Federal Reserve Bank *of* Atlanta

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Did the stimulus package actually stimulate?

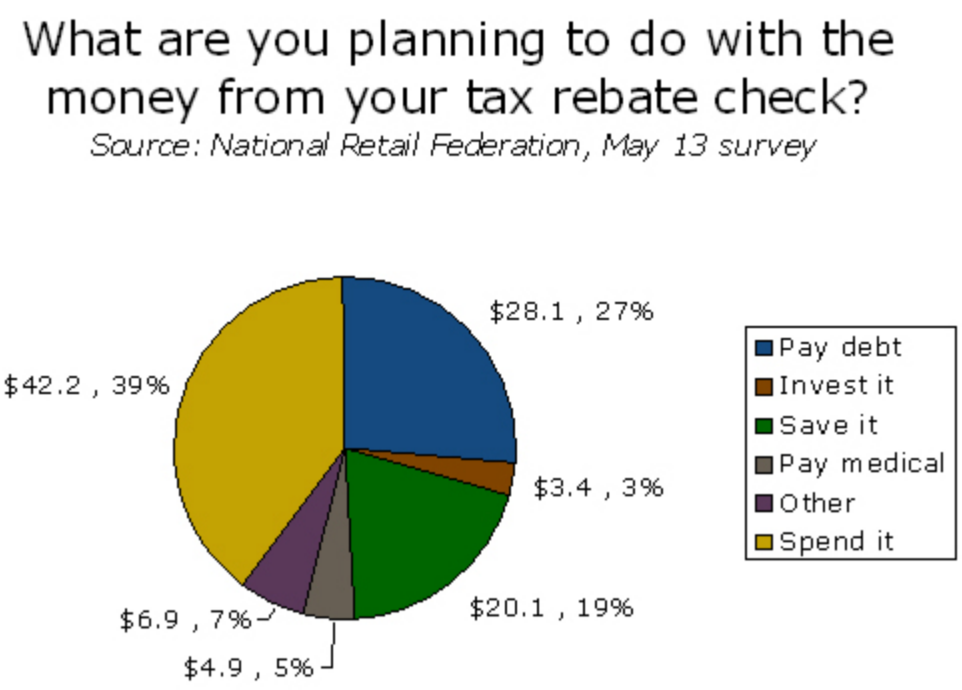
One of the big questions of the policy season is surely "Did the $100 billion of tax rebates distributed to households in May, June, and July actually work?" "Work" in this case means "stimulate consumer spending." You may want to sit down before I tell you this, but so far economists disagree. In one corner you have Christian Broda at the University of Chicago and Jonathan Parker at Northwestern University:

> The Economic Stimulus Act of 2008 was aimed at increasing disposable income temporarily through tax rebates in the hope this would stimulate spending and end or at least mitigate the severity of a U.S. economic slowdown. We find that to a significant extent they succeeded. The stimulus payments are initially being spent at significant rates. These rates are slightly higher than those observed in 2001 when fiscal policy has been credited with helping end the 2001 recession.

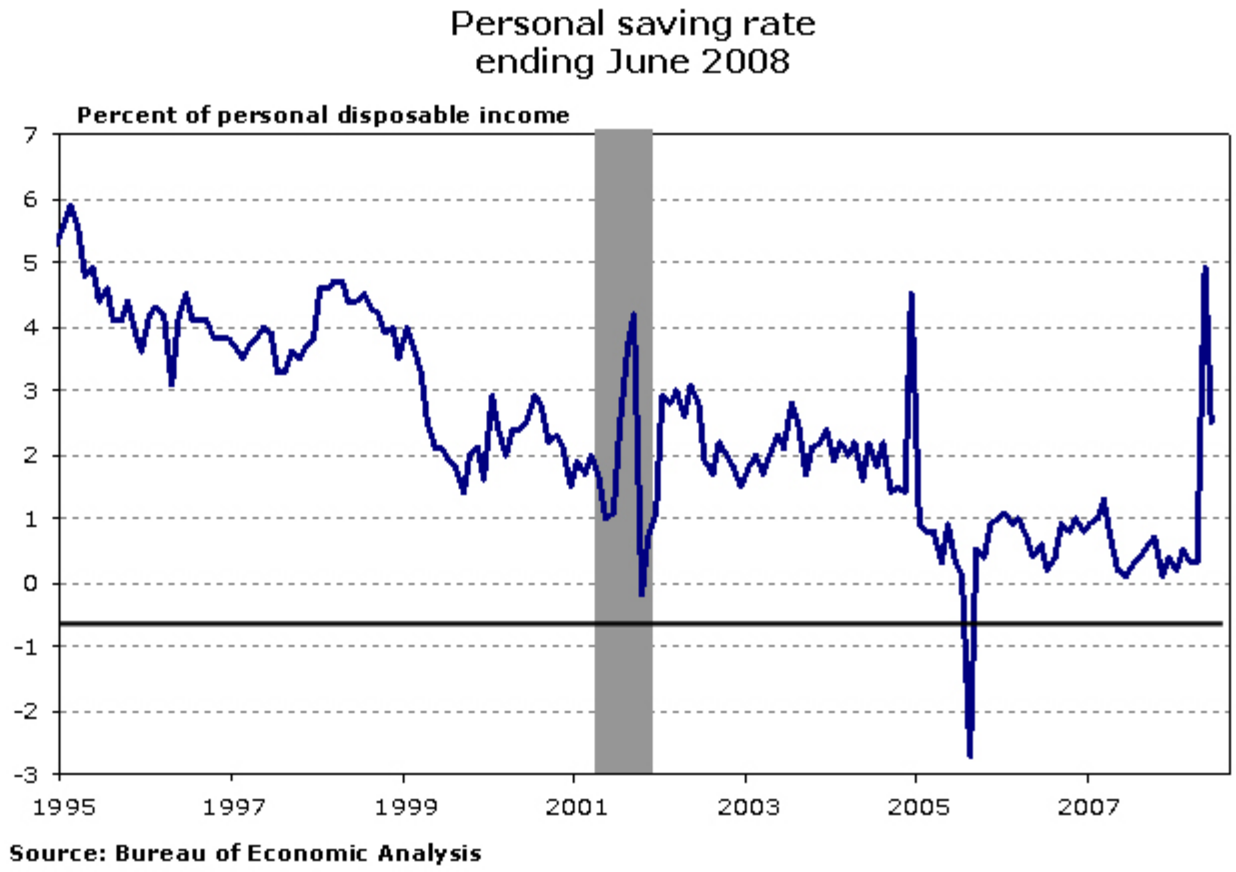
In the other you have Martin Feldstein:

> Although press stories emphasizing that the rebates induced additional consumer spending were technically correct, they missed the important point that the spending rise was very small in comparison to the size of the tax rebates.
>
> A recent, widely reported academic study by Christian Broda and Jonathan Parker showing that the rebates led to increased spending on nondurable items (like food and drugs) does not contradict the implication of the more comprehensive data—on national retail sales and total consumer spending—that the induced rise in consumer outlays was small relative to the size of the rebate.

Oh boy. Let's back up a step. Before the fact, here is what people said they were *planning* to do with their rebates (by at least one report):



So what did the people receiving the rebates do with them? Well, if we could answer that one, it would be easy to resolve the Feldstein vs. Broda-Parker dispute. It does seem undeniable that a pretty good piece of those rebates was saved, at least in the first two months.



Can those elevated saving rates recorded in May and June reflect an outbreak of thriftiness? The real answer is “who knows?” but we can do a little back-of-the-envelope arithmetic to put things in perspective. Ignoring the Katrina-related dip in August 2005, the average saving rate from the beginning of 2005 through this past April was about 0.61 percent.

So, here’s the question: Assuming that consumers saved out of nonrebate income at the rate of 0.61 percent, how much would they have had to save out of the sums distributed in May and June to raise the overall saving rates to the observed values of 4.9 and 2.5 percent?

If you do the annualized calculation for the $43 billion of rebates in May and $28 billion in June you get some pretty striking numbers: An implied saving rate out of the rebates of somewhere in the neighborhood of 83 percent in May and 63 percent in June.

You can argue that there is a sense in which even these figures are understated. Durable goods purchases, for example, are theoretically a form of household saving, and the Broda-Parker survey respondents did indicate that about 20 percent of their rebates went toward the purchase of durables. However, if that is so durable expenditures without the tax rebates would have been really low. Though expenditures on durables grew at an annualized rate of 5.8 percent in May—not bad—they shrank by 17.4 percent in June.

These back-of-the-envelope calculations are pretty rough, of course, but they are broadly consistent with evidence from the 2001 tax rebates. That evidence also suggests that about one-third of the rebates were spent in the quarter following their disbursement, so the spending effects of this year’s model may yet have legs.

On the other hand, even if the rebates do prop up consumer spending in the short run, that would hardly settle the debate about whether they were the best way to spend $100 billion. But that’s a different debate for a different time.

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