Economist's View

Economist's View, January 16, 2008

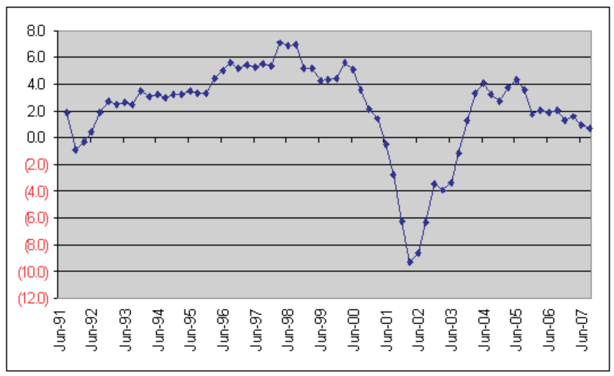
"A Tool to Stimulate the Economy"
By Mark Thoma

Jared Bernstein writes to the editor of the *NY Times* about how to stimulate the economy:

> "A Tool to Stimulate the Economy"
> To the Editor:
>
> Your Jan. 8 Business Day article about economic stimulus didn't mention one important tool that has particular currency right now: ratcheting up federal grants to states. States and localities depend on property taxes to finance much of their operations, but as foreclosures grow and home values fall, local revenues are taking a big hit, forcing towns and cities to cut back on needed projects at precisely the wrong time, economy-wise.
>
> Tax collections are already down in 24 states because of the housing slump, and the 10 states hit the hardest, including California, will lose $6.6 billion in tax revenue this year. By increasing aid to states, the federal government can help offset this revenue crunch.
>
> Moreover, economists have shown that this type of stimulus works quickly and effectively, with a large bang for the buck.

Here's a bit more on this point. This is the year-over-year growth rate for state tax revenues. The quarterly data are a bit noisy, so the data are smoothed by taking a three quarter centered moving average, e.g. the observation dated 2002:Q2 is the average from 2002:Q1 through 2002:Q3:

Year-over-Year Growth in
State Tax Revenue
(Three Quarter Centered Moving Average)



[Data: Rockefeller Institute at SUNY State Revenue Report]

As you can see, state revenues are beginning to fall. States can amplify cycles when they are forced to cut spending as state revenues fall, so Jared's idea is a good one. Preventing layoffs by helping states avoid cutting back on projects is just as good, better even, than attempting to create new jobs after the workers have been laid off.