not profitable, then we will have a painfully slow recovery. If private investment is not worth doing, then the Federal Reserve will be unable to boost things by creating more bank reserves, because people will have no motive to borrow. The Federal Reserve will be pushing on a string.

We can solve that problem by making investment more profitable, so the private sector will be pulling on the string, and the Fed will not have to do so much of the work. The 2003 tax cut encouraged investment, especially in equipment. But that added capital was formed by 2007, and investment was slowing to more normal levels. Failure to promote investment after the 2003-2007 boom had run its course is one of the reasons that Federal Reserve credit spilled so much into housing and commodity speculation. Other investment was slowing, creating slack in GDP and the credit markets.

We need to restore the strong growth of investment to employ the saving and the credit creation so that it does not later turn into another round of double digit inflation, or get pumped into wasteful government projects. The stimulus package as currently structures does not do any of that. It will balloon the debt, cripple future budgets with huge increases in interest payments, and force tax hikes down the road that will permanently depress GDP. Even the Congressional Budget Office admits that the stimulus bill will reduce GDP longer term as we have to pay for it. Here is the first paragraph their reply to a letter of inquiry by Senator Grassley. We think their short run gains are wrong, but fully agree with the long run losses.

> "At your request, the Congressional Budget Office (CBO) has conducted an analysis of the macroeconomic impact of the Inouye-Baucus amendment in the nature of a substitute to H.R. 1. CBO estimates that this Senate legislation would raise output and lower unemployment for several years, with effects broadly similar to those of H.R. 1 as introduced. In the longer run, the legislation would result in a slight decrease in gross domestic product (GDP) compared with CBO's baseline economic forecast."

The Senate stimulus package contains a huge amount of money spent in Washington for items that are not urgent, shovels money out to state and local governments to support unrealistic spending levels that have outstripped GDP for years, and a miserable catch-all package of energy provisions that spend a great deal more money than the value of the energy they produce or save. Meanwhile, the package does little or nothing to promote real job growth in the private sector. It will serve mainly to drive up the national debt and saddle future taxpayers and Congresses with enormously higher interest costs. We can do better.

Stephen J. Entin
President and Executive Director

Note: Nothing here is to be construed as necessarily reflecting the views of IRET or as an attempt to aid or hinder the passage of any bill before the Congress.