Bush goes for broke
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President George Bush’s new economic stimulus package is bigger and bolder than previously expected. But will it work? And will it help Mr Bush’s re-election prospects?

GEORGE BUSH has set himself a tough challenge with his latest economic stimulus package. Initial reactions suggest he will have to work hard to secure the necessary political backing to get the proposals through Congress. He will also have to convince the wider electorate—and the economics establishment—that the package will do what he says he intends it to.

In political terms, it is not difficult to see why Mr Bush should be so keen on a new package now. The American president is determined above all to win a second term in the White House, so laying the ghost of George Bush senior, who was defeated ignominiously in his campaign for re-election in 1992. It is this determination to avoid the mistakes of his father that has led the younger Mr Bush to switch the focus to domestic issues as he reaches the half-way point of his first term. He has decided to go for broke with a $670 billion stimulus package—double the size predicted just a few days before the package was announced on January 7th.

But there is a certain—possibly deliberate—lack of clarity about what the package is aiming to do. The belief that a new stimulus package—Mr Bush’s second—is needed has its origins in the still sluggish and erratic economic recovery. As unemployment has crept up recently, there have been signs that consumer confidence might be softening, while business investment remains much too weak for comfort. The view that fiscal measures are needed to reinforce the aggressive loosening in monetary policy seen in the past two years has gained widespread currency in political circles.

Yet it is still not clear how much extra help the economy needs. America was one of the fastest-growing industrial economies in the year to September 2002, and made it into first place in the third quarter of the year. The risks of a double-dip recession have receded. Most economists think the full effects of the substantial interest-rate reductions have still to work their way through—after all, the most recent cut (of half a percentage point) was only in November.

The bulk of the latest package comprises measures which may not provide the short, sharp boost for which many political leaders, including Mr Bush himself, have been calling. The single most controversial measure is the abolition of tax on share dividends, costing $300 billion over ten years. White House insiders are quoted as
saying this should boost share prices—in the doldrums for more than two years now—by around 10%. There may be a long-term case for getting rid of dividend taxation, though even that is open to debate. It is not clear, however, that such a move would provide a short-term economic stimulus, especially since nearly one-third of America’s top companies do not pay a dividend at all. High-tech companies in particular are more likely to reinvest profits in the business than provide shareholders with short-term gains.

It certainly lays Mr Bush open to the familiar charge that he is favouring the better-off, and the Democrats have been quick to seize on that. One study has shown that the average annual benefit for people earning less than $10,000 a year would be $6, while that for those with million-dollar-plus incomes would be more than $45,000. Conventional economics suggests that the richer people are, the less propensity they have to spend each additional dollar of income. America might have a long-term need to boost savings rates, but that will not help stimulate the economy.

Similar arguments can be applied to Mr Bush’s plan to bring forward income-tax cuts already scheduled to take effect in 2004 and 2006. He is also planning extra relief for married couples and a rise in child tax credit. The White House is seeking to counter critics who allege that such tax cuts help the rich by arguing that they will, above all, benefit middle-class Americans—coincidentally, those whose votes Mr Bush will need in 2004. The government claimed that the measures announced by Mr Bush would give 92m taxpayers an average tax cut of $1,083 this year. “By speeding up the income-tax cuts, we will speed up the economic recovery and the pace of job creation,” said the president. “If tax relief is good enough for Americans three years from now, it is good enough for Americans today.”

The funds set aside to ease the financial plight of the unemployed, and for the states who shoulder much of the burden of helping them, are small by comparison with Mr Bush’s tax-cut plans. So too are the Democrats’ own plans for a stimulus package: $136 billion, with the bulk coming in the first year. The Democrat plan, released on January 6th, is little more than a base from which to criticise Mr Bush. Since losing control of the Senate in the November mid-term elections, the Democrats have been struggling to put together any coherent opposition to the Republicans, who now control both houses of Congress.

Even so, Mr Bush has a tough battle on his hands. The Republicans in Congress, and especially in the Senate, are not all convinced either of the need for a package or of the size of some of Mr Bush’s tax-cut plans. John McCain of Arizona, a long-time rival of the president, has already voiced doubts, and the Republicans have only bare majority in the Senate. And a key Democratic supporter of the president’s 2001 tax-cut plan, Senator John Breaux, has said the new plan is too big. Some observers think the White House is already preparing for only a partial victory.

Mr Bush is taking a big political risk with such a large and potentially controversial series of economic measures at this stage in his presidency. If the economy continues to gather momentum, the short-term political consequences may not be all that great: what matters for his re-election campaign is that voters feel more confident about the economic outlook. If the economy is still sluggish in 18 months’ time, though, Mr Bush is bound to get some of the blame, having associated himself so explicitly with efforts to boost recovery.

Perhaps more worrying is the longer-term impact of Mr Bush’s fiscal plans. When he took office two years ago, he inherited projected budget surpluses as far as the eye could see. These have shrunk at alarming speed, reflecting a combination of Mr Bush’s own ambitious tax-cutting programme, higher government spending in the wake of the September 11th attacks and the economic downturn. Excluding social security, the budget is in deficit for most of the next ten years at least—and beyond if Mr Bush succeeds in his separate push to make the 2001 tax cuts permanent beyond 2010. The latest plan reduces what surpluses there might be before then even further. The price of Mr Bush’s stimulus gamble could be an open-ended return to deficit-run government—not necessarily the political legacy he would want.