Committee for a Responsible Federal Budget U.S. Budget Watch

Analysis of The American Recovery and Reinvestment Act

February 17, 2009

Today, President Obama signed into law the *American Recovery and Reinvestment Act of 2009*. The "stimulus bill" represents the latest and largest effort by the federal government to boost the deteriorating economy. (For details of all efforts to date, see www.usbudgetwatch.org/stimulus).

The bill will cost an estimated **$787 billion** over ten and a half years, including **$501 billion in increased spending**, and **$286 billion in tax cuts**. The larger provisions include a $400 per person "Making Work Pay" tax credit, a one–year patch for the Alternative Minimum Tax (AMT), an expansion of food stamps and unemployment benefits, funding for infrastructure projects, increased spending on health care and education, and additional aid to states and individuals.

Fig. 1: Stimulus Spending by Category (billions)

STIMULUS TYPE	COST
Making Work Pay Credit	$116.2
AMT Patch	$69.8
Other Individual Tax Cuts	$46.5
Corporate Tax Cuts	$6.2
Other Tax Provisions	$47.9
Education Spending	$49.7
Health Care Spending	$153.8
Additional Aid to States	$56.3
Infrastructure	$121.2
Unemployment and Other Assistance	$58.1
Food Stamps	$20.0
Other Spending	$41.5
Total	**$787.2**

Source: Congressional Budget Office and Joint Committee on Taxation
Note: Cost represents 10.5 year budgetary impact

Stimulus Spend-out

The final version of the stimulus bill distributes **23 percent** of its total costs in the second half of FY2009, **74 percent** by the end of FY2010 and **91 percent** by the end of FY2011.

Fig. 2: Stimulus Costs by Fiscal Year (billions)

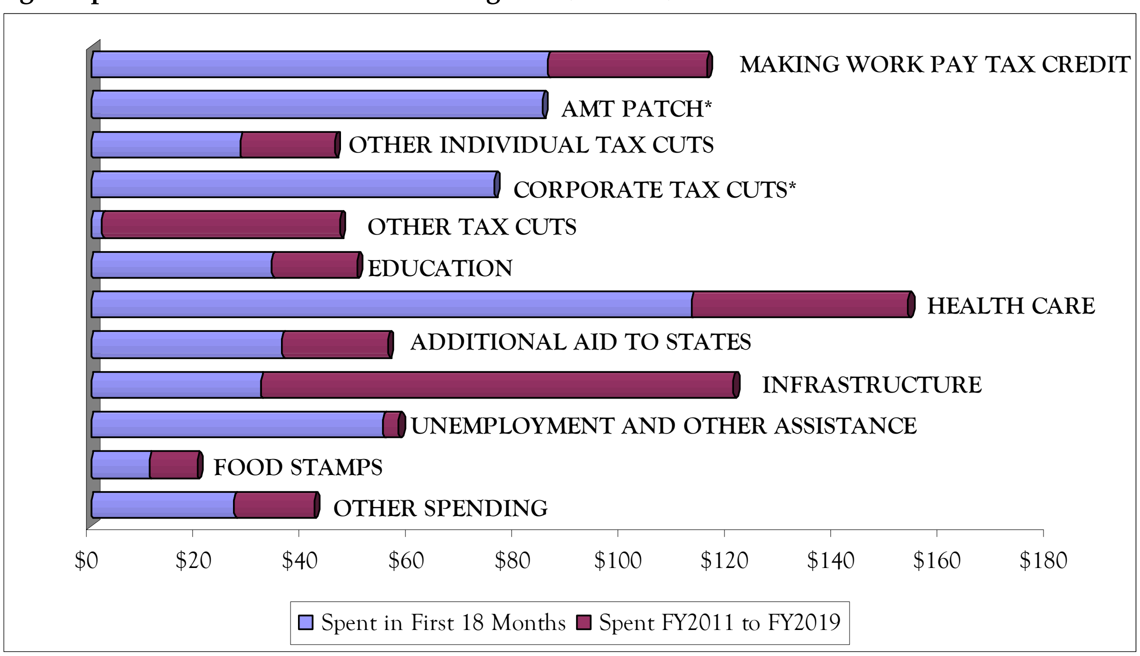
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2009-2019
Cost	$185	$399	$134	$36	$28	$22	$5	-$7	-$8	-$6	-$1	$787
Percent	23%	51%	17%	5%	4%	3%	1%	-1%	-1%	-1%	0%	100%

Source: Congressional Budget Office

A fast spend-out rate is important, particularly in the current environment in which a downward economic spiral is a serious risk. A short "inside lag" – as it is referred to by economists – gives stimulus a better chance of making its way through the economy in time to assist in a recovery. The flipside of this, however, is that faster spend-out rates increase the risks that the money will be used less efficiently or for less worthy projects.

Not all provisions in the bill spend out at the same rate. Many tax cuts and transfers to individuals, for example, distribute the bulk of their total spending (or tax breaks) within the first year and a half. Other spending, especially on infrastructure, tends to have a slower spend-out rate.

Fig. 3: Spend-out Rates of Stimulus Categories (billions)



Source: Congressional Budget Office and Joint Committee on Taxation

*Provisions raise revenue, relative to baseline, between FY2011 and FY2019

The speed at which the government can disburse a stimulus item should not be the only criterion by which effectiveness is measured. It also matters how fast and ultimately how much of that money makes its way through the economy. So while many tax cuts can be distributed to individuals relatively quickly (the inside lag), individuals or businesses may not necessarily spend that money with any speed (the outside lag). In fact, some provisions with the fastest spend-out rates (including the corporate tax cuts and the AMT patch) are believed to have the lowest "bang for the buck."[1]

Macroeconomic Impact of Stimulus

The effect of the stimulus on short-term economic activity depends largely on the "fiscal multipliers" of the various provisions – the amount of economic output that each dollar of government spending (or tax cuts) would produce. Economists disagree considerably over the correct multipliers for given policies (See www.crfb.org/documents/StimulusComparisons.pdf, pages 3 and 4, for a discussion of this debate).

Still, most economists believe this stimulus will positively impact GDP and employment over the short-run. Estimating the impact of a stylized stimulus similar in size to this one, White House advisors Christina Romer and Jared Bernstein found that the package could improve GDP by 3.7% and create 3,675,000 jobs by the end of 2010. Mark Zandi of Moody's Economy.com, meanwhile, found that the original (and larger) House version of the stimulus could improve GDP by 5.5% and create 4.3 million jobs in 2011.[2]

The Congressional Budget Office (CBO) recently ran its own analysis of the economic impact of the stimulus package, based upon the average effects of the House and Senate versions of the bill.[3] The CBO found that the stimulus would increase economic growth every year through at least 2013, improving GDP by 1.1% to 3.3% and creating 1.2 million to 3.6 million jobs by the end of 2010.

Fig. 4: Macroeconomic Impact of Stimulus through 2013

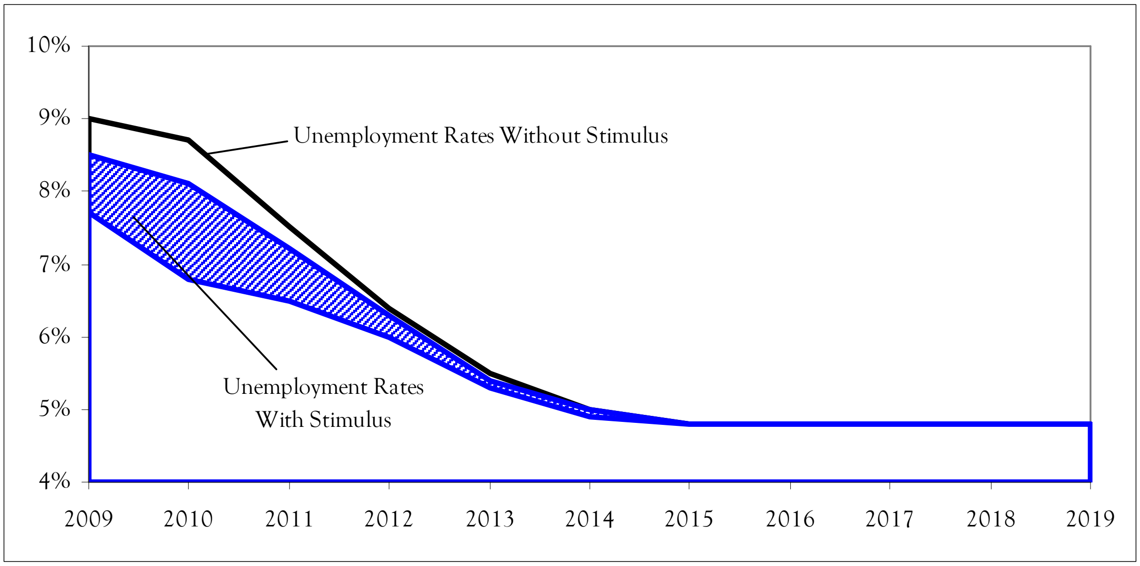
	GDP		EMPLOYMENT	
Year	**Low**	**High**	**Low**	**High**
2009	+1.4%	+3.8%	+800,000	+2,300,000
2010	+1.1%	+3.3%	+1,200,000	+3,600,000
2011	+0.4%	+1.3%	+600,000	+1,900,000
2012	+0.1%	+0.7%	+300,000	+800,000
2013	+0.0%	+0.4%	+100,000	+400,000
Average	**+0.6%**	**+1.9%**	**+600,000**	**+1,800,000**

Source: Congressional Budget Office

[1] Congressional Budget Office, http://www.cbo.gov/ftpdocs/96xx/doc9619/Gregg.pdf.
[2] Romer and Bernstein and Mark Zandi, http://otrans.3cdn.net/ee40602f9a7d8172b8_ozm6bt5oi.pdf and http://budget.house.gov/hearings/2009/01.27.2009_Zandi_Testimony.pdf.
[3] Although both bills were somewhat larger than the final legislation, they are similar in composition.

CBO also found that the bill would reduce unemployment from 9% to between 7.7% and 8.5% in 2009, from 8.7% to between 6.8% and 8.1% in 2010, and by smaller but still significant amounts through 2013 as the stimulus wears off. By 2015, CBO projects unemployment will have returned to its natural rate (4.8%).

Fig. 5: Projected Unemployment Rates



Source: Congressional Budget Office

Long-term Impact of Stimulus

Although the stimulus is likely to create jobs and enhance growth in the short run, its longer run impact depends on how much additional growth is created by the public investments and to what extent the new debt crowds out private investment. CBO projects that as the stimulative effects of the bill wear off, the productive effects of infrastructure investment on underlying growth may be offset by the crowding out effects from higher debt. As a result, it projects GDP to be between 0% and 0.2% *smaller* in 2015 and later than it would be absent the stimulus package.[4]

Moreover, the costs of the stimulus package might extend beyond the $787 billion projection. Although the direct costs of the stimulus will largely subside beginning in 2012, the bill would have a permanent impact on the deficit through higher interest payments on additional public debt. CBO estimated that the debt service costs from the somewhat larger House stimulus bill would reach over $50 billion a year by 2018.[5] Devoting more federal resources to debt service will mean less money for other spending and tax priorities in the future.

[4] Congressional Budget Office, http://www.cbo.gov/ftpdocs/99xx/doc9987/Gregg_Year-by-Year_Stimulus.pdf.
[5] Congressional Budget Office, http://www.cbo.gov/doc.cfm?index=9970.

The costs of the stimulus could increase further if any provisions were renewed. In an earlier release, CRFB warned that a number of items in the stimulus package could be difficult to reverse, either because they were originally proposed as permanent changes during the Presidential campaign, or because they would simply be too popular (www.crfb.org/ documents/ReleasePermanent.pdf). These measures, for the most part, have remained in the final law – although the largest one, the Making Work Pay Credit, has been scaled back. Renewing all of these provisions would cost roughly $100 billion a year, requiring either significant tax increases, spending reductions, or new debt, which would need to be financed.

Fig. 6: Cost of Extending Selected Stimulus Provisions (billions)

STIMULUS PROVISION	COST
Making Work Pay Credit*	$513
Earned Income Tax Credit Expansion	$35
Funding for Pell Grants, Head Start, and Child Care and Development Block Grants	$52
American Opportunity Tax Credit	$62
Child Support Incentives	$6
COBRA Subsidies	$121
IDEA Funding	$59
Total Cost	**$848**

Source: Congressional Budget Office
Note: Cost represents 10.5 year budgetary impact
*CRFB estimates based upon CBO analysis

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The Committee for a Responsible Federal Budget is hopeful that the passage of the stimulus bill, along with other efforts, will help put the economy on a path toward recovery. Most economists believe that the bill will provide at least some short-term boost to the macroeconomy, improving both GDP and employment over the next few years.

Over the long run, however, the new debt created from the stimulus – especially if accompanied by deficit-financed renewal of some provisions – will become a burden, creating a significant drag on the economy. To ensure sustained economic growth, policymakers must begin to deal with this debt and address the long-term fiscal gap more broadly once the economy recovers.