Fiscal Policy

Has it worked?
Is more needed?

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What is Fiscal Policy?

• A text book definition would be something like: A plan for government spending and taxes designed to achieve some goal.

• So there are two components, spending (the government buying goods and services) and taxes (net of transfers).
How Does Fiscal Policy Work?

• Multiplier effects
• Government spending and tax multipliers can differ
  – Speed of impact
  – Size of impact
  – Effects on economic growth
• Graphs of Disposable Income and Government Spending
Disposable Personal Income
1990:M1 – 2009:M8, Nominal

Disposible Personal Income (DSPI)
Source: U.S. Department of Commerce: Bureau of Economic Analysis

First Stimulus Package
Second Stimulus Package

Shaded areas indicate US recessions.
2009 research.stlouisfed.org
Disposable Personal Income
1990:M1 – 2009:M8, Real

Real Disposable Personal Income (DSPIC96)
Source: U.S. Department of Commerce: Bureau of Economic Analysis

Shaded areas indicate US recessions. 2009 research.stlouisfed.org

First Stimulus Package
Second Stimulus Package
Federal Government Expenditures
1990:Q1-2009:Q2

Source: U.S. Department of Commerce: Bureau of Economic Analysis

Second Stimulus Package

Shaded areas indicate US recessions.
2009 research.stlouisfed.org
### Multiplier Estimates

(Romer and Bernstein, “The Job Impact of the ARRA,” May 2009)

Output effects of a permanent stimulus of 1% of GDP (percent)

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Government Purchases</th>
<th>Tax Cuts</th>
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<tr>
<td>1</td>
<td>1.05</td>
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<tr>
<td>2</td>
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<td>16</td>
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</table>
What Can Go Wrong?

- Tax Cuts Saved, Not Spent
- Stimulus not large enough
- Bad Timing
- Private Activity Crowded Out
- Deficit Not Repaid when Things Improve
Has it worked?

• To assess whether it has worked, need a baseline (what would have happened without policy)

• What is the baseline?

• We don’t know, it must be estimated

• Estimates are model dependent

• Evidence
Real GDP
1990:Q1 – 2009:Q2
Monthly GDP Estimates
(from Macro Advisers)

Billions of chain-type (2005) dollars

- First Stimulus Package
- Second Stimulus Package

Aug 2008
May 2009
Aug 2009
Tax Rebates and Consumption

2008 Economic Stimulus Payment (tax rebate) used mostly for—

- Paying off debt: 49%
- Saving: 18%
- Spending: 30%
- Reason not reported: 3%

Source: Consumer Expenditure Survey, June 2008–March 2009
Other Evidence?

• Countries with larger stimulus packages grew faster in 2009Q2
• States that spent more lost fewer jobs
• Estimated effects
• Cash for Clunkers
• Incentives to purchase new homes
Cross-Country Evidence

Stimulus around the Globe

Change in Q2 GDP growth from November forecast (percentage points)

Discretionary Stimulus in 2009 (percent of GDP)
States that Spent More Had a Bigger Employment Change
Estimated Effects of ARRA

## Contribution of the ARRA to GDP Growth in 2009:Q2

<table>
<thead>
<tr>
<th>Forecaster</th>
<th>Estimate (percentage points)</th>
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<tbody>
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<td>Goldman Sachs</td>
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<tr>
<td>Economy.com</td>
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<td>Macroeconomic Advisers</td>
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Is More Stimulus Needed?

- Things are looking better, but a double dip or very slow return to trend for GDP is not out of the question.
- The recovery of employment is likely to be even slower.
- More stimulus, especially if it generates jobs quickly, would likely boost the recovery.
- So yes, more is needed, but we needed it six months ago. Given lags, harder to justify now.
- In any case, major policy change is unlikely.
FRBSF Estimates of Recovery Trajectory

A large output gap will likely persist

Real GDP
Seasonally adjusted chained 2005 dollars

CBO Potential Output
Output Gap
FRBSF Forecast

2006 2007 2008 2009 2010 2011 2012

$ Trillions
15
14.5
14
13.5
13
12.5
Unemployment Lags Output

Civilian Unemployment Rate (UNRATE)

How Much Higher?

Delayed Peaks

Shaded areas indicate US recessions.
2009 research.stlouisfed.org
Unemployment Since 1990

Unemployment hasn’t turned the corner yet

Delayed Peaks in 90-91 and 2001 recessions


Shaded areas indicate US recessions.
2009 research.stlouisfed.org
Long-Term Unemployment

Civilians Unemployed for 27 Weeks and Over (UEMP27OV)

Shaded areas indicate US recessions.
2009 research.stlouisfed.org
Employment to Population Ratio

Civilian Employment-Population Ratio (EMRATIO)

Shaded areas indicate US recessions.
2009 research.stlouisfed.org

Low Employment to Population Ratio
Private Employment

All Employees: Total Private Industries (USPRIV)

Shaded areas indicate US recessions.
2009 research.stlouisfed.org

Employment is Falling
Average Weekly Hours: Private Industry

Average Weekly Hours: Total Private Industries (AWHNONAG)

Average Hours are Falling
Conclude

• Some evidence that fiscal policy has worked
• But too early to say anything conclusive
• Things look better, but not out of the woods yet
• Speed of recovery and, importantly, employment would likely improve with more stimulus
• Politically unlikely