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Consumers not likely to spend tax rebates

Kathleen Pender

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Congress is plowing ahead with a plan to stimulate consumer spending by issuing tax rebates, even though most Americans say they would save them or use them to pay off debt.

I looked at five formal or informal surveys that asked consumers whether they would save, spend or apply rebates toward debt.

Only 15 to 38 percent said they would spend them.

The biggest group - 27 to 51 percent - said they would use them to pay debt or bills; 18 to 36 percent said they would save or invest them (See box on Page C4).

In a sixth survey, which didn't give debt-payment as an option - 51 percent of respondents said they would spend the money, 36 percent said they'd save it and 10 percent said they'd spend some and save some.

Granted, some of the surveys were not scientific. The Turbo Tax and Wall Street Journal polls were based solely on people who responded to online polls.

Still, the results are hard to ignore, especially because they correspond fairly closely to the results of an academic survey that asked people what they did with tax rebates they received in 2001.

But what consumers say they will do and what they really do are two different things. A lot of us vow to get in shape in January. By June, we haven't lost a pound. A separate academic study suggests that consumers who paid down credit card cards with their 2001 refund had put it back on their credit card within nine months.

Although saving or repaying debt would certainly benefit many households, it wouldn't have the desired economic impact - preventing a recession by stimulating consumer spending, which accounts for more than two-thirds of gross domestic product.

A plan passed by the House would provide rebates of up to \$600 for singles and \$1,200 for married couples, with an additional \$300 per child. The tax rebates would begin phasing out for individuals earning more than \$75,000 and married couples making more than \$150,000.

A Senate version would provide up to \$500 for individuals and \$1,000 for couples, plus \$300 per kid. The rebates would start phasing out at roughly twice the income limits in the House plan. The Senate bill would extend rebates to seniors living on Social Security and disabled veterans.

Both houses would have to agree on a compromise bill before it could go to President Bush's desk. This being tax-filing season, the Internal Revenue Service probably would not begin issuing checks until mid-May.

Economic studies show that before 2001, rebates didn't work because by the time Congress got around to approving them, the economy had already recovered.

The 2001 rebates were different because they were sent out quickly - while the economy was still in a recession. But there's still debate as to their effectiveness.

University of Michigan economists Matthew Shapiro and Joel Slemrod asked households in the fall of 2001 what they planned to do with their rebates. They found that only 21.8 percent planned to spend most of their refund, 32 percent said they would save most of it and almost 46.3 percent said they would use it mostly to pay off debt. A follow-up survey in 2002 yielded similar results. They found "no indication that low-income households were more likely to spend the rebate - in fact, higher-income households were more likely to say that the tax rebate led them to mostly increase spending."

A separate team of researchers attempted to see what consumers actually did with their rebates - not what they said they would do. David Johnson, Jonathan Parker and Nicholas Souleles gauged the impact of the tax rebates by looking at changes in the government's Consumer Expenditure Survey. They concluded that Americans spent 20 to 40 percent of their rebates in the first three months, and had spent two-thirds of it within nine months of receiving it.

They found that lower-income people spent more of their rebates than middle-income people. Higher-income people spent more than middle-income people, but this difference was not statistically significant. The study estimated that the rebates raised total personal consumption by 0.8 percent in the third quarter of 2001 and 0.6 percent in the fourth.

In a follow-up study, Souleles, an associate professor at the Wharton School, looked at the impact of the rebates by focusing strictly on credit card data.

The study showed that households' credit card debt immediately dropped upon receipt of the 2001 rebate, but rose over the next nine months, suggesting that the rebate that was originally used to pay off debt was later spent.

Souleles divided credit card customers into those whose balances were at or near their credit limit and those whose balances were farthest from their limit. He called these people liquidity constrained and unconstrained, respectively.

He found that "the unconstrained guys used the rebate to pay down debt and their debt stayed down for the period we were observing - nine months."

The constrained people also paid off their debt initially, but their balances started rising in the second month after they received the rebate and continued rising through the eight months.

"Insofar as your goal is to stimulate the economy, the result is you want to target to constrained households," Souleles says.

Whether the 2008 rebates, if they get passed, would have the same impact is an open question.

The 2001 rebate "was really unique based on previous experience in that the timing was very good and it was the first installment of a longer-term tax cut. That gave people an added reason to spend it," says Stanford University economist John Taylor.

The 2001 rebate was an advance refund of a tax cut that lowered the lowest marginal tax rate to 10 percent from 15 percent. That tax cut is still in effect through 2010.

The tax cut Congress is contemplating now would come from lowering the lowest marginal rate - which applies to the first \$6,000 in income for singles and \$12,000 for couples - from 10 percent to zero, but only for one year - 2008.

"You really can't expect too much from a package like this," Taylor says. "My own feeling is that, if it's possible to add to this some more permanence to the program, it would help a lot."

On a related note, in response to my Jan. 29 column - which answered questions about the House-approved tax rebates - quite a few readers asked if they would get a rebate if they owed the IRS back taxes.

IRS spokesman Jesse Weller says he cannot answer that question, because the rebates are not approved. But he says the 2001 rebates, which he calls an advance payment, were applied first to any federal income tax owed. "If the advance payment amount for a taxpayer was larger than the debt owed, the taxpayer got a check for the difference. If the full amount of the advance payment was applied to the back taxes owed, they did not receive a check."

-- What will you do with your rebate? To vote, go to the poll above on this page.

Not in a spending mood

Most people say that if they receive a tax rebate, they will save it or use it to pay off debts, according to scientific and unscientific polls.

Survey	Spend	Save/ invest	Pay debt/bills	Not sure/ other
ABC News/				

Washington Post	20%	33%	31%	16%
Lightspeed Research	20	24	51	5
TransUnion/ Zogby International	21	27	42	10
TurboTax	38	18	43	NA
Wall Street Journal online	15	33	27	25
Fox News/ Opinion Dynamics*	51	36	NA	3

*An additional 10 percent said they would save some and spend some of their rebate. Paying debt was not a survey option.

Source: Chronicle research

Net Worth runs Tuesdays, Thursdays and Sundays. E-mail Kathleen Pender at kpender@sfchronicle.com.

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