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How To Get Consumers To Spend Again

By JON BARON and ROBERT SHEA, The Fiscal Times on Nov 30, 2010

Conventional wisdom holds that the fate of the U.S. economy lies in the hands of the American consumer, who must start spending again to sustain the recovery and generate rapid job growth. Indeed, consumer spending comprises 70 percent of G.D.P., so pinning our hope on consumers coming back to life does not seem unreasonable.

But when it comes to how to make that happen, conventional thinking offers no more than that: hope. With the Federal Reserve having pushed interest rates to near zero, policymakers have little remaining influence over consumer spending, whose course will instead be shaped by unpredictable factors such as consumer confidence and the unemployment rate. The main policy instrument proposed to stimulate consumer spending is a tax cut, but critics argue that consumers will save rather than spend most of it, especially in a weak economy.

In fact, there is strong reason to believe that how a tax cut is offered – its specific form and method of delivery – can make a major difference in its effect on consumer spending. Evidence on behavioral change suggests it could actually have a large impact if provided to consumers with a clear incentive and easy path to spend it.

Consider the following illustrative approaches, which Congress and the President could readily incorporate into any forthcoming agreement on extending Bush-era tax cuts.

- Consumers could be given a tax rebate check accompanied by a list of businesses that have agreed to provide a storewide 20 percent discount to customers who make a large purchase with their check within three months.
- Consumers could be given a rebate check with a letter from the President and Congressional leaders urging them to spend rather than save it – and if possible to match it with additional money – as a way to help America sustain the recovery and create jobs.
- Consumers could be given a six-month holiday on their state sales tax, with the federal government reimbursing the state for the lost revenue.

Some strategies of this type would work--inducing the burst of spending needed to jump-start the economy toward sustained recovery--because they do not require a change in behavior, such as losing weight or quitting smoking. Rather, their aim is to get consumers to go on a spending spree with a check from the government--something that many would find, well, enjoyable. And, absent a difficult behavioral change, positive results can often be induced through small financial incentives, easy access, or even a straightforward request.

This concept has been demonstrated in rigorous studies, using the gold-standard method of randomly assigning individuals to treatment and control groups, in diverse areas. For example, nonpartisan door-to-door canvassing to urge people to vote has been shown to raise voter turnout by between two and nine percentage points. Greatly simplifying the federal college financial aid application process for low income students was shown to increase their likelihood of enrolling in college the following fall by 26 percent compared to students eligible for the same aid through the usual process. In rural India, a child immunization campaign coupled with small incentives (a $1 bag of lentils for each immunization) was shown to more than double the percentage of young children fully immunized.

It is hard to predict in advance which methods of providing a tax cut will have the largest impact on consumer spending, and indeed some may have little effect. It would therefore be important for the federal government to simultaneously test a variety of methods – for example, by randomly assigning U.S. counties or other jurisdictions to one method versus another, with every jurisdiction getting some form of the tax cut. Those methods found to stimulate the largest sustained spending increases in their assigned jurisdictions over a period of six months or a year would be scaled up nationally.

It has been widely assumed that overall consumer spending is not susceptible to direct policy intervention. The evidence on behavioral change suggests otherwise. We may not yet know exactly which strategies will succeed in getting consumers to open their wallets, but Congress can use any forthcoming extension of the Bush-era tax cuts as an opportunity to find out.

Baron is President of the nonprofit, nonpartisan Coalition for Evidence-Based Policy. Shea is a former Associate Director of the Office of Management and Budget (OMB) for Administration and Government Performance.