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Obama's Desperate Search for Effective Stimulus

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An economy floundering and an election looming have President Obama thrashing about for a viable jobs policy. Obama has spent the nation into unsustainable deficits, leaving little room for additional policy. And as Senator Michael Bennett (D–CO) correctly pointed out, "We have nothing to show for it."[1] The economy remains nearly stagnant.

With two months to go before an election, Obama's congressional allies are deeply worried that the weak economy will cost them badly at the polls, and so Obama needs to appear active. In response, he is rolling out yet another set of stimulus proposals. Some of these proposals are already known, such as yet another $50 billion infrastructure package. Fifty billion spread over six years in a $15 trillion economy. Not that a larger package would do any better, but as economic stimulus it leaves little wonder his proposal was not taken seriously except by the construction unions.

Another reason Obama's proposals are not taken seriously is because it will be difficult for Congress to pass major, new legislation in the few weeks remaining before they bolt to campaign back home. Congress should not leave to campaign without having passed an effective stimulus policy that prevents tax hikes—starting with extending the 2001 and 2003 tax relief for all taxpayers—makes a good effort to rein in spending, and cuts taxes judiciously.

What to Do, What to Do. While nothing Obama and Congress can do will improve the economy in the very near term—economies simply do not turn on a dime—they can act quickly to give the economy a needed boost in 2011. The first, most obvious step is to abstain from raising taxes.

Normally, abstaining from inflicting injury would not be regarded as stimulus, but in today's environment the most important missing ingredient in the economic mix is confidence. Families and businesses are anticipating a huge tax hike come January 1, 2011, when the 2001 and 2003 tax cuts expire. The tax hike is bad enough, but given the state of the economy, what this tax hike says about Washington's priorities is draining America's confidence in its government. There is no argument for raising taxes on a weak economy, and Americans know it.

The obvious policy, and one which Obama continues to resist, is to keep taxes from going up in 2011 as scheduled. Even Peter Orszag, Obama's first Director at the Office of Management and Budget, has called for extending the tax cuts for two years.[2] A permanent extension would be much better, but two years is a good start not only at deflecting the tax hike but restoring some confidence in Obama's willingness to ignore ideology for the good of the country.[3]

Another tax hike rumored to be under consideration is to raise tax rates on America's manufacturers.[4] This tax hike is apparently intended to help offset the cost of the President's new infrastructure program. It is a wonder the President complains

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about being labeled a "tax-and-spend liberal" when he repeatedly proposes tax hikes to pay for new spending. It is an even greater wonder that he would propose a tax hike on manufacturers coming out of a recession.

Positive Steps. An obvious positive step Congress and the President could take immediately would be to pare back the spending recently put in place. The original Obama stimulus failed, yet much remains unspent. Don't spend it.

Spending in general has soared in recent years. Congress should freeze total spending at 2010 levels. Shutting off the stimulus funds and freezing spending would not correct America's fiscal problems, but they would be a start.

There are other positive steps the President could propose to provide some useful pop to the economy in the near term. According to one report, the President is preparing a major proposal to allow all businesses to deduct their investment costs immediately (called "expensing") rather than deduct these costs over time.[5] This proposal—long a centerpiece of the flat tax—would improve investment incentives, encouraging more investment sooner.

With the economy operating at significant excess capacity and with interest rates already incredibly low, the effectiveness of expensing today would surely be blunted. Nevertheless, some businesses would increase investment levels if given a reason, either from improved business prospects or lower investment costs.

The details of the policy matter, however, and these are as yet unavailable. If, as reported, expensing is allowed for a short period, such as through 2011, then it would provide a modest stimulus for 2011. But the proposal would then create a double downward push in 2012, first as traditional depreciation disincentives reappeared and also through the added uncertainty the on–off policy would create about the real strength of the economy.

What the proposal lacks, however, is its companion element: rate reduction. Expensing would be especially useful for businesses like semiconductor manufacturers that invest heavily in new machinery; it would do very little for the increasingly important labor-intensive service providers like professional businesses and retailers; therefore, expensing needs to be coupled with a lower corporate income tax rate.

Another useful proposal rumored to be in the offing is to press again to make the Research and Development (R&D) tax credit permanent. Generally, tax credits are poor tax policy aimed at economic or social engineering. In this case, however, the credit is intended to help the company making the R&D investment capture more of the economic benefits that result, thus encouraging a more appropriate level of investment.

The R&D tax credit has existed for many years, but it has always been enacted on a temporary basis, thus greatly diminishing its effectiveness. Making the credit permanent has long enjoyed bipartisan support. The flaw in the ointment, according to reports, is that Obama intends to offset the cost of keeping current policy by raising taxes.

One could argue, given current budget deficits, that permanent tax cuts should be paid for, preferably by spending reductions. But it is nonsensical to argue for offsetting the costs of keeping current policy. Again, it is this kind of confidence-draining

1. Jack Minor, "Bennet Says We Have Nothing to Show For All of Our Debt, Will Not Commit to Position on Card Check," *Greeley Gazette*, August 24, 2010, at *http://www.greeleygazette.com/press/?p=5029* (September 7, 2010).
2. Peter Orzag, "One Nation, Two Deficits," *The New York Times*, September 6, 2010, at *http://www.nytimes.com/2010/09/07/opinion/07orszag.html* (September 7, 2010).
3. Conn Carroll, "Debunking Orzag's Tax Hike Myths," The Foundry, September 7, 2010, at *http://blog.heritage.org/2010/09/07/debunking-orszags-tax-hike-myths.*
4. Anna Fifield, "Obama Unveils Infrastructure Plan," FT.com, September 6, 2010, at *http://cachef.ft.com/cms/s/0/1f4caf04-b9c8-11df-968f-00144feabdc0.html* (September 7, 2010).
5. Jonathan Weisman and John D. McKinnon, "Obama to Push Tax Break," *The Wall Street Journal*, September 6, 2010, at *http://online.wsj.com/article/SB10001424052748704392104575475920686869934.html?mod=WSJ_hpp_MIDDLENexttoWhatsNewsTop* (September 7, 2010).

political game-playing that contributes to a weak economy.

What Not to Do. A powerful lesson of recent months is that gimmickry makes good bumper stickers but lousy economic stimulus. This was true of the "cash for clunkers" program, and it was true of the first-time homebuyers' tax credit.

It would also be true of proposals like a temporary payroll tax holiday rumored to be under consideration by the Obama Administration and still popular in certain quarters in Congress. Worse than ineffectual, yet another foray into tax gimmickry in the name of economic stimulus would serve only to re-affirm the sense Washington is desperate for any stimulus policy that might fill the airwaves. This would add to the growing unease of American families and businesses, and as their confidence wanes, so too would prospects of a stronger economy.

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