The JFK Stimulus Plan

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Got an economic downturn? Need a stimulus package? Why not adopt full or partial first-year expensing (or its cousin, the investment tax credit), which has come to the rescue many times since 1962, when President John F. Kennedy first administered this type of remedy to the economy?

By allowing more of the cost of machinery and equipment to be deducted more quickly, first-year expensing causes new investment to be made sooner. More investment means more productivity -- and 80% of the net benefit from increased productivity goes to labor. Expensing is a no-risk tax cut. It worked four times in the 1960s and 1970s. It worked in 1981-1982 and again in 2002-2004.

It also has bipartisan appeal. Democrat Dan Rostenkowski proposed it in 1981, when he was Chairman of the House Ways and Means Committee. More recently, Democrat Max Baucus, the current Chairman of the Senate Finance Committee, was the Senate sponsor of 30% partial expensing in 2002.

During the recession that started in 2000, the economy did not respond much to a Keynesian tax cut in 2001, consisting mostly of a new 10% bottom bracket for individuals and a child credit. In the first quarter of 2001, real investment began falling at an annual rate of 6%. The decline was stopped by the 30% partial expensing enacted in the spring of 2002. Investment started rising again at a real annual rate of 9% beginning with the enactment in 2003 of 50% partial expensing, in combination with lower rates of tax on capital gains and dividends.

Expensing is the favorite of tightfisted budgeters because ultimately it pays for most of its cost. This is true even when the Treasury uses old-fashioned static revenue estimates that do not take into account feedback revenues from the large amount of induced economic growth. Expensing is the low-cost remedy because it does not create any new deductions, but merely accelerates forward in time currently allowable depreciation write-offs.

Much of the revenue payback starts quickly. In the case of a full, first-year deduction for the cost of equipment with a five-year depreciation life, the Treasury gets 52% of its money back in the first two years. The economy gets a boost even quicker.

In terms of the real benefit from capital investment -- induced economic growth and higher living standards -- first-year expensing produces enormous bang for the buck. Experience in 2003-2004 shows that new orders for manufacturing equipment and other business durables begin to be placed within weeks of the enactment date. Small businesses and other producers will not order what they do not need. But when the price goes down (which is the effect of expensing), they can afford to order what they do need more quickly, and in larger volumes.

An analysis for the Institute for Policy Innovation in 2001 concluded that, over time, each $1 of tax cut from first-year expensing produces about $9 of additional GDP growth. The high ratio occurs in large part because more capital investment leads to more employment and higher wages.

Expensing is not the favorite of the financial accountants who treat it as a tax deferral rather than a tax cut -- and for that reason it is probably also not the favorite of some corporate financial officers. But it ranks very high with economists, tax reformers and many members of Congress. In fact, first-year expensing is not a stimulant for emergency use only. It is the correct way to treat capital investment and is, therefore, a key component of all mainstream tax-reform proposals.

A surefire economic stimulus with an exceptional pedigree that ultimately pays for most of its cost and can get enacted ought to be at the top of the list for inclusion in President George Bush's upcoming State of the Union message. It ought also to be made a permanent part of the tax code.

Although essentially revenue neutral in the long run, full and permanent first-year expensing is not "free" from a budget-accounting standpoint. The static revenue cost may on average be as much as $80 billion per year until it is paid back. But these sums do not take into account feedbacks, and are relatively small compared to all the money that simply falls through the cracks on the spending side of the budget. And then there are all the earmarks and other waste.

Surely Congress and the administration can find enough money to finance the temporary cost of a much needed tax reform that will make the American people at least $2.5 trillion better off through economic growth.

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