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Tax Rebates May Be Used To Cut Debt This Time

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As Washington debates an economic stimulus package that could give taxpayers back as much as $150 billion in lump-sum refunds, not all economists see this as a way to kick-start consumer spending.

Consumers did take the money and spend it after they received tax-rebate checks in 2001, pumping energy into the economy and -- say some economists -- helping stave off a lengthy recession. But at least one economist argues that 2008 bears no resemblance to 2001 and that consumers may well act differently this time, and keep their purse strings tightened.

"We were at a different place then," said Michael Niemira, chief economist for the International Council of Shopping Centers. "Consumers are more apt now to turn to debt reduction as opposed to spending."

President Bush and congressional leaders are negotiating an economic stimulus package that could give taxpayers back as much as $150 billion in lump-sum refunds, among other proposals. Mr. Bernanke last week told members of the House Budget Committee that a temporary plan to put money in the hands of consumers should be put in place swiftly to prop up spending within the next 12 months.

"Getting money to people quickly is good and getting money to low- and moderate-income people is good to get a bigger bang for the buck," Mr. Bernanke said, noting that $100 billion of stimulus "would be certainly measurable and would not be window dressing."

At that rate, consumers could expect to receive checks ranging from $600 to $1,000 per household. Consumers are likely to pick one of three options for the money: Spend it, use it to pay down debt, or save it.

Many economists and analysts say consumers will repeat their actions following the 2001 tax-rebate checks, when checks ranging from $300 to $600 were widely considered an unexpected windfall and spent on appliances, electronics and home goods.

"There's history behind this and the evidence is that it works," said David Wyss, chief economist for Standard & Poor's. "Give the average consumer a check for 50 bucks and he knows what to do with it."

Personal spending surged sharply in the quarter following the 2001 tax rebates, according to a Congressional Budget Office paper released last week. Consumer studies since that give-back have determined that 20% to 40% of those checks were spent within days after they were received, while two-thirds of the cumulative rebate was circulating in the economy by the end of the following quarter. Consumers tucked away only one-third of the rebate.

Retailers such as **Wal-Mart Stores** Inc. and **Costco Wholesale** Corp. turned into mini-banks as a place for shoppers to cash their rebate checks. As hoped, the cash burned holes in consumers' pockets while they were shopping in those stores and prompted them to keep up the spending spree.

If the same holds true this year, Mr. Wyss said, consumers will continue to scoop up the things they have been buying for the past six months -- electronic -- and continue to ignore apparel, footwear and home goods.

"If you ask consumers what they'll do with the money, they'll say that they spend much less than they actually do," said Moody's Economy.com analyst Scott Hoyt. "A significant number of consumers will say they will use the money to pay down debt. They will take the rebate check and mail it directly to their credit-card provider.

"But what happens to their credit-card balance six months hence? If it's where it was before the rebate checks, they've actually spent it though they don't think they have," he said.

Such stimulus packages are aimed mostly at lower-income consumers who are in the worst financial shape because they will go out and buy things, Mr. Hoyt said. Higher-income families aren't as needy for the money or wanting for goods and tend to save it.

"Think about the stresses on low-income folks with the high energy prices and such," he said. "They will be relieved to see the money and that they can spend it."

Mr. Bernanke said much the same to the House committee, noting that studies "suggest that people of lower income or those who are 'liquidity constrained' are more likely to spend in the near term."

"Liquidity constrained" is a euphemism for broke and at the end of the line when it comes to borrowing. Many of those consumers would take on more debt if creditors let them, and they have a higher propensity to spend rebate checks.

In 2001, low-income households were likely to spend more than the amount of the full rebate, while middle-income households increased spending by less than 20% of the refund check.

The same is true for households with lower credit-card limits, according to the CBO paper. In 2001, families with credit limits under $7,000 upped their spending by more than $140 soon after they got the rebates. Those with credit limits above $10,500 spent only $40.

Families that carried credit-card balances that were 90% or more of their limits increased their spending by more than $330, while those with balances from 1% to 50% of their limits raised their spending by fewer than $20.

ICSC's Mr. Niemira said debt is simply too heavy for most consumers to ignore this time. "In the aggregate, the rebates will soften the broader impact of the overhang in debt," he said.

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