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CORRECTING FIVE MYTHS ABOUT THE STIMULUS BILL

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Some critics of the economic recovery law (or "stimulus" bill) that President Obama and Congress enacted early this year continue to mischaracterize how it was supposed to work and what it was supposed to do. For instance, some critics complain that, because unemployment has risen in recent months, the law is not working. Others claim that states are improperly using the money to close budget shortfalls or finance short-term projects.

These and a number of other criticisms are off base. The law — officially the American Recovery and Reinvestment Act (ARRA) — is working as intended and, without it, the economy and the job prospects for many Americans would be worse. The $787 billion in new spending and tax cuts was supposed to slow the economy's downward spiral and then help it recover over time from what will be the nation's deepest recession in decades, if not since the Great Depression of the 1930s. The law was designed to save and create more than 3.5 million jobs over the next two years, according to the Obama Administration, and to help states close their budget shortfalls so they could avoid even greater spending cuts and larger tax increases than they are already enacting to meet their balanced budget requirements.

Here are key points to keep in mind about the recovery law:

1: Recent increases in unemployment do not mean the law is not working.

No mainstream economist believed the law would immediately revive the economy and cause unemployment to begin falling. In addition, at the time Congress enacted the law, virtually all forecasts in both the public and private sectors underestimated the severity of the downturn. Nevertheless, the law has slowed the decline and is helping the turnaround occur sooner than it would have otherwise.

- The Congressional Budget Office (CBO) concluded last month that "fiscal stimulus under the American Recovery and Reinvestment Act will significantly boost economic activity above what it would have been."[1] Specifically, CBO "estimates that real GDP will be 1.4 percent to 3.8 percent higher in the fourth quarter of 2009 than it would have been without the stimulus" and

[1] "The Budget and Economic Outlook: An Update," Congressional Budget Office, August 2009, p. 33.

"1.1 percent to 3.4 percent higher in the fourth quarter of 2010." [2]

- The President's Council of Economic Advisers, citing CBO and private economic forecasters including Goldman Sachs and Moody's Economy.com, finds "broad agreement that the ARRA has added between 2 and 3 percentage points to baseline real GDP growth in the second quarter of 2009 and around 3 percentage points in the third quarter."[3]

The continuing deterioration in the job market was expected as well. As CBO Director Douglas Elmendorf observed in May, "labor market indicators tend to lag changes in economic activity. The pattern of past recessions suggests that employment will not increase and the unemployment rate will not decline until 6 to 12 months after output begins to increase again."[4] CBO has projected that, even with the recovery law, unemployment will continue to rise through early next year.

But here, too, the recovery law has had a positive effect.

- "[T]he stimulus results in approximately 2.5 million more jobs by the end of 2010 than would have been the case without it," Economist Mark Zandi of Moody's Economy.com estimated, "and leaves the unemployment rate almost 2 percentage points lower."[5]

- CBO estimated in March that, because of the law, "the unemployment rate [in its forecast] is lower than it would otherwise be by about 0.9 percentage points in the fourth quarter of 2009 and 1.3 percentage points in the fourth quarter of 2010. The boost to total employment peaks at about 2 ½ million jobs in the second half of 2010."[6] In its August budget and economic update, CBO stated that, "Even though some elements of CBO's forecast, particularly the unemployment rate, have clearly worsened, such revisions to the forecast reflect a much sharper ongoing deterioration in underlying labor market conditions than had been anticipated, rather than a smaller impact of the legislation."[7]

2: The Administration and Congress expected the stimulus money to be spent gradually over the next two to three years, and what's been spent to date is stimulating the economy and helping millions of Americans.

The Council of Economic Advisers estimates, based on ARRA spending through the end of August, that "between one-fifth and one-quarter of the total $787 billion included in the Act will have been spent by the end of the 2009 fiscal year. This is approximately what was projected by the

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[2] Ibid.

[3] "The Economic Impact of the American Recovery and Reinvestment Act of 2009, First Quarterly Report," Council of Economic Advisers, September 10, 2009, Executive Summary.

[4] CBO Director Douglas W. Elmendorf, "The State of the Economy," testimony presented to the House Committee on the Budget, May 21, 2009, p. 6.

[5] Mark Zandi, "U.S. Fiscal Stimulus Revisited," June 22, 2009.

[6] "Preliminary Analysis of the President's Budget and an Update of CBO's Budget and Economic Outlook," Congressional Budget Office, March 2009, p. 29.

[7] Ibid, p. 34.

Congressional Budget Office (CBO) when the Act was passed."[8] In August, CBO wrote, "Indications to date are that, in total, the budgetary effects [of ARRA] have occurred at about the pace CBO anticipated when it prepared its initial estimates."[9] CBO went on to reiterate its initial estimate of ARRA's macroeconomic impact, that ARRA will boost GDP by between 1.4 percent and 3.8 percent by the end of this year.

The law "significantly boosted disposable personal income in the second quarter," CBO wrote, "and (with the exception of the one-time Social Security payments) will continue to support personal income through the end of 2010."[10]

In addition, states have used $29.8 billion through September 11 to avoid cuts and cover increased caseloads in Medicaid, bolstering the health care industry (and providing care to people could not otherwise afford it). Higher benefits under what was previously called the Food Stamp Program (now the Supplemental Nutrition Assistance Program) have pumped an additional $3.9 billion into the economy. (Zandi estimates that every dollar spent on food stamps generates $1.84 in total economic activity.)

The temporary increase in unemployment benefit levels is providing another $1.3 billion per month in help to jobless workers. Also, more than 2.5 million people are now receiving unemployment benefits due to provisions that allow unemployed workers to receive additional weeks of benefits when their regular unemployment benefits run out.

These provisions and other forms of direct assistance to vulnerable individuals are ameliorating the impact of the recession on poverty. Earlier this month, the Center on Budget and Policy Priorities estimated that seven temporary provisions of ARRA are keeping 6.2 million Americans out of poverty this year.[11]

Finally, last January, CBO Director Elmendorf stressed the need to make recovery-law funding available over a *longer period than usual*: "Because most periods of economic weakness are fairly short-lived, it is generally preferable that stimulus packages be short-lived. Currently, however, CBO projects that economic output will remain significantly below its potential for several more years, so policies that provide stimulus for an extended period of time may be appropriate. Indeed, a fiscal stimulus that ends before the economy has started to regain its footing runs the risk of exacerbating economic weakness when the stimulus ends."[12]

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[8] "The Economic Impact of the American Recovery and Reinvestment Act of 2009, First Quarterly Report," p. 5.

[9] "The Budget and Economic Outlook," p. 10.

[10] Ibid, p. 34.

[11] Arloc Sherman, "Stimulus Keeping 6 Million Americans Out of Poverty in 2009, Estimates Show," Center on Budget and Policy Priorities, September 9, 2009.

[12] CBO Director Douglas W. Elmendorf, "The State of the Economy and Issues in Developing an Effective Policy Response," Testimony presented to the House Committee on the Budget, January 27, 2009, p. 20.

3: The nation faces a very serious long-term budget problem, but the recovery law will exacerbate that problem only a very small amount.

Although the recovery law significantly increases short-run deficits, the fiscal effects of the bill over the long run are tiny. In January, the Center on Budget and Policy Priorities calculated that the recovery law would add just 3 percent to the budget shortfall through 2050.[13] That's because the tax cuts and new spending in the law are temporary. The main driver of the nation's long-term budget shortfall is ongoing factors, the most notable of which is steadily rising health care costs.

As noted above, CBO has projected that, by the end of next year, 2.5 million more people will have jobs than would have been the case if the recovery law had not been enacted. In addition, millions of others will benefit from the higher incomes produced in an economy that is less weak than it otherwise would have been. The economy clearly needed the boost in demand that the new spending and tax cuts generate. Failing to provide this boost due to fear of very slightly increasing the long-term budget problem would have been foolish.

4: The law was specifically designed to help states close their budget shortfalls.

State revenues have fallen sharply due to the recession. As a result, states face a combined $350 billion in projected budget gaps over the next two years. Because states also face legal requirements to balance their budgets, they must enact program cuts and tax increases to close their budget gaps. Such measures, however, reduce demand for goods and services, making a weak economy even weaker. Without federal funds, states would have to take even more dramatic measures that, by reducing demand, would cost jobs and make the recession even more severe.

The recovery law is giving states roughly $140 billion over the next two years in Medicaid and education funding, reducing the $350 billion shortfall by that amount, helping states avoid some of the largest program cuts they were contemplating, and reducing the negative impact of their budget-balancing steps on the economy. Virginia, for example, reversed plans to end funding for hundreds of sheriffs' deputies, thousands of school personnel, and three mental health facilities. New York reversed a major proposed cut to senior citizens' prescription drug benefits and another major cut to school funding.

Other states are responding similarly, says a Government Accountability Office (GAO) report released in July. In at least eight states (out of 16 states studied), GAO found that increased education funding was helping local school districts keep teachers on the payroll who would have been laid off. "Overall, states reported using Recovery Act funds to stabilize state budgets and to cope with fiscal stresses," GAO concluded. "The funds helped them maintain staffing for existing programs and minimize or avoid tax increases as well as reductions in services."[14]

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[13] Paul N. Van de Water and Kris Cox, "Economic Recovery Bill Would Add Little to the Long-Run Fiscal Problem," Center on Budget and Policy Priorities, January 16, 2009.

[14] "Recovery Act: States' and Localities' Current and Planned Uses of Funds While Facing Fiscal Stress," U.S. Government Accountability Office, July 2009.

5: States are properly using stimulus funds for short-term projects.

In the recovery law, Congress required that states put their additional federal funds to work as quickly as possible, which in many cases means investing in existing projects and programs rather than mounting major new initiatives. That helps to achieve the goals of both stimulating demand for goods and services and saving or creating as many jobs as possible, as quickly as possible.

In infrastructure spending, GAO found that many states are using recovery law funds for paving improvements and other projects that are "shovel ready" and can create jobs relatively quickly. Longer-term projects could require years of planning and would not create jobs as quickly. In education spending, GAO found that many states and school districts are using the money to avert elementary and secondary school layoffs, minimize tuition increases at colleges and universities, and address other immediate needs.