Taking Stock of the Fiscal Stimulus Package: The CEA Report and Beyond
September 14, 2009

Is the largest fiscal stimulus package adopted in U.S. history working? Is it worth the high fiscal cost in the future? Not surprisingly, the President's Council of Economic Advisers' (CEA) first quarterly report gave a tentative positive answer to the first question, but did not answer the second.

According to the CEA, with 20 percent of the stimulus package ($151 billion of the $787 billion total) working its way through the economy in its first six months, the stimulus played a key role in slowing output and job losses and the economy's trajectory has improved. The stimulus is estimated to have added roughly 2.3 percentage points to real GDP growth in the second quarter and 1 million jobs as of August. The CEA analysis and methodology is consistent with other reputable mainstream analyses, including those done by the Congressional Budget Office.

Most economists, including those at the CEA, expect economic growth to pick up in the second half of the year as multiplier effects of tax cuts and spending increases kick in and additional stimulus resources are released. The consensus view is that the economy is turning positive, and that third quarter growth will be around 3 percent - a sharp turnaround from the 1.0 percent decline in the second quarter.

Comments

For U.S. taxpayers, the stakes are high. To stop the economy from spiraling into depression, Congress and the President adopted the American Recovery and Reinvestment Act of 2009 (ARRA) in February to provide government resources over the next few years to stimulate the economy. At the time of passage, the cost of inaction was judged to be higher than the cost of stimulus. That being said, the cost of the stimulus package is high. Enormous sums of money are being borrowed by the federal government to provide fiscal stimulus through additional spending and tax cuts. This borrowing has pushed the annual fiscal deficit and debt to postwar record levels. We will have to service the higher debt for years to come and it is taking away precious resources from other priorities.

On the plus side, based on the limited data available, it appears that the stimulus package has thus far been effective. In particular, second quarter GDP and subsequent related monthly data show that government resources provided by the stimulus package have been the key source of recent economic growth in addition to foreign trade improvements. The economy is no longer in free fall as it was one year ago.

However, it is too soon to declare victory. The outlook for the economy next year remains an open question, and the CEA does not address this. While things look better, it is still far from clear whether the stimulus will successfully jump start the economy and growth will become self-sustaining. Even with positive effects from the ARRA, the economy and financial sector remain weak and the risks of a double dip recession continue to be high. Recoveries from recessions induced by financial crises tend to be slower than more typical recoveries. The U.S. economy has often shown itself to be tremendously resilient, but economic headwinds are strong and the situation complex. While powerful, the stimulus package may not have been powerful enough.

An additional political, economic and social challenge is that even a reasonable economic recovery would not have an immediate positive impact on the job market or the poverty rate (which, as we have recently learned, has deteriorated). The employment situation is the worst of any postwar recession and there are legitimate fears that we may be facing yet another jobless recovery, which could limit overall momentum. Productivity gains have been very strong as businesses cut costs by limiting employees, and this may not bode well for employment in the near term. The savings rate has also increased sharply, but, while important for longer term rebalancing of the economy, this has limited much-needed consumer spending to get the economy moving again.

In the next few months, the administration and Congress will be assessing whether any further policy steps should be taken – or withdrawn – to support economic and financial recovery. In this context, it is critical to recognize that the stimulus package is only one part of a multipronged strategy: the extraordinary resources provided by the Federal Reserve and Treasury Department to stop the financial crisis have also played critical roles. It is also important to note that coordinated stimulus among our trade partners has probably boosted the U.S. economy through trade.

Looking ahead, we are entering a very dangerous period and the administration faces a delicate balancing act. A double dip recession would bring with it additional costs (including fiscal) and risks. Yet, the administration must also start making plans to get its fiscal house in order once recovery takes firm hold. For the U.S. to retain its pre-eminent role in the global economy and the support of our creditors, our fiscal management must improve. Moreover, we are getting closer to the arrival of the budget tsunami from the retirement of the Baby Boomers. It is all the more important that we have a Fiscal Recovery Plan in place soon.