Committee for a Responsible Federal Budget

Guide to Stimulus Proposals: The 2008 Presidential Election

US Budget Watch

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US Budget Watch is a project created to increase awareness of the important fiscal issues facing the country through and beyond the election. The project seeks to bring attention to the presidential candidates' tax and spending policies, to help the public become informed about these issues, and to track the new president's fiscal policies after the election. This guide is not intended to recommend voting for or against any particular candidate, nor does it reflect an assessment of the overall merits of any specific policy proposal.

US Budget Watch is a project of the Committee for a Responsible Federal Budget, which is a non-profit organization committed to educating the public about issues that have a significant fiscal policy impact. The Committee is a bipartisan group of leading budget experts including many of the past chairmen of the House and Senate Budget Committees, directors of the Congressional Budget Office and Office of Management and Budget, and members of the Federal Reserve Board.

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SUMMARY

John McCain’s Stimulus Proposals	
Policy	**Cost (Billions)**
Purchase Distressed Mortgages	$0*
Strengthen Student Loans System	Unknown
Temporarily Cut Capital Gains Rates	$10
Offer Relief to 401(k) and IRA Holders	$36
Eliminate Taxes on Unemployment Benefits	$6.5
Allow Greater Deduction of Capital Losses	Unknown
Reduce Energy Prices	N/A
Net Cost:	**$52.5**

*Would cost $300 billion, but funds have already been allocated as part of the recently passed $700 billion Treasury stabilization package

Barack Obama’s Stimulus Proposals	
Policy	**Cost (Billions)**
Provide Tax Rebates	$65
Create a State Growth Fund	$25
Create a Jobs and Growth Fund	$25
Provide Assistance for Small Businesses	$5
Implement Incentives for Job Creation	$40
Offer Relief to 401(k) and IRA Holders	Unknown
Help for Laid-off Workers	$10
Provide Relief for Mortgage Holders	$12.5
Reduce Energy Prices	N/A
Provide Additional Loan Guarantees to Automakers	$4 to $7.5
Net Cost:	**$186.5 to $190**

GUIDE TO STIMULUS PROPOSALS: THE 2008 PRESIDENTIAL ELECTION

Background

The United States is in the midst of an economic crisis. Financial institutions are failing, the credit markets are frozen, and global stock markets have experienced large-scale losses. This crisis has also had significant effects on the "real" economy. Home values have tumbled, consumption has dropped, and jobs are disappearing.

During economic downturns, the government regularly takes actions to try to combat the effects of the decline. Most of its actions fall into one of four categories: **monetary stimulus, fiscal stimulus, targeted stabilization,** and **economic relief**.

Monetary stimulus involves the Federal Reserve Board ("the Fed") reducing interest rates, making it cheaper to borrow. The Fed is able to act quickly (economists refer to this as a short inside lag), and decisions are made by economists who can implement policy free of political or administrative considerations. But monetary stimulus has a long "outside lag," meaning it takes a while to work its way through the economy.

With **fiscal stimulus**, the government uses its power to cut taxes and spend in order to boost consumption, which in turn increases sales, employment, wages, and profits. Some of this stimulus occurs through "automatic stabilizers," as tax revenues are inevitably lower and unemployment and other benefits are inevitably higher during an economic downturn. Other fiscal stimulus requires action from Congress – such as the passage of tax rebates or new spending. Once put in place, fiscal stimulus can have a fast impact on the economy (it has a short outside lag), but it generally takes politicians a long time to put together a stimulus package, and when they do, it is often filled with "fiscal pork" — politically popular items that do little to stimulate the economy.

Targeted stabilization aims to boost economic performance by focusing on the immediate causes of an economic downturn. The goal is not to address structural problems, such as low levels of capital investment or insufficient educational attainment, but to prevent crises in certain sectors of the economy from spilling over into other areas of the economy. Although this strategy has the advantage of being more targeted, it carries the risk of misdiagnosis, and can easily be subject to political abuse. Unlike fiscal stimulus, this method of shoring up the economy does not require running deficits.

Finally, **economic relief** helps individuals and businesses to weather an economic downturn. The goal in this case is not to boost the economy as much as to mitigate the impact of the downturn on certain segments of the population. Many policies can simultaneously stimulate the economy and offer economic relief.

A number of measures have already been taken to address the current downturn. Since last September, the Fed has dropped the federal funds rate from 5.25 percent to its current rate of 2 percent. This past spring, the Fed twice took the unusual step of dropping the rate by 75 basis points (0.75 percent), rather than the normal 25 or 50 basis point reduction.

Additionally, Congress passed a $168 billion fiscal stimulus package in February that included tax rebates, spending on veterans and seniors, and "bonus depreciation" for businesses. This was followed by an $8 billion extension of unemployment benefits and a housing bill, which included over $16 billion in home buyer tax credits, $4 billion in targeted grants to communities hit by high foreclosure rates, and loan guarantees for some homeowners facing foreclosure. The bill also authorized the Treasury Department to loan money to or buy stock from Fannie Mae and Freddie Mac – the private Government Sponsored Enterprises (GSEs) which managed the secondary mortgage market. The Treasury has since taken over both of these institutions (and agreed to buy up to $100 billion of stock in each) to ensure that they remain solvent. To stabilize the housing sector and promote market liquidity, the Treasury has also agreed to purchase $10 billion mortgage-backed securities and allow Fannie Mae and Freddie Mac to purchase an additional $144 billion in securities. The Fed has also offered special loans and guarantees to a number of financial firms, including Bear Stearns, AIG, and J.P. Morgan.

So far this year, the Federal Deposit Insurance Corporation (FDIC) has had to cope with the failure of 15 banks, costing the FDIC insurance fund approximately $11.5 billion. The FDIC also increased the maximum insurable amount from $100,000 to $250,000 per account. As a further measure to shore up the banking system, the Fed announced that it will dramatically increase the amount of term auction loans it offers to $900 billion this year.

More recently, Congress approved a $700 billion "rescue package" for financial firms, which was designed to purchase "toxic" mortgage-backed securities and resell them as the market recovered. So far, $250 billion of the $700 billion has been dedicated to buying bank equity to improve banks' liquidity. The Treasury has not yet announced how it will spend the other $450 billion. In September, Congress approved long-term, low-interest loans to auto manufacturers and part suppliers totaling $25 billion dollars. Finally, the Fed has agreed to purchase up to $540 billion of commercial debt paper from money market mutual funds.

Government Actions Related to the Financial Crisis

Date	Policy	Exposure	Budgetary Impact	Notes	Who
Feb. 2008	Temporary Tax Breaks	$168 billion	$168 billion	Traditional stimulus	Congress
March 2008	Bear Stearns Funding	$29 billion	None	Loan from Fed to J.P. Morgan for buyout	Federal Reserve
June 2008	Extension of Unemployment Benefits	$8 billion	$8 billion	13-week extension of unemployment insurance	Congress
July 2008	IndyMac Takeover	$18 billion	$9 billion	Exposure reflects insured deposits; budgetary impact reflects cost to FDIC	FDIC
July 2008	Community Housing Grants	$4 billion	$4 billion	Helps neighborhoods with high foreclosure rates	Congress
July 2008	Housing Tax Credits	$16 billion	$16 billion	$7,500 tax credit for some first-time homebuyers, expansion of low-income housing credit	Congress
July 2008	FHA Loan Guarantees	$300 billion	$2 billion	Allows FHA to insure distressed mortgages	FHA
Sept. 2008	Mortgage Backed Securities (MBS) Purchases by Fannie/Freddie	$144 billion	Unknown	Fannie's and Freddie's MBS purchases increased to portfolio limits of $850 billion	Treasury
Sept. 2008	Fannie/ Freddie Takeover	$200 billion	$25 billion	Government pledged to buy up to $200 billion in stock	Treasury
Sept. 2008	J.P. Morgan / Lehman Financing	$87 billion	None	Fed repaid J.P. Morgan for $87 billion loan advance to Lehman	Federal Reserve

Date	Policy	Exposure	Budgetary Impact	Notes	Who
Sept. 2008	AIG Loans	$123 billion	None	AIG gets up to $85 billion in loans over 2 years. In October, Fed agreed to loan additional $38 billion	Federal Reserve
Sept. 2008	Money Market Guarantees	$50 billion	None	Treasury guarantees money market funds against total losses <$50 billion for 1 year	Federal Reserve
Sept. 2008	Treasury Purchase of MBS	$10 billion	Unknown	Treasury purchases $10 billion in Mortgage Backed Securities	Treasury
Sept. 2008	Auto Manufacturers Loans	$25 billion	$7.5 billion	DOE will provide low-interest loans to automakers	DOE
Sept. 2008	WaMutual Takeover	None	None	Sale to J.P. Morgan, averted losses	FDIC
Oct. 2008	Financial Bailout Package	$700 billion	$0-$700 billion*	Rescue package for purchasing "toxic" mortgage-backed securities from banks; $250 billion allocated for immediate use by Treasury (spent on nonvoting equity shares of banks). President must certify next $100 billion; last $350 billion subject to Congressional approval	Treasury
Oct. 2008	Short-term Bank Loans	$750 billion	Unknown	28- and 84-day Fed term auction loans	Federal Reserve
Oct. 2008	FDIC-insured Small Bank Failures	$2.6 billion	Unknown	15 bank failures so far in 2008	FDIC
TOTAL		**$2,635 billion**	**$240 - $940 billion**		

Note: Actions taken by the Federal Reserve do not directly affect the budget.

* The Congressional Budget Office has said it would likely cost more than zero, but they also said it would likely cost substantially less than $700 billion.

Campaign Proposals

Both Senator McCain and Senator Obama have put forth proposals to strengthen the short-term economy, which they argue would complement their long-term economic policies. These proposals take the form of fiscal stimulus, targeted stabilization, and economic relief. Many have direct budgetary implications, although some are regulatory. Some of these proposals are meant to be enacted before the next president takes office, while others are meant to be sustained over a longer time period.

Senator McCain

In January, Senator McCain recommended cutting in the corporate tax rate, introducing new expensing rules that would allow companies to deduct the value of equipment up front, and making the research and experimentation tax credit permanent, to create a more favorable business and investment climate.[1] In May, McCain proposed a "gas tax holiday," which would have suspended the 18.4 cents per gallon gasoline tax and the 24.4 cents per gallon diesel tax between Memorial Day and Labor Day of 2008, but would have expired by now. Currently, Senator McCain is supporting the following initiatives:

Purchase Distressed Mortgages ***$0 (Part of the already passed $700 billion package)***

Senator McCain supports a HOME plan to address the rising number of foreclosures. Under the plan, qualified individuals who purchased their homes after 2005 would be allowed to replace their sub-prime adjustable-rate mortgages with a 30 year fixed-rate mortgage guaranteed by the Federal Housing Administration (FHA), with the rate reflecting historical norms and the current market value of the home.

Senator McCain has also unveiled a Homeownership Resurgence Plan under which the government would purchase mortgages from creditworthy individuals living in their homes. According to his campaign, these mortgages would be replaced with FHA-guaranteed fixed-rate mortgages at terms manageable for the homeowner. The plan would cost $300 billion, but this money could come out of the $700 billion appropriated for the bailout. Senator McCain also supports the efforts of groups like NeighborWorks America that provide mortgage assistance to homeowners in their communities.

Strengthen Student Loan System ***Cost Unknown***

In order to address short-term liquidity concerns in the student loan system, Senator McCain has proposed a Student Loan Continuity Plan. Although he has not offered many specifics, according to his campaign he would ensure that the federal and state governments are prepared for possible loan problems, and would expand "lender of last-resort" capabilities while cracking down on troublesome private lenders.

[1] These plans are detailed in *Promises, Promises: A Fiscal Voter Guide to the 2008 Election* but are not included in this report because they would be permanent rather than temporary policies.

Temporarily Cut Capital Gains Rates ***$10 billion***

Senator McCain would cut the top rate on long-term capital gains from 15 percent to 7.5 percent in 2009 and 2010 in order to encourage individuals to invest, which would in turn help support the stock market and other asset markets.

Offer Relief to 401(k) and IRA Holders ***$36 billon***

Senator McCain supports a number of measures designed to help individuals with IRA or 401(k) retirement accounts. Senator McCain proposes establishing a new flat 10 percent tax rate for the first $50,000 withdrawn from these accounts by retirees in 2008 and 2009. At the same time, he would suspend current rules that require individuals to begin withdrawing money from their retirement accounts once they reach age 70.5.

Eliminate Taxes on Unemployment Benefits ***$6.5 billon***

Senator McCain would exempt unemployment benefits from taxation for 2008 and 2009. This exemption would apply to all unemployed workers making less than $100,000 a year.

Allow Greater Deduction of Capital Losses ***Cost Unknown***

Under current law, individuals are allowed to deduct from their income taxes up to $3,000 a year in capital losses. Senator McCain would temporarily allow individuals to deduct up to $15,000 of capital losses for the years 2008 and 2009.

Reduce Energy Prices ***N/A***

Senator McCain supports a number of other measures to reduce the cost of energy products in the short term. He proposes lifting the federal moratorium on drilling for oil and natural gas in the Outer Continental Shelf and would direct the Department of Defense to work with states to develop the infrastructure to drill for fossil fuels in the OCS. Although it could take a decade or more before these oil and natural gas resources would be available, the McCain campaign has argued that drilling, along with other measures of his energy plan, would reduce current prices by signaling to "oil producing countries and oil speculators that our dependence on foreign oil will come to an end."

Senator McCain would also address oil speculation, which can have the effect of driving up the current price of oil. He has supported ongoing efforts in Congress to investigate the precise impact of energy futures markets on the price of oil, and has vowed "swift punishment" where abuses are found. He has also called for regulatory reform for the oil futures market.

Finally, Senator McCain would reform the laws governing ethanol in gasoline, arguing that they have artificially driven up both the cost of gasoline and the cost of food. To reduce the cost of both of these commodities, he would roll back rules requiring corn-based ethanol as an additive to gasoline, eliminate subsidies on domestically produced ethanol, and repeal the current tariff on imported sugar-based ethanol.

<u>Senator Obama</u>

Prior to the passage of the stimulus package, Senator Obama proposed a broad economic stimulus program. His $75 billion plan would have offered each worker a $250 tax rebate ($35 billion), offered Social Security recipients a one-time $250 supplement ($10 billion), established a fund to help families avoid foreclosure ($10 billion), offered relief to state and local governments ($10 billion), and extended unemployment benefits ($10 billion). The plan called for an additional $45 billion in rebate checks if the economy continued to do poorly.

Senator Obama voted for the congressional stimulus package that passed. He later proposed a second stimulus plan, which would have included $20 billion in stimulus checks and $30 billion for unemployment expansion, foreclosure assistance, and aid to state and local governments. Since the passage of the bills addressing unemployment insurance and foreclosure assistance, both of which Obama supported, he has modified his stimulus proposal several times, changing and adding a number of provisions. His current plan calls for the federal government to do the following:

Provide Tax Rebates ***$65 billion***

Senator Obama supports an "emergency energy rebate" of $500 per worker or $1,000 per family. Although he has not provided all the specifics, his campaign states that the rebate would be modeled after the "Making Work Pay Credit", which phases in for those earning less than $8,000 a year. He would also extend these expedited tax credits to retired seniors.

Senator Obama planned to pay for these rebates through a five-year windfall profit tax on oil companies when the cost of a barrel of oil exceeded $80 (with oil prices as high as $140 per barrel, this was expected to fully finance the tax rebates). Given the recent drop in oil prices to well below $80 a barrel, his campaign now says that the rebates should be issued even in the absence of revenues to pay for them.

Create a State Growth Fund ***$25 billion***

Senator Obama would create a state relief fund to prevent states from having to make significant spending cuts or tax increases, which could exacerbate an economic downturn. According to his campaign, more than 29 states face deficits totaling around $50 billion, and because most have to balance their operating budgets, many have begun cutting spending. Included in these funds would be money to counteract high heating costs. Senator Obama has also called for the creation of a Treasury Department mechanism that could loan directly to state and local governments having difficulty accessing credit to cover expenditures — a move similar to the Fed's recent purchasing of short-term commercial debt paper.

Create a Jobs and Growth Fund ***$25 billion***

Senator Obama would increase infrastructure investment by $25 billion to create jobs and stimulate long-run economic growth. The plan would focus on ensuring that those projects currently in progress were not sidelined due to revenue shortfalls and were fast-tracked where possible. Specifically, his plan would focus on two areas. First, it would replenish the Highway Trust Fund so that current projects to improve roads and bridges would not be stopped or slowed because of funding shortfalls. Second, the plan would fund and fast-track school repairs, especially those aimed at improving energy efficiency.

Provide Assistance for Small Businesses ***$5 billion***

Senator Obama would employ a number of measures to support small businesses. First, he would allow the Small Business Administration to make direct fixed-rate loans to small businesses though its Disaster Loan Program. Second, he would expand the SBA's loan guarantee program by temporarily eliminating fees for borrowers and lenders. And finally, he would extend current tax rules, which allow companies to deduct their first $250,000 in qualified expenses for one year.

Implement Incentives for Job Creation ***$40 billion***

Senator Obama would offer a $3,000 per employee tax credit to corporations for every additional full-time employee hired during 2008-09. The tax credit would be enough to offset the cost of payroll taxes to the company for the first $50,000 paid to each new employee.

Offer Relief to 401(k) and IRA Holders ***Unknown***

Senator Obama would temporarily suspend rules that impose a tax penalty on early withdrawal from a 401(k) or IRA plan, allowing workers below retirement age to withdraw up to 15 percent or $10,000 (whichever is less) from their retirement accounts. At the same time, he would suspend rules that require individuals to begin making withdrawals from their IRA or 401(k) accounts at age 70.5 and would exempt withdrawals, up to the minimum required amount, from taxation.

Help Laid-off Workers ***$10 billion***

To assist unemployed workers who have difficulty finding new jobs in a weak economy, Senator Obama proposes extending unemployment benefits for an additional 13 weeks and temporarily suspending taxes on these benefits.

Provide Relief for Mortgage Holders ***$12.5 billion***

Senator Obama would mandate a 90-day moratorium on foreclosures for companies participating in the Troubled Assets Relief Program (TARP), provided the homeowner was "making a good faith effort" to pay his mortgage. In addition, Senator Obama would ask the Treasury Department and the Department of Housing and Urban Development to more aggressively pursue revisions in the terms of some mortgages, and propose new legislation to reform the bankruptcy code so judges can redefine mortgages on primary residences. Finally, he would fast-track his Universal Mortgage Tax Credit proposal, which would provide a refundable tax credit to taxpayers who do not itemize equal to 10 percent of their mortgage interest payments.

Reduce Energy Prices ***N/A***

Senator Obama has made a number of proposals designed to reduce energy costs. He would crack down on excessive energy speculation and increase transparency in the oil futures market, in part closing energy industry market loopholes. He would tap some of the oil from the U.S. Strategic Oil Reserve. And he would encourage domestic oil production by requiring oil companies to develop the land they have leased but are not drilling on, or otherwise forfeit their leases.

Extend Additional Loan Guarantees to Automakers ***$4 to $7.5***

Senator Obama has called for doubling the amount of loan guarantees to the auto industry, from $25 billion (which Congress recently passed) to $50 billion. These loans would be focused on helping the auto industry "retool" by producing more fuel-efficient cars and developing new battery technologies, among other changes. Senator Obama would also speed up implementation of the first $25 billion in loan guarantees.