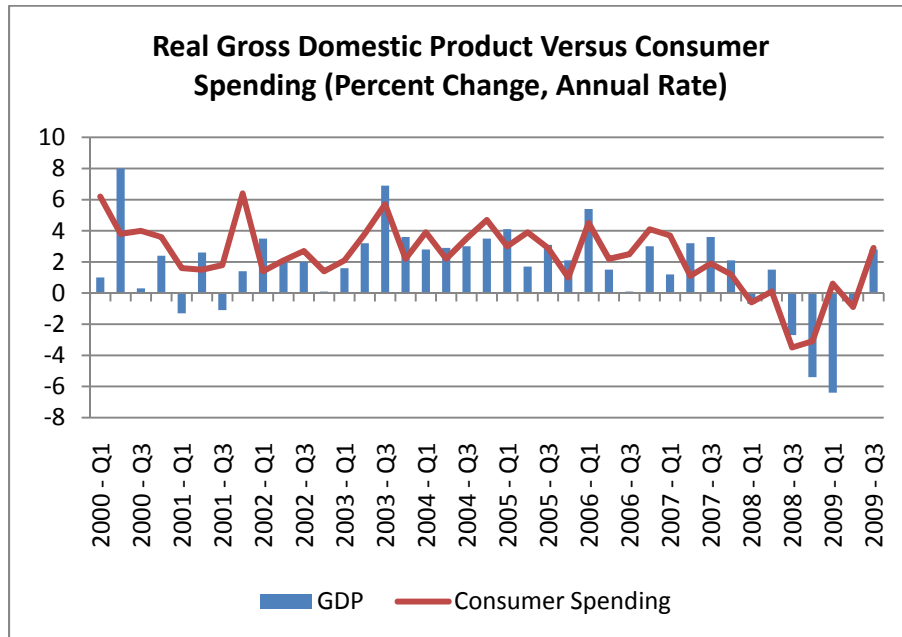


Assessing the Impact of the Government Stimulus

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Economic growth resumed in the third quarter of 2009, posting a 2.8% annual growth rate. The rise was fueled by a jump in consumer spending and government stimulus to the economy.¹ A significant amount of the growth is thought to be attributable to the government's 2009 economic stimulus program, the American Recovery and Reinvestment Act (ARRA). However, it is a challenge to assess the true impact of the stimulus because that requires assumptions about how the economy would have fared if the stimulus money were spent differently, or not at all.



Source: Bureau of Economic Analysis

While the government has only spent a quarter of the stimulus enacted in February, many of the spending projects so far might end up being short-term jolts to the economy that fizzle out, rather than a source of long-term growth. For example, the \$3 billion "cash for clunkers" program, funded partially by stimulus money, pulled consumers into auto dealerships nationwide from July 24 to August 24, when the program ended. Motor vehicle sales soared in August to \$57.7 billion, accounting for 17% of all retail sales for the month, and then slumped in September to \$48.6 billion without the trade-in

¹ Bureau of Economic Analysis.

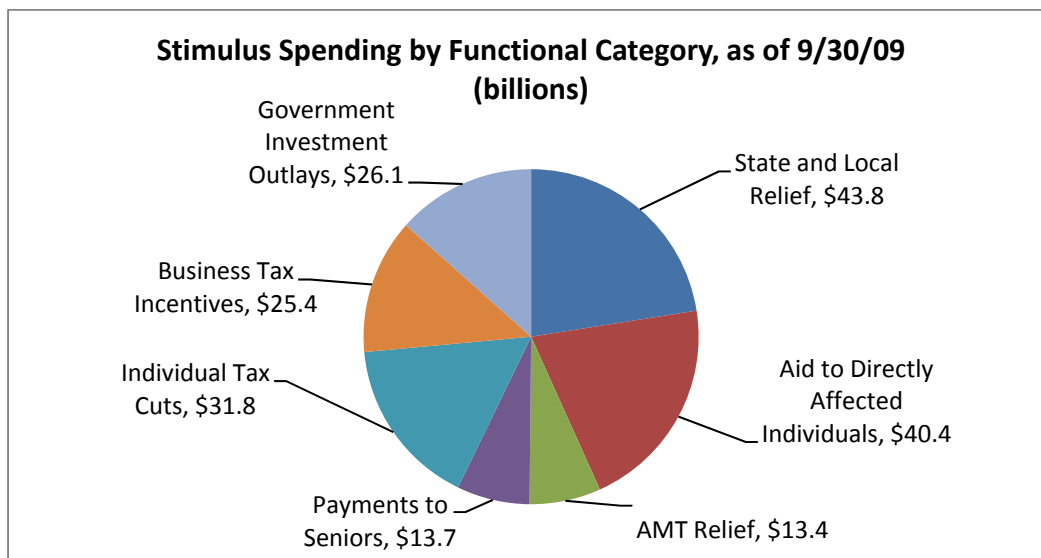
incentive. Since then, auto sales have recovered gradually, according to the motor vehicle sales component of retail sales, rising to \$52.7 billion in October.²

The new homebuyer tax credit program helped spur activity in the housing market in recent months. Originally set to expire November 30, the homebuyer program will be extended until spring of 2010 under recently enacted legislation. This legislation also expands the program to give all homebuyers who meet the income criteria a \$6,500 tax credit, provided they have been in their previous home for at least five years.³ While these programs have provided a boost to the economy, they have been overshadowed by the severe weakness in the labor force that continues to threaten the recovery.

The nonpartisan Congressional Budget Office recently announced that the federal stimulus package saved or created between 600,000 and 1.6 million jobs in the third quarter and raised the gross domestic product (GDP) by 1.2 to 3.2 percentage points above what it would have been without the stimulus.⁴ These numbers are consistent with research by Moody's Economy.com that showed real GDP in the third quarter was 1.5% greater than it would have been without the stimulus. In addition, Economy.com estimated that the stimulus has boosted employment by 1.1 million jobs.⁵

Long-Term Impact

When the stimulus program became law in February 2009, officials planned for much of the money to kick in during 2010. Some parts of the stimulus were quick injections to aid struggling states and the unemployed. But large pieces, such as bridge and park projects, are just getting started now. As of the end of the third quarter of 2009, \$194.6 billion of the ARRA's \$787 billion had been spent.⁶



Source: Recovery.gov

² Census Bureau.

³ "Senate Throws a Lifeline to the Jobless," by Tammy Luhby, CNNmoney.com (11/5/2009).

⁴ "CBO: 600,000 to 1.6 million," Joseph White, wsj.com (11/30/2009).

⁵ Economy.com, Dismal Scientist.

⁶ Recovery.gov.

Since only a small portion of the ARRA funds have been spent, a large amount remains that can contribute to the economic recovery. However, not all of this money will provide a boost to the economy in calendar years 2009-2010. Approximately \$70 billion of this appropriation was for a one-year patch of the Alternative Minimum Tax (AMT). However, Congress has always moved to adjust the AMT in this manner. There was probably no one who actually expected to pay the higher tax rate without an AMT fix, so this patch does not realistically provide any boost to the economy. Furthermore, some of the ARRA spending will continue beyond 2010. For example, the money appropriated for modernizing the electrical grid and computerizing medical records will be spent over the next decade. These may be very useful expenditures, but money spent in 2015 will not boost the economy in the near future.⁷

Taking the \$787 billion ARRA appropriation and excluding the \$70 billion AMT patch and the \$146 billion scheduled to be spent after 2010, the stimulus available for 2009 and 2010 falls to \$571 billion, approximately 2% of GDP for the two years.⁸ Another short-term stimulus will be provided by legislation recently signed by the President to lengthen unemployment benefits by up to 20 weeks. The legislation extends jobless benefits in all states by 14 weeks and an additional six weeks in states with unemployment greater than 8.5%. The benefits will be funded by extending a longstanding federal unemployment tax on employers through June 30, 2011, therefore not impacting the ARRA funds.⁹

State Budget Woes

While the ARRA funds are likely to provide the economy a boost next year, state budgets are facing their steepest decline in tax receipts on record, according to the Center on Budget and Policy Priorities. As a result, even after making very deep cuts, states continue to face large budget gaps. An increasing number of states are struggling to keep their 2010 budgets in balance as they approach the mid-point of the fiscal year (which began July 1 in most states). Because revenues have fallen short of projections, mid-year shortfalls have opened up in 26 states. These new shortfalls are in addition to the gaps states closed when adopting their fiscal year 2010 budgets earlier this year. Counting both initial and mid-year shortfalls, 48 states have addressed or still face such shortfalls in their budgets for fiscal year 2010, totaling \$178 billion or 26% of state budgets, the largest gaps on record.¹⁰

Initial indications are that in the upcoming 2011 fiscal year, states will face shortfalls at least as big as those they faced this year. States will continue to struggle to find the revenue needed to support critical public services for a number of years.

⁷ "The State and Local Drag on the Stimulus," by Dean Baker & Rivka Deutsch, Center for Economic Policy and Research (5/2009).

⁸ Ibid.

⁹ "Obama Signs Jobless Benefit Extension," by Tammy Luhby, CNNmoney.com (11/6/2009).

¹⁰ "Recession Continues to Batter State Budgets," by Elizabeth McNichol & Nicholas Johnson, Center for Budget and Policy Priorities (10/20/2009).

Another Federal Stimulus?

With states facing shortfalls and unemployment remaining high, the ARRA stimulus probably will not be enough to support 3% economic growth next year.¹¹ Even though the stimulus will continue to boost spending next year, problems such as high unemployment and state government budget shortfalls will remain a drag in 2010 and for years in the future. Therefore, while some of the short-term programs like cash for clunkers have had a significant impact on growth, the longer-term infrastructure programs will not provide the large burst to growth that the economy may need next year. Even if the economy is in a sustainable recovery, it will likely be a recovery of slow growth coupled with high unemployment.

It is clear from the slow pace of the economic recovery that another stimulus of some sort is needed to assist the recovery of the U.S. labor market. While there is some political backlash against a second stimulus, it appears that the administration favors additional spending to support the labor market. President Obama spoke on December 8 about many of his proposals to accelerate job growth, such as small business tax cuts, home retrofits, and infrastructure investments.¹² While the 2009 stimulus is working to some extent, it does not appear to be sufficient to significantly lower the unemployment rate.

This article contains forecasts, estimates, opinions, and other information that is subjective. Statements concerning economic, financial or market trends are based on current conditions, which will fluctuate. There is no guarantee that such statements will be applicable under all market conditions, especially during periods of downturn. It should not be considered as investment advice or a recommendation of any kind. All statistics are current as of December 15, 2009, unless otherwise noted.

¹¹ The Federal Reserve is forecasting growth in 2010 to be in the range of 2.5% to 3.5%.

¹² "Obama Focuses on Jobs, Infrastructure, Energy Rebates," by Maya Jackson Randall, Wall Street Journal (9/8/2009).