

Understimulated

Why rebate checks won't buy us a better economy.

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The Senate seems to have agreed on a deal for a [stimulus package](#) that would send more than \$100 billion in cash (checks of \$600 to individuals making less than \$75,000 and \$1,200 to families making less than \$150,000) to American taxpayers later this spring. And not a moment too soon. [Falling employment](#), [slowing growth](#), and [terrible January retail sales](#) indicate a serious slowdown is upon us. Even Wall Street economists, typically the last to notice a recession coming, [have seen the dark](#).

The theory behind the rebates is that American taxpayers, being Americans, will take the \$100-plus billion, and spend it--thus providing a jolt of stimulus to the economy.

But will they? A survey that arrived in my inbox from [American Century Investments](#) found that only 27 percent would spend the rebate right away, while 36 percent would use the cash to pay down debt and 25 percent would save or invest it. Of course, surveys document intentions rather than actions. But if the folks in the survey are true to their word, the stimulus will be less than stimulating. Putting a few hundred bucks in a certificate of deposit, or in a mutual fund that invests in Indian stocks, or paying down your home equity line of credit won't do much to help the proprietor of a local boutique, or Wal-Mart.

We've been here before. In 2001, Washington sought to jolt the economy back into life with tax rebates. Economists have studied that episode and its impact. (For an excellent primer on stimulus, see this [paper](#) by Jason Furman and Douglas Elmendorf of the Brookings Institution.) The bad news: a stimulus may not deliver the immediate jolt that we hope it will. The good news: Americans don't have a good track record of keeping their promise to be thrifty.

Between July and September 2001, the U.S. government mailed income tax rebates of \$300 to individuals and \$600 to married couples. In all, 90 million households received some \$38 billion in cash, a sum equal to 0.4 percent of 2001 Gross Domestic Product. At the time, the folks at the University of Michigan who [gauge consumer sentiment](#) quickly added some questions to their surveys about what consumers would do with their rebates. The results are described in this [paper](#) by Joel Slemrod and

Matthew Shapiro. In the late summer and fall of 2001, only 21.8 percent of those receiving the rebate said it would lead them mostly to increase spending, while one-third said it would lead them mostly to save, and 45 percent it would lead them mostly to pay down debt. Slemrod and Shapiro note that their findings echoed those of a Gallup Poll from July 2001: 17 percent said spend, 32 percent save, and 47 percent pay off bills. Another result from the survey confounded conventional wisdom: Those with less income said they'd be more likely to save the rebate than those with more income.

"This spending rate is remarkably low," Slemrod and Shapiro concluded. They suggested that the responses imply that such rebates have "a small impact on aggregate demand" and that the result "raises a cautionary note about the reliability of fiscal policy in general." Of course, the answers could have been dictated in part by the questions. When asked if a check from the government will lead you "mostly to increase spending, mostly to increase savings, or mostly to pay off debt," it's probably natural to respond by saying you'll do the responsible thing (save or pay debt) rather than the irresponsible thing (spend it immediately).

When economists delved into consumption and spending data in the months after the rebates, they discovered that Americans were either lying to pollsters or simply unable to control themselves. Upon [crunching the numbers](#), David Johnson of the Bureau of Labor Statistics, Jonathan Parker of Princeton University and Nicholas Souleles of the Wharton School found that "households spent 20-40 percent of their rebates on non-durable goods during the three-month period in which their rebates were received and roughly another third of their rebates during the subsequent three-month period." The rebates helped boost total personal consumption expenditures by an impressive 0.8 percent in the third quarter and 0.6 percent in the fourth quarter. They also found, contra Slemrod and Shapiro, that "people with low income and low levels of liquid assets spent more." In addition, there's evidence that moves to pay down debt today simply laid the groundwork for higher spending in the future, as noted in this [paper](#) by Sumit Agarwal of the Federal Reserve Bank of Chicago, Chunlin Liu of the University of Nevada at Reno and Souleles. They found that, "on average, consumers initially saved some of the rebate, by increasing their credit card payments." But down the road, in the nine months after receiving the rebate, credit card spending rose again.

Of course, there's no guarantee that American will turn their 2008 rebates into consumer activity instantaneously, or in six months. The only way to do that would be to make the rebate something more like a reimbursement. Require taxpayers to collect \$300 worth of receipts from the Cheesecake Factory, Target, and Dick's Sporting Goods, and then mail them to the IRS order to receive a rebate. That would certainly be a backwards way of boosting the economy. But it would be perfectly in keeping with Washington's general approach to managing the nation's fiscal affairs.

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