

The Federal Economic Stimulus Package and the New Mexico Impact

The Issue

The collapse of the housing price bubble and the impact of the subprime lending debacle have made it very likely that a recession will hit the nation beginning in the first half of 2008. The pending slowdown became evident in the increase in unemployment and the anemic growth in Gross Domestic Product during the fourth quarter of 2007. According to the National Bureau of Economic Research (NBER):

A recession is a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales. A recession begins just after the economy reaches a peak of activity and ends as the economy reaches its trough.¹

The impact of a recession on working families can be tracked through several key economic indicators. The Center for Economic and Policy Research recently released a paper called "What We're In For: Projected Economic Impact of the Next Recession." The authors, John Schmitt and Dean Baker, use the experience of the last three recessions to forecast the impact of the recession of 2008 on the workforce. The story is sobering. The 2008 recession will result in a severe negative impact on the living standards of the American worker in five ways: 1.) a substantial increase in unemployment; 2.) a decline

in the employment rate; 3.) a decline in the proportion of the population covered by health insurance; 4.) a decline in average family income; and 5.) an increase in the number and percentage of Americans living in poverty.

Policy Options

Several proposals were put forth in Washington in an attempt to avert the onset of the recession or to blunt its effects. To their credit, both Congress and the White House realized that policy measures needed to be taken swiftly, and a compromise plan was reached between the White House and Congress in early February 2008.

The compromise stimulus package, however, is inadequate. Although the plan provides \$150 billion in stimulus, the impacts will not be timely and they will eventually have a negative effect on state budgets. The plan has two main components: a rebate package for households and a set of business investment incentives. The main problem with the rebate package is that checks will not be sent out until May or June. By this point the recession may be fully upon us. In addition, the investment incentives to business could cost New Mexico's state government up to \$27 million because of the linkage between state and federal income taxes.²

Other stimulus policies could have a much more certain anti-recession impact than the business incentives in the compromise stimulus package. For instance, additions

¹ The NBER's Recession Dating Procedure, Business Cycle Dating Committee, National Bureau of Economic Research, Wash., DC, October 21, 2003

² "‘Bonus Depreciation’ and ‘Expensing’ Would Cost States Billions of Dollars," Center on Budget and Policy Priorities, Wash., DC, January 22, 2008

to food stamp payments would help those who will not be covered by the tax rebate program because they don't file tax returns. Extending the period during which unemployment compensation could be received would also provide a boost to those most likely to spend their increased income. Both of these measures would provide more lift to the economy, and the unemployment compensation extension would help about 6,000 New Mexicans who are likely to exhaust their unemployment in the first six months of 2008.³ The Senate Finance Committee package initially included an extension of unemployment compensation, but it was stricken from the final bill.

The final component of an effective stimulus package is direct aid to state government. In the first George W. Bush recession in 2001, Congress enacted a program to increase the federal match to the Medicaid program, which provides health insurance for low-income Americans, along with a flexible block grant to state governments. That measure was delayed to Federal Fiscal Year 2003. The contribution of the Medicaid match increase to

New Mexico state government in FFY 2003 was slightly more than \$100 million, a significant contribution to a state budget of about \$6 billion.⁴

Local Impacts

The New Mexico state revenue picture will be grim next year. State revenue growth is expected to slow drastically even in the absence of a national recession. If the national economy topples into recession, growth in state government revenues will slow even more. State government will be forced to confront revenue deficiencies by cutting services or raising taxes. Both cutting services and raising taxes aggravate the impact of a recession on the economy. During a recession, the government should be increasing expenditures and cutting taxes, not the reverse. Stimulus measures that include assistance for state governments would help avert cuts in programs for health care, education and public safety. Direct help to state government would also act to soften the impact of the loss in revenues due to the ill-advised business tax cuts.

³ "Senate Proposal to Add Unemployment Insurance Benefits Improves Effectiveness of Stimulus Bill," Center on Budget and Policy Priorities, Wash., DC, January 31, 2008

⁴ Budget Brief 08-01, State Grants proposed as Part of Economic Stimulus Package, January 29, 2008, Federal Funds Information Service, Wash., DC, 2008

The Fiscal Policy Project, a program of New Mexico Voices for Children, is made possible by grants from the Annie E. Casey Foundation, Brandon Roberts & Associates, the Center on Budget & Policy Priorities, and the Economic Policy Institute.

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New Mexico Voices for Children
2340 Alamo S.E., Suite 120
Albuquerque, New Mexico 87106
(505) 244-9505
www.nmvoices.org