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ISSUES IN FOOD ASSISTANCE

Effects of Changes in Food Stamp Expenditures Across the U.S. Economy

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Issue: The Food Stamp Program (FSP) is one of the Federal Government's primary countercyclical assistance programs, providing assistance to more households during a recession and to fewer households during an economic expansion. These countercyclical changes in FSP expenditures can also have beneficial stabilizing effects on the economy, stimulating economic activity during a recession and slowing demand during an expansion. The extent of the program's economywide stabilizing effect depends on how the program is financed. The Budget Enforcement Act of 1990¹ requires that all Federal programs be funded through budget-neutral means (balanced budget) except in emergencies as determined by Congress. The Food Stamp Program provides an economic stimulus during a recession only if emergency-type² financing is used. Determining the ultimate stimulative effect of the Food Stamp Program on economywide consumption, production, and income requires simultaneous analysis of the effect of budgeting requirements, government spending, household spending patterns, labor supply, and the level and distribution of production.

Background: During a recession, FSP expenditures increase as the program expands to provide benefits to more households. The rise in benefits increases spending by recipient households, which then stimulates production. Higher production boosts labor demand and household income. Increased household income triggers additional spending. Ultimately, the initial increase in food stamp expenditures provides an automatic stimulus to an economy in recession. However, this result occurs

only if the Government finances the increase in program expenditures through emergency financing. In a recession scenario with excess liquidity, excess productive capacity, and unemployment, government borrowing does not crowd out private investment. In this case, emergency financing stimulates economic activity.

If the same recession-driven increase in FSP benefits is financed through increased taxes or other budget-neutral means, the stimulus effect of the increase in expenditures is dampened or even reversed. If program growth is financed through an increase in taxes, it redistributes income primarily from high- and mid-income households, in the form of taxes, to low-income households, in the form of food stamps. In this case, the stimulus effect of increased spending by food stamp recipient households is muted by reduced spending by taxpaying households. The net result of the shift in spending from mid- and high-income households to low-income households is an increase in demand in some sectors and a decrease in demand in other sectors. This redistribution of demand occurs for two reasons:

- Households with different income levels spend money differently. High-income households are more likely to spend an additional dollar of income on more expensive goods and services (more expensive automobiles and vacations) than low-income households. Low-income households are more likely to spend an additional dollar of income on necessities such as food and housing.
- Households spend food stamp benefits differently than cash. Economic research has shown that low-income households purchase more food with a dollar of food stamp benefits than with a dollar of cash income. As a result, a transfer of income from all taxpaying households to low-income recipient households in the form of food stamp benefits will likely provide an additional boost to food spending.

¹ The major provisions of the Budget Enforcement Act of 1990 expire at the end of fiscal year 2002.

² In this analysis, emergency financing includes the Food Stamp Program contingency fund. This fund is designed to accommodate caseload increases during a recession that requires expenditures greater than budgeted. Expenditures from this fund do not count against budget neutrality.

Ultimately, whether growth in the Food Stamp Program stimulates economic activity depends on the specifics of the funding mechanism and the economic interaction among households, industry, and government. Analysis of the net effect of these complex interactions requires the use of economywide economic models.

Findings: To investigate the effect of a recession-driven increase in FSP expenditures funded through emergency borrowing, Economic Research Service (ERS) researchers hypothetically increased annual Food Stamp Program expenditures by \$5 billion.³ In this scenario, the funds for program expenditures were borrowed from financial markets without crowding out private-sector investment. Though the amount of the hypothetical change was small compared with total economic production (\$17.3 trillion in 2001) and household income (\$8.7 trillion in 2001), it was close to 32 percent of total program expenditures and close to 12 percent of total food consumed at home by all low-income households. This magnitude of change is not unusual for the Food Stamp Program. For example, food stamp benefit costs are expected to increase by 22 percent, from \$15.5 billion in FY 2001 to \$18.9 billion in FY 2002, in response to rising participation and benefits in the face of a weak labor market.

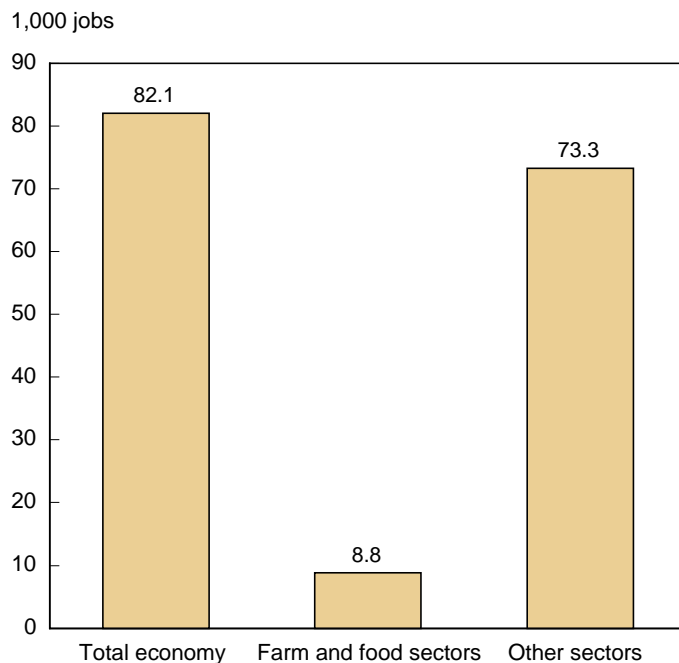
The \$5 billion rise in food stamp expenditures resulted in a \$1.3 billion increase in spending on food items by recipient households. By shifting cash income previously spent on food to nonfood spending, recipient households increased their spending on nonfood items by \$3.7 billion. The increase in demand for both food and nonfood items stimulated new production and jobs in those industries where the demand occurred—and in industries supplying inputs to them. Ultimately, the additional \$5 billion of FSP expenditures triggered an increase in total economic activity (production, sales, and value of shipments) of \$9.2 billion and an increase in jobs of 82,100 (fig. 1). The farm and food-processing sectors gained 8,800 jobs (growth of about 0.22 percent) while nonfood sectors gained 73,300 jobs (growth of about 0.06 percent).

To investigate the effect of an increase in recession-driven FSP expenditures that was funded through budget-neutral tax increases, ERS researchers hypothetically increased both FSP benefits and personal income taxes by \$5 billion.⁴ As in the emergency-financing scenario,

³ For this experiment, researchers used an input-output multiplier model because it provides a good approximation of an economy with excess capacity, labor supply, and financial funds.

⁴ For this experiment, researchers used a computable general equilibrium model because it provides a good approximation of an economy where the funding of Federal Government programs must be budget neutral.

Figure 1—A \$5 billion budget-deficit increase in food stamps leads to job gains in all sectors of the economy



Source: ERS calculations from model analyses.

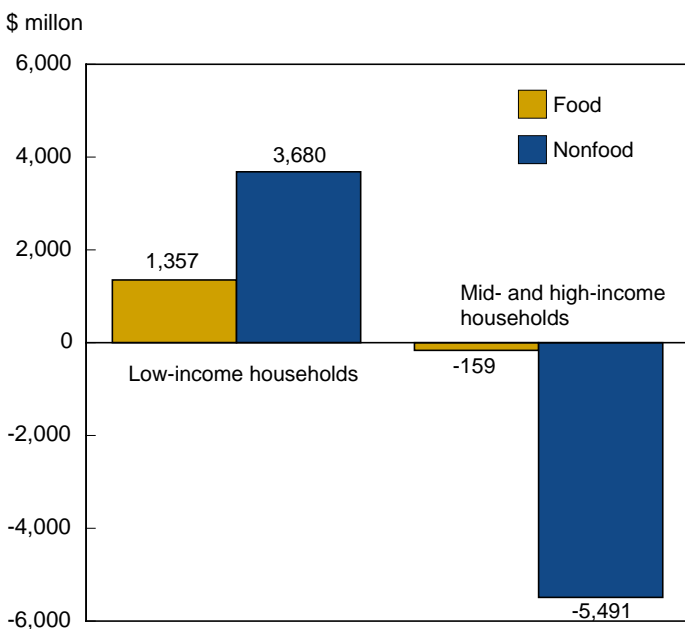
the first effect of the increase in FSP expenditures was a rise in spending by recipient households for both food and nonfood items. However, in this scenario, the rise in recipient household spending was countered by a decline in spending by taxpaying households. Ultimately, once all the economywide effects were accounted for, the budget-neutral \$5 billion increase in food stamp benefits induced a spending increase by low-income households of \$1.357 billion on food and \$3.608 billion on nonfood goods and services. Mid- and high-income households cut food spending by \$159 million and nonfood spending by \$5.491 billion (fig. 2).

As a result of the redistribution of expenditures, total economic activity declined by almost \$1 billion with a loss of 14,400 jobs, though the farm and food-processing sectors had production increases and job gains of 7,870 jobs. The nonfarm and nonfood-processing sectors of the economy declined, losing 22,270 jobs (fig. 3). In aggregate, mid- and high-income households lost 14,000 jobs and low-income households lost 400 jobs. The primary reason for the decline in economic activity and the loss of jobs was that the shift in household spending was toward goods and services produced by relatively less labor-intensive sectors of the economy. As jobs and earnings were lost, household income and spending fell, which led to less economic activity.

After all of the production changes had worked through the economy, household income fell by \$1 billion. However, low-income households had income gains of about 2 percent (\$4.965 billion) due to the infusion of food stamps—though the rise in low-income household income was slightly less than the additional \$5 billion in food stamps because of a reduction in earnings (fig. 3). Income for mid- and high-income households fell by 0.1 percent (\$5.965 billion)—an amount greater than the initial increase in taxes because of a reduction in earnings and a further increase in income taxes (fig. 4). To maintain budget neutrality, income taxes needed to increase by an additional \$134 million to make up for reductions in other tax revenues such as sales tax revenue.

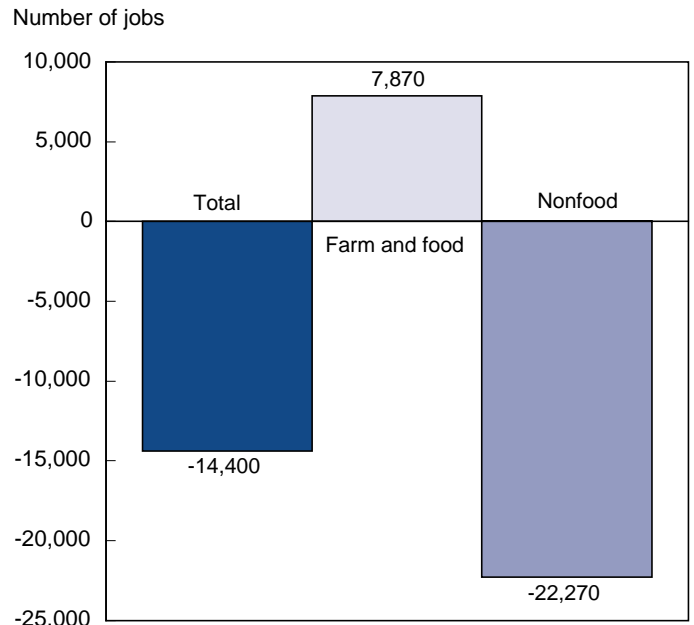
Conclusions: Ultimately, whether growth in the Food Stamp Program stimulates economic activity depends on the funding mechanism—emergency financing stimulates economic activity in a recession, while budget-neutral financing does not. However, in either scenario, the increase in FSP expenditures raises the budgets of food stamp recipient households, stabilizing recipients’ food consumption and their well-being during economic downturns. Both scenarios also result in increased demand and production in the agriculture and food sectors, stabilizing economic activities in these key rural sectors during downturns in the economy.

Figure 2—A \$5 billion budget-neutral increase in food stamps shifts spending from mid- and high-income households to low-income households



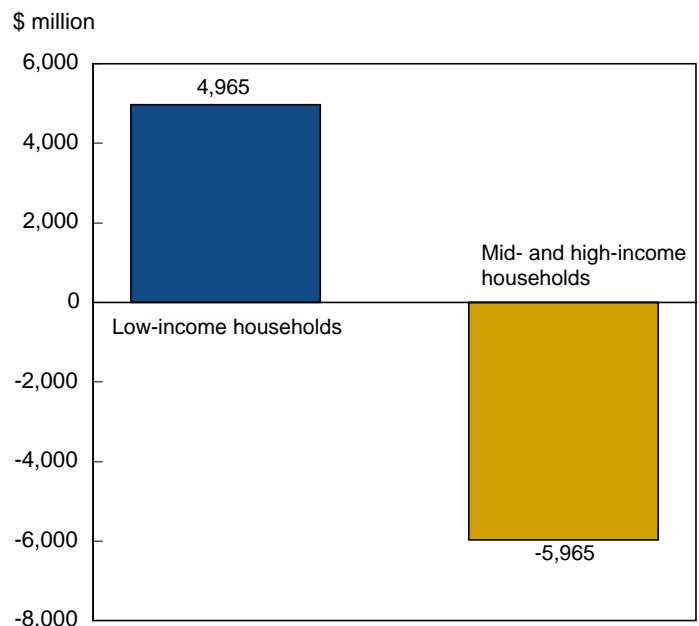
Source: ERS calculations from model analyses.

Figure 3—A \$5 billion budget-neutral increase in food stamps leads to job gains in farm and food sectors and losses in other sectors



Source: ERS calculations from model analyses.

Figure 4—A \$5 billion budget-neutral increase in food stamps raises income for low-income households, but not by the full benefit amount



Source: ERS calculations from model analyses.

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For more on the Food Stamp Program:
<http://www.ers.usda.gov/briefing/foodnutritionassistance/foodstamps>
<http://www.fns.usda.gov/fsp>

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