THE STIMULUS: TWO YEARS LATER

HEARING

BEFORE THE

SUBCOMMITTEE ON REGULATORY AFFAIRS, STIMULUS OVERSIGHT AND GOVERNMENT SPENDING

OF THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

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THE STIMULUS: TWO YEARS LATER

WEDNESDAY, FEBRUARY 16, 2011

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON REGULATORY AFFAIRS, STIMULUS
OVERSIGHT AND GOVERNMENT SPENDING,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The committee met, pursuant to notice, at 10 a.m., in room HVC 210, Capitol Visitor Center, Hon. Jim Jordan (chairman of the committee) presiding.

Present: Representatives Jordan, Buerkle, Labrador, Kucinich, and Cummings.

Staff present: Chris Hixon, deputy chief counsel, oversight; Molly Boyl, parliamentarian; Tyler Grimm, professional staff member; Mark D. Marin, senior professional staff Member; Justin LoFranco, press assistant; Ben Cole, policy advisor and investigative analyst; Linda Good, chief clerk; Laura Rush; deputy chief clerk; Adam Fromm, director of Member liaison and floor operations; Jeff Wease, deputy CIO; Drew Colliatie, staff assistant; Mike Bebeau and Gwen D'Luzansky, assistant clerks; Carla Hultberg, minority chief clerk; Lucinda Lessley, minority policy director; Dave Rapallo, minority staff director; Suzanne Sachsman Grooms, minority chief counsel; Cecelia Thomas, minority deputy clerk; and Alex Wolf, minority professional staff Member.

Mr. JORDAN. The Subcommittee on Regulatory Affairs, Stimulus Oversight and Government Spending will come to order.

I thought I would start today with the mission statement of the Oversight Committee, just to try to always remind us what our focus should be. We exist to secure two fundamental principles: first, Americans have a right to know that the money Washington takes from them is well spent; and second, Americans deserve an efficient, effective Government that works for them. Our duty on the Oversight and Government Reform Committee is to protect these rights. Our solemn responsibility is to hold Government accountable to taxpayers, because taxpayers have a right to know what they get from their Government. We will work in partnership with citizen watchdogs to deliver the facts to the American people and bring genuine reform to the Federal bureaucracy.

Again, I want to welcome all the Republican members who are here this morning. It is great to have you as part of the committee, and we may introduce the rest of our team as they arrive. It is a busy day, as you all know, here on Capitol Hill.

I am also pleased to have as our ranking member, Mr. Kucinich, a good friend of mine from the great Buckeye State, whom I have enjoyed working with on a number of issues over the past two Congresses. So it is great to have you, as well as the ranking member of the full committee who has joined us today, Mr. Cummings. We appreciate your presence as well.

I will start with an opening statement, then we will have time for Mr. Kucinich's opening statement, then get right to our great panel. Unfortunately, as you can see, the two individuals we invited from the administration, former member of the administration and current member of the administration, have decided not to come. We think that is unfortunate, and we will talk about that a little bit later.

Two years ago, the President signed the single most expensive piece of legislation in American history, more expensive than the entire Vietnam War or all the Apollo missions. An official report released in January 2009 by the Office of the President-Elect and the Vice-President-Elect made very specific promises for the stimulus. This record-breaking spending spree was supposed to keep unemployment under 8 percent, and by today it was supposed to be at 7 percent. Instead, of course, the unemployment rate has been at or above 9 percent for 21 consecutive months. In our State of Ohio it has been higher than that for that same time period.

Thirteen point nine million Americans remain unemployed. But that doesn't tell the whole story. Over the same time period, almost 100,000 people have dropped out of the work force in our State of Ohio. We now know the disappointing truth: the stimulus failed. It failed to meet the administration's goals for job creation, it failed to meet the administration's goals for growth, it failed to meet every meaningful performance standard, every metric of economic activity, basically every single market test of prudent public policy.

Two years ago, the administration sold the American people on a long-discredited Keynesian pipe dream: that the Federal Government could spend our way out of a recession. Today, taxpayers are left with a larger national debt, compounding interest, and nothing to show for it except the longest period of record unemployment since the Great Depression.

Today we will hear from some of the world's foremost experts on fiscal policy, who will assess the collateral damage to the Nation's global reputation, our economic recovery and credibility gap between this administration's lofty promises and the real world consequences of failed economic policy.

What we will not hear, however, is an explanation from the Obama administration, an administration, by the way, that promised unprecedented levels of oversight and accountability for this very bill. Unprecedented accountability, indeed. It is unconscionable that the administration has refused to provide any witness who can account for the goals set forth for the stimulus when it was conceived. This level of obstruction and defiance of the Congress does not reflect the values and vision for transparency and accountability the President promised on many occasions.

When the stimulus was proposed to Congress, the halls of the Capitol were filled with administration officials, lobbying hard for its passage. The charts and graphs and projections were everywhere. Members of Congress were told that failure to pass the stimulus would result in prolonged recession, that passage would be a boon to the growth. The American people were told that the President had the best economic advisors, armed with the most reliable economic modeling, to get the country back on the right path.

But now the White House refuses to answer for the failure of their experiment with the American people's money. We invited two of the architects of the economic rationale for the stimulus to testify here today, Dr. Christina Romer and Dr. Jared Bernstein. Both refused to appear. We have given the administration the opportunity to discuss the stimulus in the context of the policy's original goals, metrics and promises. Today there are two empty chairs where Dr. Romer and Dr. Bernstein should be sitting. When an opportunity comes to explain the administration's position on the design and goals of the stimulus, no voice will be heard.

The oversight of the stimulus is not about extracting a pound of flesh or scoring political points. This subcommittee, however, has a duty to the American people to seek to understand how the stimulus was conceived and why it failed, so that taxpayers are not subject to this sort of economic misadventure again.

The budget released by the President this week reaffirmed the need for hearings like the one we are having today. The budget revealed that the administration is unwilling to answer the mandate put forth by the American people last November, that they want Washington to stop wasting their tax dollars. The budget showed that spending would be higher than it was in 2009 and 2010, when we were in the midst of the downturn. Federal spending this year will be $3.8 trillion and comprise an astonishing 25.3 percent of GDP and result in a deficit of $1.65 trillion, the highest since World War II.

Call it investment, call it whatever you want, our economic position is extremely fragile, and we are in danger of losing the future. The longer it takes to get us on a pro-growth track, the worse off we will be. This hearing, in my mind, is the first step in understanding why the President's policies have failed, why doubling down with more spending and more borrowing will only result in more of the same poor results that have left our great Nation in its precarious economic situation.

With that, I would yield time to our distinguished ranking member, the gentleman from Ohio, Mr. Kucinich.

Mr. KUCINICH. Mr. Chairman, it is good to be here today.

I want to point out that in terms of the invitations, that your staff invited one private citizen and one public citizen who were unable to attend today's hearing. I have been informed that the administration offered to provide two other high-level administration officials, notably a deputy secretary of Commerce, and a deputy assistant secretary for transportation policy from the Department of Transportation. And I have been told that your staff declined and further said the administration didn't want to make anyone available to talk about the stimulus program.

I just want to point out for the record that two top administration officials were ready and willing to come today. And I think it is appropriate that we review the stimulus. I have no problems with that whatsoever.

My point of view, a little bit different, I think that the Recovery Act was too small. Our economy is still fragile, we have an unemployment rate of over 9 percent. The depth of the recession was greater than predicted. Those who argued that the stimulus package was too small accurately predicted the severity of the recession was much worse than any economist initially thought.

The Blinder-Zandi report people, critical of the ARRA's effect on job creation, said "Critics who argue that the ARRA failed because it did not keep unemployment below 8 percent ignore the fact that A, unemployment was already above 8 percent when the Stimulus Act was passed, and B, most private forecasters, including Moody's Analytics, misjudged how serious the downturn would be. If anything, this forecasting error suggests that the stimulus package should have been even larger than it was."

The same report also notes: "While the strength of the recovery has been disappointing, this speaks mainly to the severity of the downturn. Without the fiscal stimulus, the economy would arguably still be in recession, unemployment would be well into double digits and rising, and the Nation's budget deficit would be even larger and still rising."

So Americans need to get back to work, which means our Government is going to need to continue to spend in order to increase demand for goods and services. Public spending is necessary to get us out of this recession. We gave significant tax breaks to the private sector. If the private sector hasn't that to create jobs, if the money that went to Wall Street didn't cause the private sector to create jobs, then the public sector has a responsibility to create the jobs in order to get us out of this recession.

Today, throughout the day, I will be pointing out that the Recovery Act succeeded in avoiding a recession that could have been worse, that there was an increase in GDP and job growth, that the stimulus impacted the recession quickly, and that according to Blinder and Zandi, there was a great depression averted.

I want to point out that, and I am not the only one who has pointed this out, as a matter of fact, there is a book that has just been released recently called The Great American Stickup. It talks about how Republicans and Democrats enriched Wall Street while mugging Main Street. So we are both here trying to clean up a mess that has actually been created by people in both parties.

And when you look at deregulation, deregulation was a failed policy. We have had a full committee hearing where we had people testify about the financial service industry was inadequately regulated for decades. And you have somebody in one of the publications today trying to still discount rules on derivatives, which sets the stage for another boom-bust cycle.

And then you have to look at the war. CRS has a report that says the cost of the war for the last, since Iraq and Afghanistan have come into our awareness, has been about $1.2 or $1.3 trillion. Now, this administration has actually accelerated spending in Afghanistan. And the Democrats, my party, accelerated spending in Iraq in 2007.

Both parties have responsibilities here. But the cost of this, the wars are taking our ability to do a budget, they are just destroying it. And when you consider now that we have more information about the war in Iraq being based on untruths, when we have more information about the corruption of the Karzai administration and the total loss and waste of American taxpayers, we see that policy changes are called for, and both parties are going to have to come together and do something about it.

One thing that I have confidence in is that Mr. Jordan and I do have the ability to work together. We may not agree on things, but we do have an ability to work together, and maybe this working relationship can create circumstances where we can come up with some common sense approaches that will enable our country to get back on good footing.

So I am glad to be here with you. Let's go to the witnesses.

Mr. JORDAN. I thank the gentleman. I would just point out a couple of things about his comments. This administration has certainly increased spending on everything. That is true. And again, two deputy secretaries offered as witnesses by the administration I think just did not meet the test, when you think about this being the most expensive piece of legislation in American history. We wanted the architects, we wanted the people who put it together, who were the ones who understood the modeling and the reasons that they put the bill together. We wanted them here.

Frankly, when you think about the mission of this committee, it seems very appropriate when we are talking about the amount of taxpayer money that was put into this legislation, to have the folks who put it together to come and testify.

Mr. KUCINICH. May I respond briefly?

Mr. JORDAN. Certainly.

Mr. KUCINICH. I agree with the gentleman, that the gentleman as chair has a right to ask anybody to testify. And I am disappointed that the two witnesses were not available. On the other hand, they did offer replacements. Now, the replacements may not have been to your liking, I can understand that.

Mr. JORDAN. If the gentleman would yield, I would think the witnesses offered by the administration would not be to anyone's liking. As the gentleman indicated, this should not be partisan. And in fact, as the gentleman highlighted some of the spending that was done in the past Congress, you and I both voted against the TARP bailout and some of the other things. We do agree one some issues.

I would think Republicans and Democrats both would say, the witnesses offered by this administration were not appropriate for a piece of legislation of this magnitude.

Mr. KUCINICH. I want to say again, the gentleman is correct in having the right to ask anybody that you think is important to be able to get the answers from to appear before this committee. That is just unquestioning. I am just stating that someone was offered, and they were turned down.

So thank you.

Mr. JORDAN. I thank the gentleman.

Let's go now to our distinguished panel. Before that, Members have 7 days to submit opening statements for the record. We will now recognize our distinguished guests. We first have Professor John Taylor, Ph.D., the Mary and Robert Raymond professor of economics at Stanford University and the George P. Shultz senior fellow in economics at the Hoover Institution. I actually heard Mr.

Taylor speak a few weeks ago out in California, and it is great to have you with us today.

Professor Russell Roberts, Ph.D., is the J. Fish and Lillian F. Smith distinguished scholar at the Mercatus Center, and professor of economics at George Mason University.

And Dr. J.D. Foster is the Norman B. Ture senior fellow in the economics of fiscal policy at the Heritage Foundation.

It is the policy of the committee that all witnesses be sworn in before testifying. So if you would please rise and raise your right hands.

[Witnesses sworn.]

Mr. JORDAN. Let the record reflect that all witnesses answered in the affirmative. Thank you, and we will start with Mr. Taylor.

STATEMENTS OF JOHN B. TAYLOR, PH.D., MARY AND ROBERT RAYMOND PROFESSOR OF ECONOMICS AT STANFORD UNIVERSITY AND GEORGE P. SHULTZ SENIOR FELLOW IN ECONOMICS AT STANFORD UNIVERSITY'S HOOVER INSTITUTION; RUSSELL ROBERTS, PH.D., PROFESSOR OF ECONOMICS, GEORGE MASON UNIVERSITY, J. FISH AND LILLIAN F. SMITH DISTINGUISHED SCHOLAR, MERCATUS CENTER, RESEARCH FELLOW, STANFORD UNIVERSITY'S HOOVER INSTITUTION; AND J.D. FOSTER, PH.D., NORMAN B. TURE SENIOR FELLOW IN THE ECONOMICS OF FISCAL POLICY, THE HERITAGE FOUNDATION

STATEMENT OF JOHN B. TAYLOR, PH.D.

Mr. TAYLOR. Thank you, Mr. Chairman, Ranking Member Kucinich, for inviting me to speak today.

My research on the Stimulus Act of 2009 shows that it had no significant positive impact on the economy that we can measure. And indeed, I think the legacy in terms of increased debt and uncertainty is harmful for the economy.

In my view, this really shouldn't come as a surprise. Research on previous types of discretionary, counter-cyclical actions like this from the past, from the 1970's, even more recently than that, shows problematic results, if you like. What I have tried to do in my written testimony is provide facts, provide what actually happened, rather than trying to simulate models about which there is considerable disagreement.

When you look at the facts of ARRA, you see according to the Department of Commerce, according to the Bureau of Economic Analysis, three main ways in which the money went out. It is important to trace the money. First, the Federal Government purchases goods and services, including infrastructure. Second, grants to the States with the intent that they would increase infrastructure spending. And third, temporary transfer payments to individuals such as a $250 check sent out last year, in 2009, mainly.

When you look at these carefully, you see some really striking facts. First of all, a very small amount of infrastructure spending came from the Federal level. It is amazing, only 0.04 percent of GDP went to infrastructure spending from the Federal level. This is by any measure immaterial and could not plausibly be a factor in the recovery that is sometimes mentioned. Economists sometimes debate the size of the multiplier. It is irrelevant when the thing the multiplier is multiplying is so teeny.

When you look at the grants to the States, of course, these were substantial. But you also look at what the States actually did with the funds. They did not increase infrastructure spending. In fact, they didn't even increase purchases of goods and services as measured in the national income for all accounts. Instead, it looks like these funds were used to reduce the amount of borrowing and perhaps increase other kinds of transfer payments to individuals. Again, it just couldn't have had an effect based on what the data show.

Then finally, the temporary transfer payments to individuals, which were substantial of magnitude, the purpose, of course, was to jump start consumption, people would spend this money. But when you look at what happened, they didn't spend the money. For the most part, it too was used, they have increased saving, draw down some of the debt and reduced the borrowing. This was not the way it was supposed to work.

This in fact is what economics would tell you: temporary payments like this do not stimulate consumption in an appreciable magnitude. We have seen that in the past. We saw that even back as short ago as 2008. Again, this is what one would have predicted.

When I look at the, if you like, cross-checks of these data to see, in the aggregate, how much Government purchases stimulated the economy, there is no correlation between that and the recovery. Instead, you see private investment, you see net exports driving whatever recovery we have had. So when I look at this overall, it seems to me, looking at the data, looking at the facts, tracing where the money went in the aggregate, using data provided by the Department of Commerce, you see a very small effect, I would say even immaterial.

I would just conclude by saying, in addition to that, I think the legacy of the increased debt and in addition, the tendency that the stimulus packages themselves had to distract people from dealing with the longer-term debt and spending problems that we have to address was also detrimental. I would be happy to answer any questions you may have, Mr. Chairman and the members of the committee.

[The prepared statement of Mr. Taylor follows:]

The 2009 Stimulus Package: Two Years Later

John B. Taylor*

Testimony Before the
Committee on Oversight and Government Reform
Subcommittee on Regulatory Affairs, Stimulus Oversight and Government Spending
U.S. House of Representatives

February 16, 2011

Chairman Jordon, Ranking Member Kucinich, and other members of the Committee, thank you for the opportunity to testify on the impact of the American Recovery and Reinvestment Act (ARRA) of 2009, enacted two years ago this week.

My empirical research during the past two years shows that ARRA did not have a significant impact in stimulating the economy.[1] I do not think this finding should come as a surprise. Earlier research on the discretionary countercyclical Economic Stimulus Act of 2008—enacted three years ago this week—indicates that it too did little to stimulate the economy.[2] Research on the discretionary countercyclical actions in the late 1960s and 1970s—the most recent period of such large interventions prior to this past decade—also shows disappointing results, including high unemployment, high inflation, high interest rates, and frequent recessions; the poor results of the 1970s policies led top macroeconomists to write influential papers, such as "After Keynesian Macroeconomics," which questioned the whole approach and to decry "that countercyclical discretionary fiscal policy is neither desirable nor politically feasible."[3]

My purpose here today is not to explain this recent revival of a failed approach to policy, but rather to summarize the facts which once again raise doubts about its effectiveness. I take a macroeconomic perspective, looking at the impact of ARRA on the major components of GDP, such as government purchases and consumption expenditures. Changes in GDP are of course directly related to employment growth, with faster growth of GDP creating more jobs. I make use of a new data set developed by the Bureau of Economic Analysis (BEA) at the Department of Commerce which traces the impact of ARRA on the economy through the National Income and Product Accounts, the major source of data for macroeconomic analysis. I present and analyze the data through a series of simple graphs, but the findings can be verified and supported through statistical analysis.

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* Mary and Robert Raymond Professor of Economics at Stanford University and George P. Shultz Senior Fellow in Economics at Stanford University's Hoover Institution

[1] Much of this research has been conducted jointly; see for example Cogan, Cwik, Taylor and Wieland (2010), Cogan and Taylor (2010), Taylor (2010), and Taylor (2011)

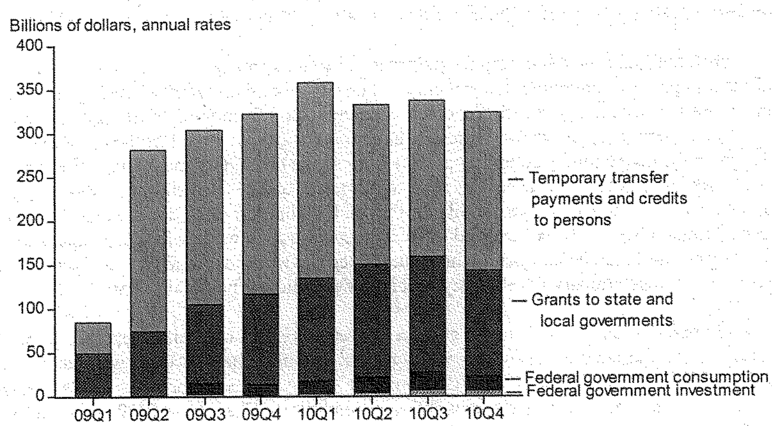
[2] Taylor (2009)

[3] Examples of papers on temporary tax cuts and countercyclical grants to states are Blinder (1981) and Gramlich (1979), respectively; the paper about after Keynesian macroeconomics is by Lucas and Sargent (1978) and the quote is from Eichenbaum (1997)

The Major Macroeconomic Components of ARRA

The bar chart below summarizes the impact of ARRA on federal government sector transactions during the two years or eight quarters since enactment.[4] Three components of ARRA are highlighted:

(1) Federal government purchases of goods and services (both government consumption and government investment),
(2) Federal grants to states and local governments, and
(3) Temporary transfers and credits which increase the disposable personal income of individuals and families.



Two-Year Effect of ARRA on Major Federal Budget Categories
(Source: Bureau of Economic Analysis)

For the purposes of assessing the impact of ARRA on the economy it is very important to distinguish between these three categories and consider each in turn.[5]

[4] The data are from the BEA table "The Effect of the ARRA on Selected Federal Government Sector Transactions" posted on the BEA webpage.
[5] A small part of ARRA—not shown in the bar chart—was classified as going to the business sector in the form of subsidies and tax benefits, for example for renewable energy or first time home buyers credits, which I do not consider in this testimony. It should also be emphasized that ARRA is one of many other fiscal interventions during the past two years, including the cash-for-clunkers program and an unusually large increase in appropriated funds not officially counted as part of ARRA. See Anderson (2011) for details.

The first category, government purchases of goods and services, is part of GDP and thereby contributes directly to changes in GDP. The amount by which an increase in government purchases in a stimulus package raises GDP is called the government purchases *multiplier* which has been a subject of much disagreement among economists in the two years since ARRA was enacted. Those who argue that the ARRA has been effective typically assume a large multiplier. Those who argue that the effects are small usually use models with a small multiplier.[6]

The second and third components of ARRA are not direct purchases of goods and services but rather transfers (grants) to state and local governments and transfers (one-time payments and tax credits) to persons. Such transfers are not part of GDP, but if and when the transferred funds are used by governments or persons to purchase goods and services—cars, trucks, food, health care, etc—those purchases are part of GDP. So the task of determining how much ARRA affects GDP requires looking at how much of those transfers are used for state and local government purchases and how much are used for personal consumption expenditures by households.

I now consider each category, starting with federal government purchases.

Federal Government Purchases

Perhaps the most striking finding in the data shown in the bar chart is that only a tiny slice of ARRA has gone to purchases of goods and services by the federal government. Of the total $862 billion in the ARRA stimulus package, the amount allocated to federal government consumption summed to only $24.2 billion in the two years 2009 and 2010. The amount allocated to infrastructure investment at the federal level was $5.6 billion in 2009-10, or only 0.6 percent of the total ARRA.

Measured as a percentage of GDP the amounts are even smaller. At the maximum level, reached in the third quarter of 2010, federal government purchases were only 0.2 percent of GDP and federal infrastructure was only 0.04 percent of GDP.

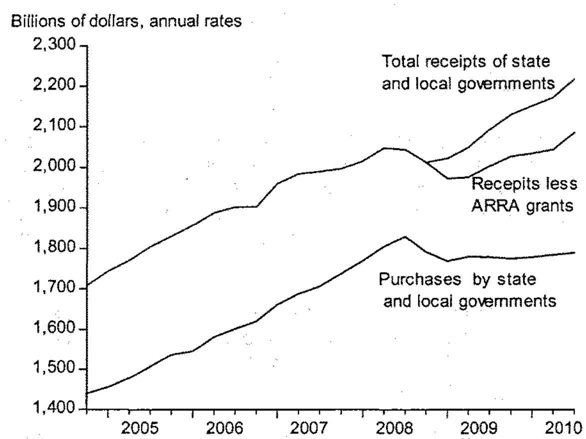
Clearly these amounts are too small to be a factor in the economic recovery. The debate over the size of the government purchases multiplier does not matter here because the multiplier has virtually nothing to multiply at the federal level. On this account ARRA has not been effective in stimulating economic growth and job creation.

[6] For example, Romer and Bernstein (2009) assume a government purchases multiplier much higher than Cogan, Cwik, Taylor and Wieland (2010) and thus estimate an impact of ARRA which is six times greater. The models stressed by Cogan, Cwik, Taylor and Wieland (2010) are of a new Keynesian variety developed, for example, by Frank Smets, Director of Research at the European Central Bank, and his colleague Raf Wouters. Another newer model comes from an International Monetary Fund study which reports estimates of government spending impacts which are much smaller than those reported by Romer and Bernstein. A multiplier that is less than one means that government spending immediately crowds out other components of GDP (investment, consumption, net exports).

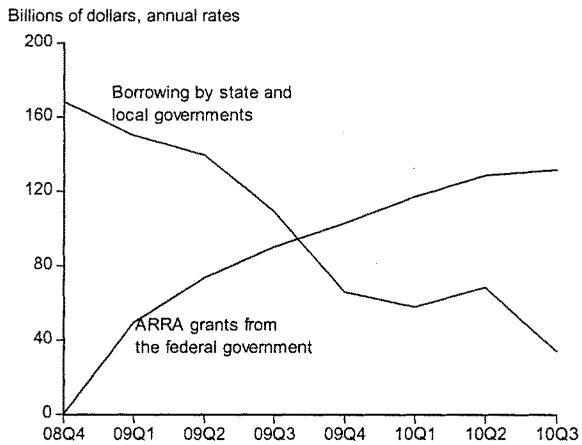
State and Local Government Purchases

State and local governments received substantial grants under ARRA as shown in the bar chart. The assumed purpose of sending these grants to the states was to encourage them to start infrastructure projects and make other government purchases which would add directly to GDP and create jobs.

But when you look at what state and local governments did with the funds, you find that they did not increase purchases of goods and services or increase infrastructure projects. This is clearly demonstrated in the following chart showing state and local government receipts, with and without ARRA grants, and purchases of goods and services. Observe how total receipts of state and local governments increased sharply due to ARRA, much more than without ARRA. But state and local government purchases have hardly increased at all and they are still below the levels of late 2008 before ARRA grants began.



What did the states do with the ARRA funds? The data show that they mainly used the funds to reduce their borrowing, as shown clearly in the next graph. In addition, some of the funds went to increase government spending other than on purchases of goods and services, including transfer payments to individuals, mainly Medicaid. Such transfers are not considered "purchases" by the BEA and they only increase GDP to the extent that they lead to a net increase in purchases by governments or persons. As with the case of federal government purchases, the debated over the size of the government purchases multiplier does not matter in this case because state and local government purchases did not increase as a result of ARRA.



Personal Consumption Expenditures

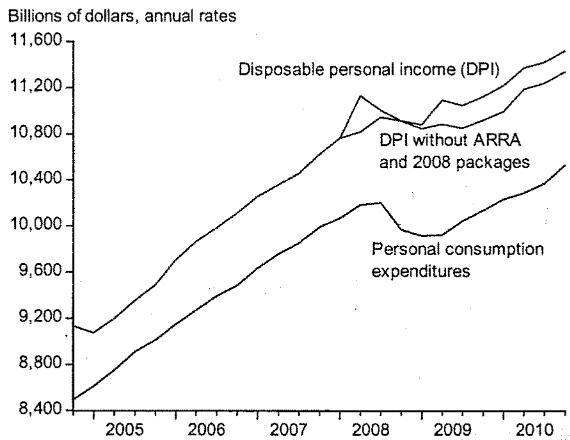
Finally, consider the third component of ARRA: temporary payments to persons such as the one-time $250 checks sent in 2009, the refundable tax credits, or the temporary changes in withholding. The macroeconomic purpose of this component of ARRA was to jump-start personal consumption expenditures—a major part of GDP—and thereby jump-start GDP and the economy.

Here it is useful to consider the Stimulus Act of 2008 along with ARRA because both acts are similar in this dimension and occurred nearly back-to-back. In the Economic Stimulus Act of 2008 checks were sent to people on a one-time basis and aggregate disposable personal income jumped dramatically though temporarily. In ARRA the amounts were initially smaller and more drawn out than the 2008 stimulus; though temporary, the increase in disposable personal income lasted through 2010.

Both cases are illustrated in the next chart which shows aggregate disposable personal income—with and without the stimulus payments—along with personal consumption expenditures from 2005 through 2010. Observe the increase in disposable income at the time of the 2008 stimulus and the 2009 stimulus.[7] However, aggregate personal consumption

[7] The increase is much more pronounced and visible graphically using monthly data as shown in Taylor (2009), but after a few months into ARRA, the BEA stopped tabulating monthly data and focused on the quarterly data summarized in the bar chart presented here. For better comparison with 2009 and 2010, therefore, quarterly data rather than monthly data in 2008 are presented in the chart.

expenditures did not increase by much at the time of these sharp increases in stimulus payments. In general, the overall pattern of personal consumption expenditures seems to move closely with disposable personal income without the addition of the stimulus funds, though the decline in consumption is greater than the decline in either measure of disposable personal income.



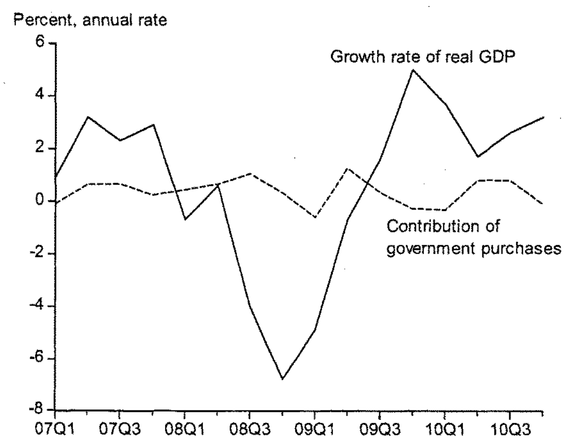
The relationship between the temporary stimulus payments versus the more permanent changes in income without the stimulus can be studied more rigorously than is possible in the above chart using regression techniques. These statistical techniques show that the effect of the temporary stimulus payments on personal consumption expenditures is much smaller than the effect of more permanent income changes and statistically insignificant from zero.[8] This is what the permanent income theory and the life cycle theory of consumption would predict from such temporary payments. As in the case of the grants to the states the temporary payments were mainly added to personal saving in the form of reduced net borrowing. In effect the increased borrowing by the federal government to finance ARRA was nearly matched by a decrease in net borrowing by the state and local governments and by persons.

[8] In a regression with correction for serial correlation over the period from 2000.1 to 2010.4 with personal consumption expenditures as the dependent variable, the coefficient on the temporary stimulus payments is 0.19 with a standard error of 0.14, while the coefficient on disposable personal income without the payments is 0.87 with a standard error of 0.05. If one separates out the 2009 stimulus, the coefficient on the temporary payments is still insignificantly different from zero and actually turns negative.

Aggregate Cross Checks

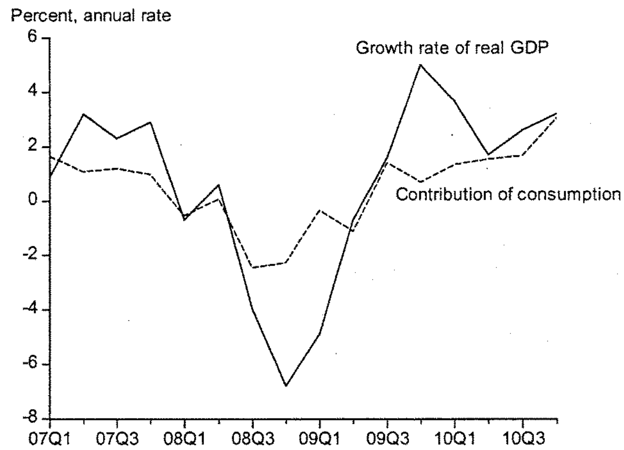
This examination of how the ARRA funds were used indicates that neither government purchases nor personal consumption expenditures increased by much as a result of ARRA, thereby raising doubts about the contribution of ARRA to the economic recovery. It is possible to cross check this finding using data[9] on the contributions of different components of GDP to the growth of GDP during this period. The next three graphs summarize these cross-checks.

In each graph the growth rate of real GDP is shown, along with the percentage contributions of government purchases, consumption, investment and net exports (the latter two combined together) to that growth rate. Observe first that the percentage contribution of government purchases (federal as well as state and local combined) to the growth of real GDP is negligible. The swing in economic growth during the recession and the recovery seems largely independent of the changes in government purchases.

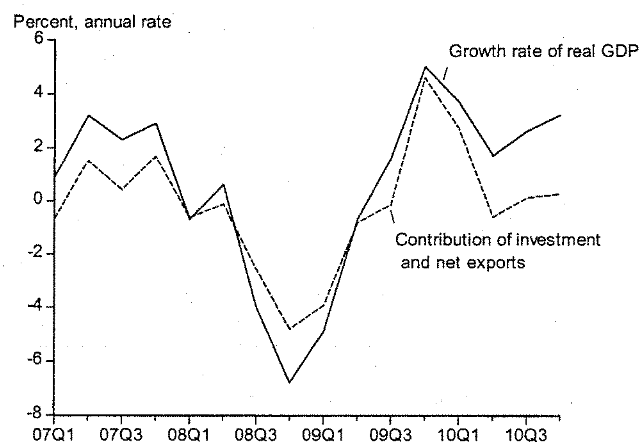


The contribution of consumption—shown in the next chart—is larger, but still consistent with the finding that the change in consumption was due to changes in income without the stimulus payments. Note that the largest contribution from consumption comes in the last quarter of 2010 at the time when the agreement to extend existing tax rates likely became anticipated and eventually a reality with increased expectations that they would become permanent.

[9] The data are updated and published each month in Table 2 of the BEA release on quarterly GDP.



The next chart shows the large contribution of investment and net exports to changes in economic growth. These two items, which were not the main focus of the 2009 stimulus, contributed far more to the recovery than government infrastructure or other purchases which were to be the focus.



Why Do Policy Evaluations Differ?

Why do some argue that ARRA has been more effective than the facts presented here indicate? Many evaluations of the impact of ARRA use economic models in which the answers are built-in, and were built-in before the stimulus package was enacted. The same economic models that said, two years ago, that the impact would be large now show that the impact is in fact large. This is why, for example, the Congressional Budget Office finds larger effects while other researchers using different models find smaller effects. The models disagree so the policy evaluations disagree.

The data I examine here place more emphasis on where the funds from ARRA actually went. The approach makes less use of simulations of existing econometric models, although it uses general theories—such as the permanent income theory or similar theories of government behavior—to analyze the data.

These data point to some inconsistencies, however, in how model simulations have been conducted. For example, many model simulations assumed that ARRA would have a much larger effect on government infrastructure and other purchases than was actually the case.[10] I believe the simulations should take account of the very small amount of funds that went to government infrastructure and other purchases. If CBO or other groups are still assuming in their simulations that a large fraction of grants to the states went to government purchases, then those simulations should be adjusted.

Conclusion

In sum, the data presented here indicate that the American Recovery and Reinvestment Act was not effective in stimulating the economy. Despite its large size, ARRA did not result in more than an immaterial increase in government infrastructure and other purchases at the federal level. The large grants to the states did not result in an increase in government infrastructure and other purchases at the state and local level. And finally an analysis of the payments that temporarily increased disposable income shows that they did not significantly affect personal consumption expenditures. In contrast changes in private investment and net exports have been much more of a factor in the recovery. Currently, the increased debt caused by ARRA—both directly through its deficit financing and indirectly through its de-emphasis on controlling spending—is likely a drag on economic growth.

[10] Cogan and Taylor (2010) show that initial estimates by government agencies and economic researchers outside of government of the increase in government purchases from ARRA were much larger than what actually happened.

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Mr. JORDAN. Thank you, Dr. Taylor.
Dr. Roberts.

STATEMENT OF RUSSELL ROBERTS, PH.D.

Mr. ROBERTS. Thank you, Chairman Jordan, Ranking Member Kucinich, and distinguished members of the subcommittee.

Over the last 2 years, the American Recovery and Reinvestment Act of 2009 has injected over half a trillion dollars into the U.S. economy in hopes of spurring recovery and creating jobs. The results have been deeply disappointing. Job growth has been anemic, while our deficit has grown, limiting our future policy options.

Fourteen million workers are unemployed. The unemployment rate among African Americans is over 15 percent. This is an American tragedy.

What went wrong? Why were the predictions so inaccurate? There have been two explanations. One is that the economy was in worse shape than we realized. The only evidence for this claim is circular, the standard Keynesian models under-predicted unemployment. I prefer a simpler explanation. The models that justified the stimulus package were flawed. Those models were broadly based on the Keynesian notion that the road to recovery depends simply on spending. In the Keynesian world view, all spending stimulates, somehow subsidizing university budgets in the Midwest or paying teachers in West Virginia helps unemployed carpenters in Nevada. It may be good politics; it is lousy economics.

This isn't the first time the Keynesian world view was wildly inaccurate in predicting the impact of changes in Government spending. Look at World War II. We frequently hear from Keynesians and others that the military spending in World War II ended the Great Depression. Certainly unemployment fell to zero because of the war.

But did the work create prosperity or boom? There was a boom for the industries related to war. There was little prosperity for the rest of the country. The war was a time of austerity. Government spending didn't have a multiplier effect on private output, it came at the expense of private output.

How about the end of the war, when Government spending plummeted? Paul Samuelson, a prominent Keynesian, warned in 1943 that when the war ended, the decrease in spending, combined with the surge of returning soldiers to the labor force, would lead to "the greatest period of unemployment and industrial dislocation which any economy has ever faced." He was not alone. Many economists predicted disaster.

What happened? Government spending plunged from 40 percent of the economy to less than 15 percent, and prosperity returned to America. Unemployment stayed under 4 percent between 1945 and 1948. There was a short and mild recession in 1945 while the war was still going on, but the economy boomed when Government spending shrank and price controls were removed.

We are told that the failure of the current stimulus proves it simply wasn't big enough to get the job is done. It is equally plausible the opposite is true, that Government intervention in the economy prevented the recovery. The truth is, our knowledge of the complex system called an economy, as modern as the United States, is woefully inadequate and may always remain that way. We ask too much of economics. Even our best attempts to measure the job impact of the stimulus make this clear.

In November 2010, a few months ago, the CBO estimated the stimulus had created between 1.4 and 3.6 million jobs, not a very precise estimate. But even this estimate was more of a guess than an estimate. The CBO estimates didn't use any actual employment data after the stimulus was passed. Instead, they based their estimates on pre-stimulus relationships between Government spending and employment, relationships that failed to predict the magnitude of our current problems.

The CBO's results, and those of other forecasters using multi-equation models of the economy are not science. They are pseudo-science, what the economist F.A. Hayek called scientism, the use of the tools and language of science in unscientific ways.

So where does that leave us? Let's get back to basics. When you are in a hole, stop digging. Stop running deficits of over $1½ trillion and counting. Act like grown-ups, get your fiscal house in order. Stop spending 25 percent of what we produce. Stop wasting my money and giving it to your friends. Stop passing legislation that makes it hard to figure out what the rules of the game are going to be. Get out of the way. Make Government smaller and give us a chance to do what comes naturally, seeking ways to make profit, avoid loss and work together. That is the only sustainable path to recovery and prosperity.

Thank you very much.

[The prepared statement of Dr. Roberts follows:]

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TESTIMONY

THE STIMULUS: TWO YEARS LATER
FEBRUARY 16, 2011

Russell Roberts

Professor of Economics, George Mason University

Committee on Government Oversight and Reform, Subcommittee on Regulatory Affairs, Stimulus Oversight and Government Spending

By the end of 2010, the American Recovery and Reinvestment Act of 2009 had injected over half a trillion dollars into the US economy in hopes of spurring recovery and creating jobs.

The results have been deeply disappointing. Job growth has been anemic while our deficit has grown, limiting our future policy options. The predictions made at the time of ARRA's passage were too optimistic.

Why? Why has the labor market proved so stubborn? Why were the predictions so inaccurate?

There have been two explanations. One is that the economy was in worse shape than we realized. There is no evidence for this claim. It is an ex-post rationalization. The only evidence is circular—the standard Keynesian models under-predicted unemployment.

The second explanation is that the models that justified the stimulus package were flawed. Those models were broadly based on the Keynesian notion that the road to recovery depends on spending. In the Keynesian worldview, paying workers to dig holes and fill them back in promotes recovery.

This is not the first time the Keynesian worldview was wildly inaccurate in predicting the impact of changes in government spending. The most important natural experiments involving Keynesian economics took place at the beginning and end of WWII.

It was once widely believed that the New Deal ended the Great Depression in the United States. But that claim has been subject to revisionism because of the recession of 1938. So was the failure of the New Deal evidence of Keynesianism? No, Paul Krugman reassured readers in November 2008—"the New Deal didn't pursue Keynesian policies. Properly measured, that is, by using the cyclically adjusted deficit, fiscal policy was only modestly expansionary, at least compared with the depth of the slump."[1]

So what ended the Great Depression?

Many now believe it was the spending on the war. Paul Krugman made that argument last year: "From an economic point of view World War II was, above all, a burst of deficit-financed government spending, on scale that would never have been approved otherwise…Deficit spending created an economic boom — and the boom laid the foundation for long-run prosperity."[2]

[1] Paul Krugman, comment on "Fiscal FDR," The Conscience of a Liberal, posted November 10, 2008, http://krugman.blogs.nytimes.com/tag/fdr/

[2] Paul Krugman, "1938 in 2010," *New York Times*, September 5, 2010. Available at http://www.nytimes.com/2010/09/06/opinion/06krugman.html

But was there an economic boom? Certainly unemployment fell to nearly zero because of the war. But did the war create an economic boom? It was a boom for the industries related to the war. But there was little prosperity for the rest of the economy. Was America prosperous in 1943? What about Germany? Or England? Each of these countries enjoyed large levels of deficit-financed spending. Yet their peoples did not enjoy prosperity. The war was a time of austerity. Government spending didn't have a multiplier effect on private output. It came at the expense of private output.[3]

When the war ended, the Keynesians predicted mass unemployment and economic crisis because of the expected big drop in government spending and the number of soldiers looking for work. Paul Samuelson, a prominent Keynesian, warned in 1943 that when the war ended, the decrease in spending combined with the surge of returning soldiers to the labor force would lead to "the greatest period of unemployment and industrial dislocation which any economy has ever faced."

Government spending did plummet. Ten million soldiers entered civilian life. Many other millions left jobs in industries devoted to war production.[4] Yet unemployment stayed under 4% between 1945 and 1948.[5] There was a short and mild recession in 1945—while the war was still going. But soon the economy boomed as government spending shrank and price controls were removed.

We are told that the failure of the stimulus proves it simply wasn't big enough to get the job done. But it is equally plausible that the opposite is true—that government intervention in the economy prevented the recovery.

The truth is that our knowledge of the complex system called the economy is woefully inadequate and may always remain that way. We ask too much of economics. Even our best attempts to measure the job impact of the stimulus spending make this clear.

In November of 2010, the CBO announced that ARRA had created between 1.4 and 3.6 million extra jobs.[6] When the upper limit of your estimate is *almost three times* the lower limit, you know it is not a very precise estimate.

But there is no way and there will never be a way to make that estimate any more precise. And there is no way of knowing if the real number falls within this absurdly large range. To do so would require using the actual data on output and employment while holding other factors constant. The CBO did not use those data. Why not?

The CBO in their November 2009 estimates of the impact of the stimulus spending said that "because isolating the effects would require knowing what path the economy would have taken in the absence of the law. *Because that path cannot be observed, the new data add only limited information about ARRA's impact.*"[7]

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[3] See "Wartime Prosperity? A Reassessment of the U.S. Economy in the 1940s," Robert Higgs, Journal of Economic History (March 1992) for further discussion of the standard of living of the average American family during the war.

[4] See David Henderson, "The U.S. Postwar Mirade,"Working Paper 10-67, November, 2010, Mercatus Center, George Mason University, http://mercatus.org/sites/default/files/publication/U.S.%20Postwar%20Mirade.Henderson.11.4.10.pdf

[5] See "Labor—U.S. Census Bureau, Table D 85-86, http://www2.census.gov/prod2/statcomp/documents/CT1970p1-05.pdf

[6] *Estimated Impact of the American Recovery and Reinvestment Act on Employment and Economic Output from July 2010 Through September 2010,* Congressional Budget Office (Washington, D.C., 2010) Available at http://www.cbo.gov/ftpdocs/119xx/doc11975/11-24-ARRA.pdf

[7] *Estimated Impact of the American Recovery and Reinvestment Act on Employment and Economic Output as of September 2009,* Congressional Budget Office (Washington, D.C., 2009) Available http://cbo.gov/ftpdocs/106xx/doc10682/Frontmatter.2.2.shtml

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TESTIMONY

That is a fancy way of saying we cannot evaluate the effect of the stimulus on job creation. The economy is too complex. Too many other variables change at the same time.

We don't have a reliable model of the economy in its current state. The CBO's results are fake science--what the economist F.A. Hayek called scientism—the use of the tools and language of science in unscientific ways.

Economics is not a science like physics that can tell us where Mars will be in June of 2012. We do not know where the unemployment rate will be in June of 2012.

In his Nobel Prize lecture, Hayek said this about macroeconomics:

"I confess that I prefer true but imperfect knowledge, even if it leaves much indetermined and unpredictable, to a pretence of exact knowledge that is likely to be false."[8]

Our current theories of macroeconomics are not testable or confirmable with the available evidence. We should be honest in admitting as much.

So where does that leave us?

What we do know is that entrepreneurs and risk-takers are acting very cautiously out of fear of the future. Government policy needs to do what it can to reduce that fear. That means a stable set of rules and a lower level of government spending. Those are the best ways to encourage the investment necessary for sustainable innovation and job creation.

We also know that we are consistently running deficits of over a trillion dollars a year, deficits that were initially justified on the grounds that they would produce prosperity. That has not proven to be true. We need to cut spending in order to grow the economy. We need to take a different path—an approach that is fiscally more prudent and that puts spending decisions in the hands of the consumers and investors rather than in the hands of bureaucrats. Cutting spending and reducing government's control over the economy is the road to stability, the road to prosperity, and the road to recovery.

[8] "The Pretence of Knowledge," Nobel Prize Lecture by F.A. Hayek, December 11, 1974, http://nobelprize.org/nobel_prizes/economics/laureates/1974/hayek-lecture.html

Mr. JORDAN. Thank you, Dr. Roberts.
Dr. Foster.

STATEMENT OF J.D. FOSTER, PH.D.

Mr. FOSTER. Thank you, Mr. Chairman, members of the committee. I appreciate the opportunity of testifying before you today.

At best, economic stimulus efforts based on deficit spending and tax cuts with little or no incentive effects have done no harm, at best. It is possible to stimulate the economy during and after recession by improving incentives to work and produce, by reducing uncertainties regarding future policy, by expanding foreign markets for our goods and services. Recent efforts have been unsuccessful because they did none of these things. Regulations increased, uncertainty increased, tax distortions were left in place, and efforts toward free trade have been anemic.

Stimulus can work, but has not worked, because the administration took the wrong approach, emphasizing incentive-neutral tax relief and massive increases in deficit spending. As he often remarks, President Obama inherited a ballooning budget deficit. His response, to push the deficit higher. And with this most recent offering, he has reached new highs.

Fortunately, recovery is underway. Uneven, stronger in some areas than others, but recovery nonetheless. The underlying strengths of our free market system are once again at work. But make no mistake, our economy is recovery despite, not because, of stimulus efforts.

The heart of the administration's policy is the equivalent of fiscal alchemy. Alchemy is the art of transmuting metals, referring specifically to turning lead into gold. Fiscal alchemy is the attempt to turn Government deficit spending whenever and wherever and on whatever into jobs. Regarding near-term stimulus, it is not a matter of how wisely or how foolishly the money is spent, nor how quickly nor slowly, or whether some is saved or not, any more than the phase of the moon or adding a bit more wolf's bane enhances the prospect for lead to become gold.

The basic theory of demand side stimulus is beguilingly simple. The economy is under-performing; demand is too low. Increase demand by deficit spending, and voila, the economy is stronger and employment is up. One wonders then why Government should not simply increase deficit spending much, much more and create instant, firm employment. Why indeed? The answer is that demand has shifted, but not increased, because Government must somehow fund this additional deficit spending and it does so by borrowing, reducing the resources available for the private sector.

Suppose you take a dollar from your right pocket and put it in your left pocket. Do you have a new dollar to spend? Of course not. Deficit spending shifts demand from private to public sector. Or imagine the level of water in a bathtub represents the total level of demand in our economy. Now, suppose you pour a bucket of water into the bathtub. You would expect the level of water to rise. But where did the water in the bucket come from? It came from dipping the bucket in the bathtub in the first place. You may make a splash, as the President did with the stimulus, but when the water settles, in terms of the water level, total demand, nothing has changed.

There are some telltale signs that it has intentionally or inadvertently fallen for demand side stimulus alchemy. One involves talk of multipliers. One must first believe deficit spending can boos total demand before investigating multipliers. One must first believe lead can become gold to investigate the advantages of incantations over potions.

Another tell-tale sign is references to whether amounts are saved or spent. Whether deficit spending moneys are saved or spent matters not a whit to the immediate level of economic activity. If spent, then private demand falls by the amount borrowed to fund the spending. If saved, then all that has happened is a shifting of portfolios. Government debt is higher, private savings is higher, but total demand is again unmoved.

Support for demand side theory often comes from observing that private saving might be parked in unproductive locations, and well it might. But unless saving is withdrawn entirely and held in cash, it remains part of the financial system. And banks and other financial institutions are lending those to somebody else to use. And if the saving is withdrawn and held in cash, out of a distrust of the financial system, then there is nothing about a government selling prodigious amounts of debt that is likely to reassure that fearful saver to put the savings back into the financial system for Government to borrow.

Because the deficit today is so enormous, the Nation's policy options, aside from halting or reversing the regulatory onslaught, are severely limited, confined essentially to expanding free trade and cutting spending deeply to restore fiscal balance. Unfortunately, in his budget, the President punted, as the Washington Post, among others, opined. It is therefore up to the Congress to act. Near-term efforts to cut spending are essential, but must be seen as but the first step in a steady march against Government spending, including reforming the major entitlement programs to stabilize these programs and to restrain Government spending. The best fiscal policy now is to get the Nation's fiscal house in order by cutting spending repeatedly.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Foster follows:]

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CONGRESSIONAL TESTIMONY

Testimony before

The Subcommittee on Regulatory Affairs, Stimulus Oversight, and Government Spending

Of

The House Committee on Oversight and Government Reform

United States House of Representatives

February 16, 2011

J.D. Foster, Ph.D.
Norman B. Ture Senior Fellow in the Economics of Fiscal Policy
The Heritage Foundation

My name is J.D. Foster. I am the Norman B. Ture Senior Fellow in the Economics of Fiscal Policy at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

At best, stimulus efforts based on government spending and tax cuts with little or no incentive effects have done no harm. At best. It is quite possible most of these efforts over the past couple of years have slowed the recovery while adding hundreds of billions of dollars to the national debt.

The record is all the more unfortunate because it is possible for a President and Congress to work together to stimulate the economy to faster growth during and after a recession. They can do so by improving incentives to produce and to work: for example, by reducing regulations and tax distortions. They can do so by reducing the uncertainties surrounding future policy. They can do so by expanding foreign markets for domestic goods and services. Recent efforts to stimulate the economy have been unsuccessful because they did little or none of these things. Regulations have increased. Uncertainty has increased. Tax distortions have been left in place or even increased in some areas. And efforts toward free trade have been anemic, at best.

Stimulus can work, but it has not worked because the Administration took another approach, emphasizing tax relief with little or no incentive effects combined with massive increases in spending. The President inherited a ballooning budget deficit and opted to grow it further. At best, this would be expected to be ineffectual. At best, because the resulting increased deficits infused economic decision-making with even more uncertainty about the consequences of massive deficit spending and how and when government will act to restore fiscal sanity.

Fortunately, the economy is showing clear signs of sustained recovery; uneven recovery to be sure, stronger in some areas than others both geographically and by industry, but recovery nonetheless. Despite the tremendous blows from the financial crisis and all that it entailed, the underlying strengths of our free market system once again are at work, giving expression to the vitality, energy, and innovation of the American people. Make no mistake: Our economy is recovering despite—not because of—the actions taken in Washington to grow it.

Signs of Taking the Wrong Road

The heart of the Administration's approach to stimulus is the equivalent of fiscal alchemy. Alchemy, "the art of transmuting metals," refers specifically to turning base metals like lead into gold. Fiscal alchemy is the attempt to turn government deficit spending—whenever, wherever, and on whatever—into jobs. Regarding near-term stimulus, it is not a matter of how wisely or foolishly the money is spent. It is not a matter of how quickly or slowly the money is spent. It is not a matter of whether some is saved or not—any more than the phase of the moon or adding a bit more wolfsbane or a stronger electric current enhances the prospects for lead to become the substance of an alchemist's dreams.

The basic theory of demand-side stimulus is beguilingly simple. The theory observes that the economy is under performing and total demand is too low, and thus total supply needed to meet that demand is too low. It would appear obvious enough, then, that a solution is to increase demand by deficit spending and rising supply will naturally follow. The net of government spending over tax revenues adds to total demand. Increase the deficit and you increase demand, supply naturally follows, and voila: the economy is stronger and employment is up. One wonders then why government should not simply increase spending much, much more and create instant full employment.

Why, indeed. The answer, as is now obvious, is that this policy does not work for the simple reason that government must somehow fund this additional spending, and it does so by borrowing. Suppose you take a dollar from your right pocket and transfer it to your left pocket. Do you have a new dollar to spend? Of course not.

Or suppose you pour a bucket of water into a bathtub. You would expect the level of the water to rise. But where did the water in the bucket come from? It came from dipping it into the bathtub. You may make a splash, but when the water settles, in terms of the water level nothing will have changed.

An increase in government borrowing to finance an increase in deficit spending produces one of two ensuing events, either of which (or in combination) leaves total demand unchanged. First, the increase in government borrowing can mean a reduction in the amount of saving available for private consumption and private investment. Government demand goes up, private demand goes down, total demand is unchanged.

Alternatively, the increase in government borrowing may be financed not by reducing private borrowing but by an increase in net inflows of foreign saving—either a reduction in the gross outflows of U.S. saving or an increase in the gross inflows of foreign-sourced saving. Total demand remains unaffected, however, because the balance of payments still balances, and so the increase in net inflows of saving is matched by an increase in the net inflows of goods and services—the increase in the trade deficit offsets the increase in deficit spending.

Underlying this simple confusion surrounding demand-side stimulus is that the theory ignores the existence of a well-developed financial system, the job of which fundamentally is to direct private saving into private consumption, private investment, or government deficit spending. Even in the past few years, when the financial system has worked poorly in the sense that institutions have failed, markets struggled, and the direction of investment dollars has been less than stellar, the markets still managed to take every dollar of saving and direct it toward a borrower willing to take it *and use it.* Demand-side theory presumes the existence of financial markets, as government must rely on those markets to issue debt to finance deficit spending, but then ignores that absent the additional government borrowing, markets would have directed the saving to other purposes, which would have added to total demand in the same amount.

These economic relationships are analogous to the law of conservation of energy, which says that energy can be neither created nor destroyed in a closed system, but can only be transformed from one state to another. If we exclude the possibility of cross-border capital flows, then the closed system is the domestic economy and the energy conserved is the amount of saving available. If we allow for the possibility of cross-border capital flows, then the closed system is the global economy and the energy conserved is the amount of domestic saving augmented or diminished by the second closed system of the balance of payments.

You Could Be a Demand-Sider If...

There are some tell-tale signs that one has intentionally or inadvertently fallen prey to demand-side stimulus alchemy. One such sign arises when one engages in discussions about multipliers. The multiplier principle is simple enough—if government deficit spending rises by a dollar, does total demand rise by more than a dollar? Make no mistake. One must first accept the possibility that government deficit spending can boost total demand before one embarks on an empirical investigation of multipliers. First, one must believe that lead can be turned into gold to investigate the advantages of incantations over potions.

Another tell-tale sign is references to whether amounts are saved or spent. For example, one argument in favor of direct spending over broad-based tax relief is that every dollar of spending is spent, whereas some portions of a tax cut are saved, and the higher the income of the tax cut recipient, the more from a tax cut is likely to be saved. A related example is the argument that the additional cash income from extending the Unemployment Insurance program for the long-term unemployed is highly likely to be spent virtually in toto, suggesting that such a policy is particularly efficacious stimulus.

Whether the monies resulting from deficit spending are saved or spent matters not a whit to the immediate level of economic activity. If these monies are spent, then private demand must fall by the amount borrowed. If the monies are saved, then government debt is higher and private saving is higher, yet total demand is again unmoved.

One of the original motivations for the demand-side theory of fiscal stimulus was the observation that private saving might be parked in unproductive locations. We hear echoes of this today when, for example, the President refers to the need for private companies to employ their enormous cash hoards to increase investment and employment.

For example, during the Great Depression many citizens took to stashing their saving around the house as faith in the security of private financial institutions crumbled. They would bury it in a coffee can in the back yard, or perhaps sew twenty-dollar bills into the lining of a suit. Clearly, in these cases, the saving has been withdrawn from the financial system and so total demand as commonly measured fell. However, this cautious financial behavior lends no support for increased deficit spending. There is nothing about a government going deeper into debt that is going to instill such confidence in a coffee can-based saver as to entice that person to disinter his or her cash just to make it available to the government.

Unless the saving has been withdrawn entirely and held in cash, it remains part of the financial system, and banks and other financial institutions are lending those monies to someone else to use. Companies today with large cash hoards are choosing not to invest these monies themselves in expanded productive capacity; however they are not locking them in the Chief Financial Officer's office safe, either. These corporate savings are deposited with and deployed by the financial system.

Why Are Demand-Siders Not Quaking?

The Congressional Budget Office recently released its analysis of the near- and intermediate-term budget picture showing a budget deficit for 2011 of almost $1.5 trillion or 9.8 percent of our economy.[1] However, under the CBO forecast based on current law, the deficit drops dramatically to 7 percent of our economy by 2012 and it drops a similar amount as a share of the economy by 2013. The Administration's Mid-Session Review released last July showed a similar pattern.[2] (This testimony was written prior to the release of the President's Fiscal Year 2012 Budget, which presumably will show the same general pattern.)

In light of these forecasts, if the Administration and other demand-side stimulus proponents believed their own theory they would today be concerned to the point of apoplexy. Rather than forecasting reasonably good growth for 2011 and 2012, they would be forecasting a growth recession at best, and more likely a return to recessionary conditions.

The measure of the amount of demand-side stimulus is whether the deficit is rising or falling relative to the size of the economy. From 2008 to 2009, the ratio of the deficit to Gross Domestic Product (GDP) rose from 3.2 percent to 9.9 percent. This 6.7 percent massive dose of fiscal stimulus represented the largest deficit burst since 1942. It was half again as large as the next biggest dose in the post-war era—a 4.4 percentage point burst in 1949. If demand-side stimulus worked, the economy's growth today should be China-esque.

On the flip side, a 5.5 percentage point drop in the deficit-to-GDP ratio from 9.8 percent in 2011 to 4.3 percent in 2013, as CBO forecasts, should raise loud alarms amongst demand-side supporters. If demand-side deficit-soaring stimulus works to boost

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[1] See Congressional Budget Office, "The Budget and Fiscal Outlook: Fiscal Years 2011 Through 2021," January 2011, at *http://www.cbo.gov/ftpdocs/120xx/doc12039/01-26_FY2011Outlook.pdf.*

[2] See Office of Management and Budget, The White House, "Mid-Session Review, Budget of the United States Government, Fiscal Year 2011," July 23, 2010, at *http://www.whitehouse.gov/sites/default/files/omb/budget/fy2011/assets/11msr.pdf.*

the economy, then a rapidly shrinking deficit should undercut the economy. Yet, no such concern is in evidence. Instead, the Administration forecasts a steady improvement in output and employment. The Administration apparently no longer believes in demand-side stimulus.

To be clear, a rapid decline in the budget deficit through a combination of strong spending restraint and revenue recovery through economic growth is exactly what the nation needs today. The point, in the current context, is merely that demand-side supporters apparently expect as little downward effect from the rapid drop in the deficit's share of our economy as we saw stimulative pressures when the deficit began its historic ascent.

The Fall, Rise, and Fall of Demand-Side Stimulus

It was not that long ago that demand-side stimulus was generally understood to be ineffective. After a couple decades of unsuccessful attempts at fiscal fine-tuning in the 1950s through the 1970s, not just in the United States but around the world, a reluctant consensus for abandoning these policies developed. For some reason, this consensus fell apart during the recession President George W. Bush inherited from President Clinton. While Bush emphasized the importance of rate reductions, it also became acceptable again to talk about "putting money in people's pockets so they could spend." Demand-side stimulus was back, and as ineffective as ever as we learned in 2001 and 2002.

The demand-siders remained ascendant as President Obama took office and as yet another recession unfolded. Facing a choice of cutting tax rates à la first President Reagan in 1981 and then Bush in 2001 and 2003, or returning to the deficit spending policies of the early post-war period, Obama and his congressional allies naturally chose not to emulate their ideological opponents. They chose to increase mightily an already rapidly growing spending bulge and budget deficit. If ever this policy was going to work, this was it. It failed.

That demand-side stimulus has again failed is increasingly obvious even to those who advanced the policy, some reluctantly, some with gusto. It is safe to predict that many of those who remained silent in opposition will soon come out and say they opposed this policy all along. It is even safe to predict that some of the loudest proponents will recant in some future year, likely asserting in all seriousness and hoping no one will check, that they knew all along that the President's demand-side stimulus policy was doomed. It matters far less that these voices will still have currency in certain quarters than that, for awhile at least, demand-side stimulus policies will again be tabled as effective only in growing the national debt.

Stimulus That Would Have Helped

There is much the last Congress could have done to stimulate the economy. A simple example is that Congress might have acted quickly, rather than waiting until the last minute, to extend the Bush tax cuts through 2012. The uncertainty surrounding tax policy slowed the recovery.

The Congress could have resisted the temptation to tinker. For example, it could have resisted the temptation of the first-time homebuyer's credit, which on balance slowed the recovery in the housing sector by first confusing and then slowing the price discovery process. To be sure, home sales at first increased, and then collapsed, and in the meanwhile housing markets had a powerful new source of market noise to filter out as they searched for proper price levels.

The Congress and the President could have halted the storm of new regulations and threatened regulations, beginning but not limited to Obamacare. According to estimates by my colleague James Gattuso, the cost of the federal regulatory burden now tops $1 trillion—before Obamacare.[3]

Above all, Congress could have focused its fiscal policies on the sources of recovery and growth, rather than give in to the perennial delight of increasing spending on politically favored causes. One example among many is that the Congress could have cut the corporate income tax rate from 35 percent to 25 percent for a decade for about the same deficit impact as all the so-called fiscal stimulus. President Obama acknowledged in his State of the Union address that the corporate tax rate is too high. Had he acknowledged this two years ago and pressed for a reduction at that time, many more fellow citizens would today have gainful employment.

Because the budget deficit today is so enormous, the nation's policy options aside from halting or reversing the regulatory onslaught are severely limited, confined essentially to expanding free trade and cutting spending deeply to restore fiscal balance. Near-term efforts to cut non-security discretionary spending are essential, but must be seen as but the first step in a steady march against government spending, including reforming the major entitlement programs to stabilize these programs and to stabilize government spending. The best Congress and the President can do now in terms of fiscal policy is to get the nation's fiscal house in order by cutting spending, repeatedly.

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[3] See James L. Gattuso and Stephen A. Keen, "Red Tape Rising: Regulation in the Obama Era," by Heritage Foundation *Backgrounder* No. 2394, April 8, 2010, at *http://www.heritage.org/research/reports/2010/03/red-tape-rising-regulation-in-the-obama-era.*

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Mr. JORDAN. Thank you. I thank the witnesses.

Look, I think the American people are asking, when does this stop? I have been saying for months, if big Federal Government spending was going to get us out of this mess, well, for goodness sake's, we would have been out of it a long time ago, because that is all the Government has done for two plus years. And frankly, it did start even under the previous Republican administration. As Mr. Foster pointed out, it has been taken to new levels with this administration.

So I think instinctively, the American people understand the stimulus didn't work, transfer payments, propping up States, bailing out, they know it didn't work. But I also think they are beginning to realize that not only did it not work, it caused harm, as evidenced by the record debt that we have in front of us.

And frankly, I think as Dr. Foster pointed out, and maybe our others as well, I still remember the first principle they teach you in Economics class, this crowding out concept, or opportunity cost. When you take resources and devote them to one thing, by definition they can't be used somewhere else. Frankly, the more efficient private sector where they can't be used.

So I think the American people get it. My question goes right to where Dr. Foster left off, so we'll start here and work backward. This budget, as I begin to look at it and delve into it, that the President unveiled on Monday, I think continues the same pattern. It is the same old, same old. It is big Government spending. It is now a record deficit on top of a record deficit on top of a record deficit.

So give me your thoughts on this budget, and frankly, the tax increase and the spending contained in it, how harmful that is going to be as we again try to get below 10 percent unemployment, get back to a more normal economy, and frankly, a growing economy. We will start with Mr. Foster and work back.

Mr. FOSTER. I think this budget, if it were enacted, would be extremely harmful to our economy for a number of reasons. One, it is an enormous increase in the national debt with the deficit projected at $1.6 trillion, finally breaching clearly the 10 percent of our economy level. This is creating more and more uncertainty as to——

Mr. JORDAN. Let me interrupt. I think this is common sense. You have to be at 3 percent of GDP or below, I would argue below that, frankly, just to have any type of sustainable deficit that you are carrying. Would you agree?

Mr. FOSTER. Depending on the rate of interest, a normal long-term rate of interest something on the order of 2½ percent to 3 percent is sustainable. We are well beyond that.

Mr. JORDAN. Exactly.

Mr. FOSTER. And oddly, we are in a situation where we are far more irresponsible, frankly, than all of our European friends, who recognize the situation they are in. The stimulus that deployed didn't work, either. And they are now embarking on a strenuous program, a painful program, of getting their spending under control and their deficits under control, because they realize that is the key to short-term and long-term prosperity. Short-term because these deficits are creating uncertainty. Uncertainty is the enemy of prosperity.

Mr. JORDAN. Well said. Dr. Roberts.

Mr. ROBERTS. The reason that uncertainty is the enemy of prosperity is we need investments, and investments require risk-taking. If the future is uncertain and people are nervous about the future and have anxiety about it, they are less likely to take risks. We have done a bunch of things in the last 3 years, 4 years, to reduce the incentives for risk-taking. And worse, the risk-taking we have encouraged has been imprudent. We need prudent risk-taking.

So we have the uncertainty about the deficit, the fact that future tax increases are coming. But we don't know the nature of that burden, how it is going to be financed. We have uncertainty about the stability of the system itself. We are financing out deficit right now, very short-term interest borrowing, which is great when interest rates are low. But when interest rates rise it could be very, very expensive. I am very concerned about that.

There is regulatory uncertainty. We have passed massive regulation of the health care and financial sectors, two large parts of our economy. It would be one thing if we passed the legislation that was in place. But of course, the rules aren't written yet, so how do people know to go forward?

And finally, we have done a bunch of bailouts that said, if you are bad at what you do, we are going to give you money anyway. So prudent risk-taking has been discouraged.

Mr. JORDAN. You made me think of one thing here. We will finish with Dr. Taylor, but if you can address this question, too. And this is one area where we may have some agreement with the President. Corporate tax rates. I am actually to the point where I think it is frankly unpatriotic not to be for lowering the corporate tax rate when you think about where we compare with our competitors around the globe. So I would like your thoughts on that, to, as you evaluate te budget, Dr. Taylor, in the last 30 seconds here.

Mr. TAYLOR. I think the most sensible thing is to reverse this spending binge of the last 2, 3 years. I think that would be so beneficial to the economy, to show the courage of our Government to be able to do that, start reducing the debt. On the taxes, I agree, the corporate tax makes us uncompetitive.

I would say the firmest thing to say to convince the American people is, we are not going to increase anybody's tax rate for the foreseeable future. That would provide certainty, remove a lot of the doubts and concerns people have about investment. And the only way you are going to get unemployment down is to encourage private investment. That is what the data shows, that is what history shows.

Mr. JORDAN. Well said, thank you.

The gentleman from Ohio, Mr. Kucinich.

Mr. KUCINICH. I thank the gentleman.

I have some questions for Professor Taylor, but before I begin, I just want to make some observations here. To have this discussion about the state of the economy without getting into the fact that the tax cuts that were sponsored by the Bush administration cost us $1.2 trillion, that the wars, which both parties have participated in, have cost us roughly about $1.2 trillion, we have a trade deficit right now of $497.8 billion, according to the latest U.S. census. NAFTA, GATT, China trade. Millions of jobs have been lost. It has been the work of both parties.

We have maybe close to 15 million people unemployed. And when you look at the boom-bust cycle that was created by the lack of regulation of over-the-counter derivatives, Warren Buffett himself in 2002 condemned these over-the-counter derivatives as financial weapons of mass destruction. This is as recounted in Bob Scheer's book, The Great American Stickup.

When you look at the $700 billion bailout, which Mr. Jordan and I both voted against, when you consider that Wall Street is recovering and Main Street is not, that stock prices are going up, but the regulations that need to be in place to stop it are the boom-bust cycle, it is still pretty shaky as to whether we will be able to avoid that.

I think that the testimony that we have here is very interesting. But maybe you don't even have enough time to get into this, but it is inevitably incomplete. We have to have a complete picture of how we got to where we are. And it has to be really not driven by partisanship, which I don't see my colleague here as a very partisan person, but it has to delivered, we have to focus on the fact.

Now, Professor Taylor, your testimony concludes with these statements: "Many evaluations of the impact of ARRA used economic models on which the answers are built-in." And you also say that "approach makes less use of simulations of existing econometric models, although it uses general theories, such as the permanent income theory or similar theories of Government behavior."

Now, Professor Taylor, earlier this month, Dartmouth economists, writing for the National Bureau of Economic Research, published a paper, which I move to put into the record, without objection, that found a positive effect of the stimulus on a State by State basis. The authors acknowledge that their approach probably understated the effect, although it was nonetheless significant.

[The information referred to follows:]

[NOTE.—No insert/information provided.]

Mr. KUCINICH. Professor Taylor, is it your testimony today that the NBER analysis of the stimulus was erroneous, because as you said, many studies had the answers built in?

Mr. TAYLOR. The NBER study you are referring to I do not know.

Mr. KUCINICH. Well, I want to have staff——

Mr. TAYLOR. I can answer with respect to my own studies of this, and also NBER publications. They show, when you look at where the money went, it did not increase infrastructure spending at the States. So it is very clear in the data.

Mr. KUCINICH. Well, I can say that, as far as the infrastructure spending as a percentage of the ARRA that I would have preferred that it had all been for infrastructure. But it wasn't. However, this NBER paper is in fact critical of your work. And what the authors wrote were that other model-based evaluations, such as Cogan, Taylor, I think they are referring to you, and Wieland, conclude that the Government spending multipliers are significantly smaller than those claimed by advocates.

Again, their conclusions are based entirely from existing models and gain nothing from the actual data, I want to stress that, from the actual data on employment before and after the implementation of the ARRA. So isn't it true that much of your testimony here today would be subject to criticism from these authors, which in fact is the same criticism you make against others?

Mr. TAYLOR. No.

Mr. KUCINICH. I just like to see economists arguing.

Mr. TAYLOR. Well, I can answer no, it doesn't apply to what I testified about today. It applies to other work that I have done in the spirit of simulating models. My whole point of this testimony is to go beyond the disagreement about the models and look at what actually happened. That is what I am doing, and I think it is very clear, when you look at the data. I couldn't agree more than you have to go beyond the models.

Mr. KUCINICH. Well, let me ask you this. Would you have said, let's say, all $787 billion should have gone into infrastructure spending? Or would it be your position we shouldn't have spent anything in trying to stimulate the economy?

Mr. TAYLOR. As a matter of what actually Government can do, why do you think such a small amount went to infrastructure at the Federal level? I think people were told, you just can't get the money out the door that fast. Instead, the idea was to send grants to the States. But they're not going to get the money out that fast, either. It is a matter of what is feasible and capable. And our experience, not just in this case, but in the 1970's, we tried to do the same thing, send grants to the States, hoping that they would spend money on infrastructure. They didn't do that, they did exactly the same thing as here. We didn't look at those.

Mr. KUCINICH. Mr. Chairman, are we going to have another round?

Mr. JORDAN. Yes.

Mr. KUCINICH. Then I will get back to this question. Thank you, Dr. Taylor.

Mr. JORDAN. And if I could, Mr. Taylor, is it true that the actual data shows that unemployment has been at record levels for the last 21 months, when it was projected to be at 8 percent?

Mr. TAYLOR. Yes.

Mr. JORDAN. OK, thank you.

The vice chairman of the subcommittee, the gentlelady from New York, Ms. Buerkle.

Mr. BUERKLE. Thank you, Chairman Jordan, and thank you all for being here this morning for this very important discussion. I always thought it was just a bit counter-intuitive that we would take a trillion dollars out of private sector and give it to the Government to redistribute back to the private sector with all sorts of strings attached, and hope that it would help our economy and job creation.

My first question, I will just refer to something that the gentleman from Ohio mentioned regarding the tax rates, and continuing the tax rates, and what they add to the deficit. Because that is something we hear as an excuse or a reason not to extend the current, the tax rates from 2001–2003. I would like you to comment on that before we get into the stimulus a bit.

Mr. TAYLOR. I think the agreement to extend the tax rates that are in the law currently is a very important stimulus to the economy. Economics tells us that more permanent changes like that, something that has been in the law for a while, is much more beneficial for people's spending decisions and investment decisions. I would like to see that extended even further. I think that would be quite beneficial and a good stimulus, more beneficial than the temporary types of changes being proposed.

Ms. BUERKLE. Thank you, Dr. Taylor. Dr. Roberts.

Mr. ROBERTS. I think it is important to remember that we cut tax rates, and that had a stimulating effect, that Professor Taylor is talking about. But if you cut revenues and you don't cut spending, all you have done is substitute taxes tomorrow for taxes today. I think the single most important thing that Congress can do now is to cut spending, because that is an implicit tax on the private sector. We spend way too much money to the Government sector, we need to spend less.

Ms. BUERKLE. Thank you. Dr. Foster.

Mr. FOSTER. I agree with Dr. Taylor that it is terribly important that we extend for a much longer period of time, if not make permanent, the tax relief that was enacted under President Bush. That uncertainty about the outcome of that policy had a major depressive effect on the economy last year. And those decisions will feed on into next year at reduced investment, which is going to be a driver of going forward.

But it is also terribly important to get the spending down now. That is probably, at this stage, the most stimulative policy that we can enact, get spending under control, the deficit down, reassure credit markets that we do intend and will get our fiscal house in order.

Ms. BUERKLE. Thank you. My next question, and it is to all three of you again, do you think that the economy would have improved and would have recovered without the stimulus? Dr. Taylor.

Mr. TAYLOR. Yes. I think that the beginnings of the recovery preceded the stimulus. When you look at the factors in the economy that drove the increase in growth, there are private investments, also net exports, not really the Government purchases. So very much so. I think that in fact, at this point in time, you can point to the stimulus and related reasons for the higher debt as holding back the strength of the recovery at this point. It has been disappointing, especially last year. We hope it is picking up. But I think it would have been better without this kind of a stimulus.

Ms. BUERKLE. Thank you. Dr. Roberts.

Mr. ROBERTS. The only thing I would add to that is the funneling of money, Federal tax money to the States encourages their misbehavior. I think it is extremely important that people live within their means, learn to change their behavior. And we continue to enable that, and we just push off the day of reckoning down the road. I think that is irresponsible, and I think we ought to be changing those incentives.

Ms. BUERKLE. Thank you. Dr. Foster.

Mr. FOSTER. As I testified, I believe we could have enacted stimulus that would have helped. But the President chose a different path. He chose a path that was not going to be effective, because you do not add money to the economy by first taking money out of the economy. That is the fundamental flaw of the theory. Thus I think on balance we would have been better off. At best, this policy did no harm, at best.

Ms. BUERKLE. Thank you. And I am sure we will get to this. My time is soon to expire. I would like to hear from all three of you regarding what your recommendations are to grow our economy and to really get at the root of this problem. What can we do as a Congress to help improve the economy of the United States?

Mr. TAYLOR. Three things, and this is before the stimulus. First is to make sure we are not going to increase tax rates. It is not necessary to do that to deal with the deficit, and it would be beneficial to growth.

Second, lay out a plan to get the debt explosion over with. We have projections by CBO of debt just skyrocketing. Lay out a plan so they score it to come back down to reasonable levels. That will reduce uncertainty, if people get faith back in our Government.

And third, I think it is important to address this spending binge we have had recently, spending going from 21 percent to 25 percent of GDP, and not really coming down very much is something that should be addressed. That will stimulate the economy, because the jobs come from the private sector.

Ms. BUERKLE. Thank you. We can maybe continue those later?

Mr. JORDAN. Sure. We now turn to the distinguished ranking member, the gentleman from Maryland.

Mr. CUMMINGS. I want to thank the chairman for calling this hearing. And I want to thank our witness for doing an outstanding job.

As a member of the Joint Economic Committee, we have had Mr. Zandi appear, Mark Zandi, who was the advisor to John McCain, Senator McCain, when he was running for President, come and testify before us. And he testified and acknowledged that the Recovery and Reinvestment Act had significant effect on the economy. He said something else that I found very interesting. He said that, a lot of people think Economics is a science where everybody is going to disagree. He said you are going to have some disagreement. But I find that I must tell you that it concerns me when I have a chorus of folks saying all the same things.

So I just want to ask a few questions, and I would just like a yes or no answer. Dr. Taylor, you talked about the facts, just the facts. And I want to go to some of the facts and see what you all think of this, and the things that we do know, the things we know. And I just want a yes or no answer on these, and then if I have time, we can come back and you can explain.

Over 75,000 total projects have been started across the country under the Recovery Act. Have they had any positive effect, yes or no? Yes or no, just yes or no, and I am going to come back.

Mr. TAYLOR. I am sure some of them have a positive effect. But the question——

Mr. CUMMINGS. OK, I have seven questions. I will come back to you, I promise. Yes or no?

Mr. ROBERTS. A little bit, yes. Surely.

Mr. CUMMINGS. OK. Dr. Foster.

Mr. FOSTER. On net, no.

Mr. CUMMINGS. OK. More than 110 million, or 95 percent of working families, have been receiving a boost in their paychecks each week through the Making Work Pay tax credit. Has this had any positive effect on these families, yes or no?

Mr. TAYLOR. Yes.

Mr. ROBERTS. Yes.

Mr. FOSTER. On the families, certainly.

Mr. CUMMINGS. Almost 70,000 small businesses have received nearly $30 billion in loan assistance through the stimulus. Has that had any positive effect on those businesses?

Mr. TAYLOR. Yes.

Mr. ROBERTS. Yes, on those businesses.

Mr. CUMMINGS. Keep your voices up, let's hear you nice and loud. Your testimony was loud. Come on, Dr. Foster?

Mr. FOSTER. Yes, on those businesses.

Mr. CUMMINGS. All right. Under the Recovery Act, more than 2,800 loans to farmers and ranchers were guaranteed. Has that had any effect on the farmers and the economy? Mr. Taylor.

Mr. TAYLOR. I haven't studied that.

Mr. CUMMINGS. OK, you haven't studied that? Sir, I'm sorry, I didn't hear you.

Mr. TAYLOR. No, I have not studied those particular——

Mr. CUMMINGS. I understand, you didn't study it. Dr. Roberts.

Mr. ROBERTS. I am sure it was good for them.

Mr. CUMMINGS. All right, but not on the economy, right?

Mr. ROBERTS. I don't know. I am not going to say yes or no to that.

Mr. CUMMINGS. OK, fine. And you, Dr. Foster?

Mr. FOSTER. On those farmers, yes.

Mr. CUMMINGS. But not on the economy? No?

Mr. FOSTER. That is correct.

Mr. CUMMINGS. All right. More than 300,000 families have made home improvements to reduce their energy use and cut their utility bills. Will those families be able to appreciate any results from the Recovery Act, and does that affect the economy, the fact that we are putting people to work to do those repairs, like in my district, and districts of almost every single, of every single Member of Congress, by the way? Mr. Taylor? Dr. Taylor, I am sorry.

Mr. TAYLOR. On the overall economy, no. On the individuals, yes.

Mr. CUMMINGS. OK. Dr. Roberts.

Mr. ROBERTS. Which projects are those, the home improvement?

Mr. CUMMINGS. Yes, the home improvement.

Mr. ROBERTS. Is that the insulation and the weather-proofing?

Mr. CUMMINGS. Weather-proofing, retrofitting.

Mr. ROBERTS. Incredibly badly run program. Very ineffective.

Mr. CUMMINGS. So you are saying it had no effect on the economy?

Mr. ROBERTS. Not a positive effect overall. Good for the people who worked doing it, but not for the rest of the economy.

Mr. CUMMINGS. People that, the 15 percent that you talked about, African American unemployment rate, as a matter of fact, it is higher in some instances in my district.

Mr. ROBERTS. Yes, sir.

Mr. CUMMINGS. But there are people who I just witnessed doing those jobs, having a tremendous impact that would not have been working but for. You say no effect on the economy?

Mr. ROBERTS. Perhaps they might have been working. It is hard to know.

Mr. CUMMINGS. No, they would not have been, believe me. I live there.

Mr. ROBERTS. Well, I am glad for them, then. That is great.

Mr. CUMMINGS. Dr. Foster, how about you?

Mr. FOSTER. On the economy, no effect. For those families, I can't judge their decisions. I presume they made wise decisions for themselves.

Mr. CUMMINGS. The Department of Housing and Urban Development has rehabilitated over 409,000 homes and built 5,700 new homes. Will the families who reside in those homes experience any benefits from the Recovery Act, and does that affect the economy in a positive way?

Mr. TAYLOR. The individuals who benefited from that are benefiting. The overall economy, no.

Mr. ROBERTS. Ditto.

Mr. CUMMINGS. Are you going to ditto too?

Mr. FOSTER. I am going to ditto, try to move it along.

Mr. CUMMINGS. We have a great chorus here.

Mr. FOSTER. Trying to help you.

Mr. CUMMINGS. Under the Recovery Act, more than 4,000 Department, and this is my last question, with the indulgence of the Chair, 4,000 Department of Defense construction and improvement projects have been started at over 350 military facilities. These include the construction or improvement of military hospitals and 25 child development centers. It also includes over 70 military family housing improvement and construction projects. Will these projects result in benefits for anyone? Do they affect the economy or did they affect the economy in a positive way? We will start with you, Dr. Foster.

Mr. FOSTER. In the aggregate, no, sir.

Mr. CUMMINGS. Yes?

Mr. ROBERTS. Don't know. Good for them. Who got the money? If you pay people to dig ditches and fill them back in and you give them a $200,000 a year salary, they will be better off.

Mr. CUMMINGS. And you, Dr. Taylor?

Mr. TAYLOR. Those people benefited, the overall economy did not.

Mr. CUMMINGS. Thank you all very much.

Mr. JORDAN. I thank the gentleman.

Let me just clear up one thing. And we will go quickly, we will have one more round, then we will get to our second panel. I wan to just clear up this issue. Some have suggested that allowing families and individuals to keep their money adds to the deficit. And I just fail to adopt that premise that reducing the tax burden on the American people somehow adds to the deficit. But I want to hear it from the experts. Are deficits and the buildup of our national debt, is that a result of letting people keep their money, or is it a result of politicians spending too much? Let's just answer this simple question first. Mr. Taylor.

Mr. TAYLOR. The largest amount is the spending, going forward. It is just basically, you just look at projections of why the deficit is where it is, where it is going, why it is increased. It is on the spending side.

Mr. JORDAN. Mr. Roberts.

Mr. ROBERTS. I just want to have the thrill of saying I agree with Mr. Kucinich a little bit. So while I agree that the stimulating effect of cutting tax rates has a positive incentive for economic activity, to cut taxes and increase spending at the same time is irresponsible.

Mr. JORDAN. I wondered, I heard your first comments.

Mr. ROBERTS. You have to do both.

Mr. JORDAN. You would stay there?

Mr. ROBERTS. You have to do both.

Mr. JORDAN. OK, let me go to Mr. Foster, and then I want to followup with another question for all of you.

Mr. FOSTER. Well, obviously, as an arithmetic matter, the deficit is the difference between debt and revenues. But if you look at where we are spending as a share of our economy, which is a simple metric, compared to any historical norm, we are far above that, indicating that is the problem.

Mr. JORDAN. OK, now let me ask you this. I would argue the problem is so big, we are running record deficits, piling up $14 trillion in debt, so big that we have to get after the spending right away. But to ultimately deal with this thing, you have to have economic growth. There is no way you can get to a balanced budget, get this ship headed in the right direction, get to where we need to go if you do not have economic growth. And allowing the private sector, allowing families, small business owners, individuals to keep more of their money, I contend, is central to having economic growth. And I would argue lowering the corporate rate as well, and regulatory policy, I get all that.

But I would argue, keeping those taxes low, allowing families to keep more of their money, is fundamental to getting the economic growth we are ultimately going to need to dig ourselves out of this mess. And I would like your thoughts.

Mr. TAYLOR. My proposal and recommendation is to not increase tax rates and to deal with this deficit and debt problem by reversing the recent spending binge and getting spending back to where it was as a share of GDP.

Mr. JORDAN. OK, let me ask you this, then. Would you agree that where the continuing resolution is, would you agree this is a good first step in saving the taxpayers approximately $100 billion over the rest of this fiscal year? Is it a good start?

Mr. TAYLOR. Yes. Getting spending back to 2008 is an excellent first step.

Mr. JORDAN. Dr. Roberts.

Mr. ROBERTS. But it is a baby step. You have to take a bigger step.

Mr. JORDAN. It is one fifteenth of the deficit.

Mr. ROBERTS. It is a rounding error, it is a deck chair off the Titanic, I mean, it is just nothing.

Mr. JORDAN. I get it.

Mr. ROBERTS. But I think again, if you want to cut taxes, the way you want to do that is cut spending. I agree with what Milton Friedman said. What is important isn't how we finance what Government does, what is important is what Government does and how much of it.

Mr. JORDAN. Because of the basic point, spending leads to borrowing which is just more taxes.

Mr. ROBERTS. Which is more future taxes. So if you cut taxes, especially if you don't cut tax rates, you just give people money back and you continue to spend, you haven't encouraged economic activity. You have told people, we are going take money out of your hide later.

Mr. JORDAN. Well said. Mr. Foster.

Mr. FOSTER. I think there is one area in which economists have a broad consensus at this point, whereas it is, and that is that economic growth is the driver for deficit reduction above all. The key to economic growth, as the President himself has said, is the private sector. And the way to get the private sector moving forward at this point, from a Washington perspective, is greater certainty. Don't raise taxes. Certainty about tax policy, suspend the regulatory onslaught and get spending under control, so they have some ability to forecast what Government is going to be doing.

Mr. JORDAN. Let me just finish with one last point with you. Earlier you said, Dr. Foster, that there was a stimulus package that could have been put together that you actually thought would make some sense. Describe that for me. Was it, as I suspect, was it the right kind of tax policy, right kinds of tax cuts and some infrastructure spending? Or was it something else that you had in mind?

Mr. FOSTER. It certainly wasn't infrastructure spending. As Dr. Taylor pointed out, you can only push so much money out that pipeline. And in the end, it wouldn't have made any difference to the immediate economy.

An effective policy, which would have been effectively no cost, would have simply been to say, at the beginning of 2009, we will not raise taxes. We will not raise taxes until the unemployment rate gets down to full employment, and we can have a debate about what the tax policy should be. If we had simply done that and eliminated the uncertainty about tax policy, our economy today would be a lot stronger.

Mr. JORDAN. So you argue that the best stimulus package at the time, early 2009, when we were in the midst of this problem, the best stimulus approach at the time would have been to establish certainty, in essence, do nothing.

Mr. FOSTER. The best no-cost policy. If we were willing to use resources, the best policy would have been to take whatever we otherwise would have spent in the stimulus law and used it to reduce the corporate tax rate, which even the President now acknowledges must be done.

Mr. JORDAN. Great point. Thank you.

We will go to the ranking member.

Mr. KUCINICH. It is really mystifying to hear witnesses extol taking the wraps off the private sector, when you consider that the reason why we went into the dumper was because you had the Financial Modernization Act passed, which permitted, which basically took down the Glass-Steagall firewalls, which separated commercial banking from investment banking, and permitted the avalanche of over-the-counter derivatives, the black box investing that went on, that created the crash that we had.

And now we are saying, well, if only the private sector, read Wall Street, can have its way again, look, they already took the country over the cliff once. I think we ought to be in a position here where we at least recognize what happened, so that we don't let it happen again.

I don't know if any of you gentlemen ever testified in favor of the Financial Modernization Act, or the Commodity Futures Trading Act. But if someone doesn't do any back analysis and understand that Glass-Steagall actually protected capitalism from itself, through having regulations, we have to be careful here advocating that we just take down regulatory structures. Because in the end, the taxpayers end up footing the bill.

I was interested to hear, I think it was Dr. Foster, I was in a discussion with staff, but I think I heard you say if you cut tax and increase spending at the same time, it is not responsible. Did you say that?

Mr. FOSTER. No, sir, I think that was Dr. Roberts.

Mr. KUCINICH. Thank you for pointing that out. So Dr. Roberts said that. I heard that, and I thought, well, I was thinking about the Bush tax cuts. And these tax cuts helped to dig the economy into a bigger hole. They took the tax burden off the shoulders of the rich, put the burden on the lower and middle classes. The rich won, the economy lost. In 2001, the tax cuts were enacted. CBO estimated that gradually rising Federal budget surplus, this is before the tax cuts were enacted, they estimated a gradually rising Federal budget surplus, and CBO forecast a surplus of 5.3 percent of the GDP in 2011. It was 10 years from the time they made the first analysis.

The 10-year, $1 trillion price tag attached to the cuts played a direct role in making the forecast a pipe dream. The Bush tax cuts that were enacted in 2001 and 2003 resulted in $1.2 trillion revenue loss from the fiscal year 2001 to fiscal year 2010.

So I would tend to agree that if you are cutting taxes and increasing spending at the same time, you are going to get in trouble. I would argue that the tax cuts set the stage for putting us in a position where it limited our ability to spend, within the construct of the current way that we handle our money.

Now, I want to throw one other thing into this discussion, Mr. Chairman. Article One, Section A of the Constitution of the United States puts the power to coin money solely in the hands of the Congress. We basically gave that away in the 1913 Federal Reserve Act. You have the Federal Reserve with the power, through quantitative easing, to just print money. Somebody here talked about alchemy, which basically you are talking about creating something of value basically out of nothing. All the money the Fed creates is backed by the full faith and credit of the United States of America. Congress is basically cut out of that deal, limited if any oversight. We can't even have transparency and find out what they are doing.

So I am thinking that when we start to address issues like the economy, and when we start to attack the ARRA as being somehow at the epicenter of this whole thing, please. It is almost laughable. Because you have to talk about tax cuts, the impact, you have to talk about the war. You must talk about the trade deficit. And if we are really going, and to look at it from what happened under both parties, to be able to really get to the bottom of what is going on in our economy.

So I would say, I have seen your testimony and I say to all of you, you have something to contribute to this. But there aren't any high priests or priestesses when it comes to the economy. I remember sitting in a committee with Alan Greenspan, who is the final arbiter or had been on the economy. And here is what he said: "I made a mistake in presuming that the self-interest of organizations, specifically banks and others, were such that they were capable of protecting their own shareholders and their equity in the firms."

Now, if the best of the best gets mystified in this town, who are we? I just say, let's look at some facts here, and Mr. Chairman, I want to thank you for holding this hearing, because it is the beginning of what needs to be a long and serious discussion about not only how we got here, but where are we going and how can we get people back to work.

Without objection, I would like to put in How The Great Recession Was Brought to an End, by Zandi and Blinder.

Mr. JORDAN. Without objection.

[The information referred to follows:]

[NOTE.—No insert/information provided.]

Mr. JORDAN. It is an amazing day. We got Dr. Roberts who agreed with Mr. Kucinich, we got Mr. Kucinich coming full circle agreeing with Ron Paul right here in front of all of us. [Laughter.]

Mr. KUCINICH. My buddy.

Mr. JORDAN. It is an amazing day.

Did you want to say something?

Mr. ROBERTS. I just want to say two quick things. When Alan Greenspan said he made a mistake, I think he was right. But the mistake he made was helping Wall Street socialize its losses of my money. And I am in favor of the private sector leading the recovery, and that would rule out Wall Street, which has been cushioned by Federal welfare from the chair of the Federal Reserves and the Congress going back to 1984. So the single most important thing I think we need to do to get that straightened out is to stop bailing out losers on Wall Street, which we have done systematically, and it is a huge problem.

Mr. JORDAN. Well said.

Mr. KUCINICH. This is our witness? [Laughter.]

Mr. JORDAN. We are both in agreement with that statement, Mr. Ranking Member.

I yield to the gentleman from Idaho, Mr. Labrador.

Mr. LABRADOR. Thank you, Mr. Chairman.

Gentlemen, thanks for being here. I think to go full circle, I am actually going to say that I agree with the ranking member on one thing that he has said, and that is that both parties have brought us to this brink of catastrophe that we are at. It is one of the reasons that I ran for Congress, is because I don't think this is a Republican problem or a Democratic problem, it is an American problem. We have had complacency and irresponsibility here in Congress for far too long.

Now, where I do disagree, I think what happens is that when you have what I used to call in my legislature the wingtip, or some people call it the wingnut coalition, where the left and the right, where they end up meeting at the same time, what ends up happening is that we reach a different conclusion.

We both agree on the problem. We agree that we have been irresponsible, but we reach a different conclusion. I think all of you said that it is irresponsible to lower taxes and increase spending. But it seems that some people on the other side say then the conclusion is that we should increase taxes and increase spending. I think that is extremely irresponsible. I think what we should be doing is decreasing spending, decreasing taxes.

But I have a question. The Tax Foundation has found, and they are talking about State levels, I have studied their State information. At the Federal level, would it be smart for us to look at some of the exemptions that are out there? Because I do think we need to reduce the corporate tax. In fact, I would like to just zero it out. But at the same time, there are a lot of exemptions that are out there that are pretty much picking winners and losers in the economy. I don't think the Government is very good at that.

What would be your take, if we start, yes, reducing corporate tax rates, but at the same time, looking at some of the corporate exemptions that are out there?

Mr. TAYLOR. I think tax reform of that kind makes a lot of sense. Reducing rates, if you like, and broadening the base by looking at exemptions and loopholes. I would, though, at this point in time, say to me, the problem is really on the spending side. And if you could get some kind of a consensus just to leave tax rates where they are for the time being, that would create certainty and then remove a cloud that people think taxes are going up rather than down.

So I would focus on what is feasible at this point, although it would be better to do the kind of reform you are talking about. I would be very happy to just leave rates where they are, and work on this terrible spending problem that we have.

Mr. LABRADOR. So even not reducing the corporate tax rate?

Mr. TAYLOR. Well, I would like to do that. But you have to get something through this system here. And it seems to me that spending is—if that can help you on the spending side, if there is a tax reform like that can help, and that may indeed be the case. But I would say that, to me, the year 2000 spending as a share of GDP by the Federal Government was 18.2 percent. It is now 25 or so. That is a gigantic, gigantic gap to get fixed. Tax revenues, when we get back to normal, will not be that much different.

Mr. LABRADOR. If I could get an answer from the others.

Mr. ROBERTS. Well, the big issue here is the corporate income tax should be zero. Most economists would agree that it should be zero. And the reason isn't because we should give money to corporations, it is because corporations don't pay the corporate income tax, consumers do. It is a hidden tax, and it discourages investment and risk-taking.

So tax simplification is a good idea. Broadening the base is a good idea. But the big problem you have is that giving away money is more fun that not giving it away. And that political challenge is what you have to face.

Mr. FOSTER. I think it would be wonderful if we could reduce the corporate tax rate, but with budget deficits as large as they are, that is problematic. The President has called for revenue-neutral tax reform, which philosophically I agree with. It is very difficult to figure out exactly what loopholes you ought to get rid of, and which are intrinsic to a corporate income tax base. But that is an important discussion.

Where we are today, however, is an economy that is struggling to recover. And if we start on a road of corporate tax reform, that means businesses don't know what tax system they are going to be operating under. We just managed to create yet another source of uncertainty. In this case, a source of uncertainty intending to do something good. But we have to understand that this new source of uncertainty will have a depressive effect, even while we sort through the process of corporate tax reform.

Mr. LABRADOR. Thank you.

I have one more question. And I apologize that I went out of the meeting, maybe you already answered this question. But I think it was Dr. Taylor who said that we didn't spend enough money on infrastructure, or there was just a little bit of money of GDP spent on infrastructure. If we would have spent the entire amount on infrastructure, would it have made a difference? Because it seems that is what I keep hearing from the other side, is that we just didn't spend enough.

Mr. TAYLOR. Of this, I think, incredibly large package, 862 or however you want to measure it, a very small fraction went to infrastructure. Remember it was advertised as spending, create jobs in infrastructure? So such a small amount went to it. I think that is the reality of these packages. That is what we found in the 1970's when we tried this. You can't get money out the door that fast. You can maybe accelerate spending that is already there, the permit is already approved. That is what I would have done, just focus on accelerating some of that spending. But it is just not feasible.

So that is really why these packages, one of the reasons why these packages fail.

Mr. LABRADOR. Thank you.

Mr. JORDAN. I thank the gentleman.

The gentlelady from New York is recognized.

Ms. BUERKLE. Thank you, Mr. Chairman.

The gentleman from Maryland, who has since departed, talked about a chorus here this morning. Indeed, it is a chorus, but it could be, we could have the sopranos here if the administration had agreed to show up. Unfortunately, we are only getting one side of the argument.

I would like to just briefly, before I get into this pro-growth that we have talked about, what we can do to help the economy, can you tel me, either one of the three of you, the approximate number of Americans who have lost jobs since the stimulus plan was passed?

Mr. TAYLOR. It is approximately 6 million extra unemployed workers, not because of this but that has occurred since the depths of the recession.

Ms. BUERKLE. Thank you. We talked about reducing spending, and the need for this Congress to really pay attention and as you mentioned, start with the $100 billion in the CR that cut. What about, we have heard the other side talking about tax rates and the need to increase taxes because of what they do to the deficit. You all said that is not so, if we can keep tax rates permanent, hopefully extend those rates permanently, what a good effect that would have.

What about if we reduced those tax rates? What if we did what Ronald Reagan did and got those tax rates down for Americans? What do you see, what effect do you see that having in terms of a pro-growth approach to how we are going to get this economy turned around?

Mr. TAYLOR. I would say very briefly, if you are able to reduce marginal tax rates, stimulate entrepreneurial activity, stimulate creation of jobs that way, that is beneficial to economic growth. You do, at that point, have to think about spending, however. And as my colleague Russ Roberts indicated, I would say that what a goal would be, and it seems to me feasible, and the American people would like it if they understood it, would be just to return spending to where it was in the year 2000 as a share of GDP. That is less than 19 percent.

So that gives you lots of opportunities to, I think, reduce tax rates the way you are asking about. But you really have to be sure that you are able to bring some kind of a consensus around it. It is not going to happen right away, to bring spending down to those levels. It was fine at that point in time. What was so bad about spending levels at 2000 levels?

So that would be the way I would look at this, focus on the spending.

Mr. ROBERTS. I would just make the point, as John pointed out, tax revenue right now is about 14 something percent of the economy, tax revenue, and we are spending 25 percent of the economy through the Government. Now, which is the tax rate? Is it 14 or is it 25? It is 25. It is 14 today and 11 tomorrow, down the road. So it is a dead horse, but you have to get this horse to life. If you want to encourage incentives and risk-taking and investment, you have to get the Government having a smaller role in the economy and give some oxygen in the room for the private risk-takers.

Ms. BUERKLE. And when you say that, and you talk about, and Dr. Foster mentioned it as well, creating certainty for businesses, and we heard that, no matter who you talk to, especially small business owners. We don't know what is going to happen with the health care bill, we don't know what is going to happen with the financial regs, we don't know cap-and-trade, fortunately that is stalled in Congress. So those kinds of things create uncertainty.

What can we do in addition to extending the tax rates permanently to create certainty that sends a message out to the private sector, we want to help you, we don't want to get in your way, we don't want to impeded your success?

Mr. ROBERTS. You don't just need certainty, you need confidence in the future. That is why I think responsible budget-cutting signals to the world and to the entrepreneurs here in America that we can act like grownups, that when we want more of something, whether it is the war in Afghanistan, or some other program, we are going to cut something else back. That is what families do. When we act irresponsibly, we tell the world we are not acting like grownups.

Ms. BUERKLE. Thank you. Dr. Foster, do you have a comment?

Mr. FOSTER. Yes. Implicit in the massive budget deficit that we have today is the uncertainty about what Congress is going to do about it, what taxes are they going to raise, if any, to close that budget deficit? What spending are they going to cut instead? If we don't know which they are going to do, they don't have certainty about the outcome of that policy.

So the budget deficit and reducing the budget deficit is part of creating the certainty that we need. That is an activist policy toward certainty that will be very helpful to the economy. We haven't mentioned it today, but another area of tremendous uncertainty that has been created that is going to unfold in the coming years is Obamacare. Now, we can have health care debates until the cows come home, but the simple fact is, from a business's standpoint, not knowing what the regulations are going to be, that they are going to be fundamental in changing that marketplace, you can't make investments, you can't hire. Because you don't know what your circumstances are going to be.

This creates a regulatory freeze on businesses. We can debate whether it was a good policy or not, but one thing is certain: this was not a good time to be imposing this kind of uncertainty, when businesses are being asked to invest because they are confident in the future.

Ms. BUERKLE. Thank you.

Mr. JORDAN. Thank you.

I want to thank our distinguished panel for your time, and for staying for a second round. We really appreciate your being here today. You have been very helpful.

We are going to move right to our second panel and hear testimony. So if the staff could get that set up for them, we will go as quickly as possible, listen to testimony, have one quick round of questioning for the second panel.

Mr. Andrew Busch is the global currency and public policy strategist for BMO Capital Markets' Investment Banking Division. Mr. Alex Brill is research fellow at the American Enterprise Institute for Public Policy Research. Mr. Chris Edwards is director of tax policy studies at the Cato Institute. And Dr. Josh Bivens is an economist at the Economic Policy Institute.

It is the policy of the committee to swear witnesses in, so we will do this again quickly, gentlemen, if we can. Raise your right hands.

[Witnesses sworn.]

Mr. JORDAN. Let the record show the witnesses answered in the affirmative. We will start with Mr. Brill, we will just move down the line.

STATEMENT OF ALEX M. BRILL, RESEARCH FELLOW, AMERICAN ENTERPRISE INSTITUTE; ANDREW B. BUSCH, GLOBAL CURRENCY AND PUBLIC POLICY STRATEGIST, BMO CAPITAL MARKETS' INVESTMENT BANKING DIVISION; CHRIS EDWARDS, DIRECTOR, TAX POLICY STUDIES, CATO INSTITUTE; AND JOSH BIVENS, ECONOMIST, ECONOMIC POLICY INSTITUTE

STATEMENT OF ALEX M. BRILL

Mr. BRILL. Thank you, Chairman Jordan and Congressman Kucinich and other members of the subcommittee, for the opportunity to appear before you this morning to speak on the stimulus bill.

Its 2-year anniversary presents an appropriate time to evaluate the legislation's effectiveness. There are many metrics by which one could assess this massive Federal policy. But in my testimony today, I will focus on just two: overall cost and "shovel-readiness."

For better or worse, the ARRA was enacted because majorities in the House and Senate believed that a large fiscal stimulus could make a positive contribution to the economy by stimulating aggregate demand. Under that premise and the assumption that the stimulus bill spending was not completely offset by a decline in private activity, the effectiveness of the legislation depends, quite simply, on the stimulus spending occurring in a timely fashion. In my testimony this morning, I would like to emphasize three points.

First, we should recognize that the bill was rushed through Congress at a blazing speed. H.R. 1 was introduced on January 28, 2009, and signed into law on February 17th. A hodge-podge of policies, ranging from high speed rail to health information technology to home weatherization, hundreds of pages and thousands of projects.

Second, the official cost estimate of the stimulus bill has varied over time, but always under-estimates the true cost. The key to securing votes for final passage of the bill in the Senate was to reduce the final cost to $787 billion. Since that time, CBO has re-estimated the cost of the bill, once as high as $862 billion, and currently to be a cost of $821 billion.

But all of these estimates fail to include the additional costs, already in excess of $60 billion, incurred when Congress extended certain portions of the bill. In fact, I would note that President Obama's fiscal 2010 budget included items to make over one-third of the stimulus bill permanent.

Third, and most importantly, the stimulus bill has done an extremely poor job at actually spending money in a timely way. Regardless of your view about the multiplier effect, the economic factor by which an injection of fiscal stimulus could, at least in theory, result in more activity down the line, the bill could not possibly be effective or cost-effective if the money is not spent in a timely fashion.

While certain activities did occur quickly, such as additional checks to Social Security recipients or unemployment benefits and transfers to the States, none of these policies constitute the much touted "shovel-ready" activity and the "reinvestment" that was the heart of this legislation. For example, the Department of Energy should never have been awarded a single dollar in stimulus funding. At the end of calendar year 2009, they had spent only 5 percent of their allocated funds. At the end of 2010, two-thirds of the Department of Energy's funds remained unspent, roughly $22½ billion. The Department of State, FCC, NEA, NSF, USAID, and the Corporation for National Community Services have collectively spent only 37 percent of their funds as of last December. At the end of 2009, they had spent collectively only 8 percent of their funds.

Even the Department of Transportation, which was supposed to ground zero for shovel-ready projects, had at the end of 2010 spent 56 percent and had nearly $20 billion left to spend. Billions more from other departments.

In my written testimony, I detail examples of programs that have, 2 years after enactment, spent only 2, 3, 4, 9 and 10 percent of their available funds.

In conclusion, while labor markets in the U.S. economy remain weak, and a robust economy has yet to materialize, the worst of the recession is long over. If the stimulus bill was ever appropriate, and I think it was never appropriate, it was in 2009, not in 2011, and certainly not in 2012 and beyond. I urge the committee, given its jurisdictional responsibility, to continue to investigate carefully the causes that have resulted in this bill, which was intended to be timely, targeted and temporary, to be implemented so slowly.

Too much money was put into this bill in the first place. Too little of it was spent at the time the economy was the weakest. Clearly, Government is not good at fiscal policy to turn the economy. And I hope the committee's work will help dissuade future Congresses from repeating these same mistakes.

I will be happy to answer any questions.

[The prepared statement of Mr. Brill follows:]

American Enterprise Institute
for Public Policy Research

Statement before the House Committee on
Oversight and Government Reform
Subcommittee on Regulatory Affairs, Stimulus Oversight
and Government Spending
On "The Stimulus: Two Years Later"

Alex M. Brill

Research Fellow

American Enterprise Institute

February 16, 2011

The views expressed in this testimony are those of the author alone and do not necessarily represent those of the American Enterprise Institute.

Thank you, Chairman Jordan, Ranking Member Kucinich, and other members of the Subcommittee for the opportunity to appear before you this morning to discuss the stimulus bill enacted two years ago tomorrow.

The two-year anniversary of the American Recovery and Reinvestment Act (ARRA) presents an appropriate time to evaluate the legislation's effectiveness. There are many metrics by which one could assess this massive federal policy, but in my testimony today, I will focus on just two: cost and "shovel-readiness."

While it is certainly clear that the stimulus bill failed to create a robust economy, I will not attempt to describe here any empirical simulations of the bill's impact (or lack thereof) on the economy. For better or worse, the ARRA was enacted because President Obama and Democratic majorities in the House and Senate believed that a large fiscal stimulus could make a positive contribution to the economy by stimulating aggregate demand. Under that premise, and the assumption that the stimulus bill spending was not completely offset by a decline in private activity, the effectiveness of the legislation depends, quite simply, on the stimulus spending occurring in a timely fashion. My testimony today will look at whether or not that happened.

As described in greater detail below, my conclusions include the following key points:

- The massive, poorly considered stimulus bill rushed through Congress was not designed to spend money quickly. While some activities such as one-time additional Social Security payments, extended unemployment benefits, and other aid occurred quickly, funding that involved actual projects or federal contracts were very slow to begin.
- In the seven months of fiscal year 2009 remaining after enactment of the ARRA, only 18 percent of the stimulus bill's spending occurred. Even now, over one-fourth of all stimulus monies remain unspent.
- A number of departments and agencies with large stimulus fund allocations appear particularly bad at getting money out the door, including the Departments of Energy, Transportation, Commerce, and Homeland Security and the GSA.
- The ARRA will continue to cost money beyond that estimated by the Congressional Budget Office (CBO) because many provisions are being extended or made permanent.

Cost of the ARRA

President Obama was inaugurated on January 20, 2009, with plans for a massive fiscal stimulus that was rushed through Congress in the first weeks of the new administration. The Chairman of the House Appropriations Committee, David Obey, introduced H.R. 1, the American Recovery and Reinvestment Act of 2009, an $819 billion stimulus bill, on January 26, 2009, and the House passed it two days later on January 28. The Senate followed suit two weeks later with their $838 billion package on February 10. A conference report was agreed to on

February 13 (with a vote of 246–183 in the House and 60–38 in the Senate). President Obama signed the bill into law on February 17, 2009.

At the time of enactment, CBO estimated the ten-year cost to be $787 billion.[1] CBO projected that $120 billion would be spent in the remainder of fiscal year 2009; $219 billion more would be spent by September 30, 2010; and the remaining $237 billion (41 percent of the total) would be spent in fiscal year 2011–2019.[2] Despite rhetoric about shovel-ready projects and the importance of getting money out the door, this bill, rushed through the legislative process in three short weeks with little time for serious deliberations, was designed to spend funds over a long period of time.

In addition, as discussed in more detail below, the budgetary cost of the ARRA does not reflect the full cost of stimulus legislation passed by Congress over the last two years. A number of provisions contained within the ARRA on a temporary basis have already been extended in law, thereby further increasing the cost.

Initial Spending Efforts

In total, actual stimulus spending in fiscal year 2009 ($113 billion) was fairly consistent with what CBO projected when the bill passed. However, and of great importance, the composition of spending differed significantly from the original top-line estimate. Spending on construction and infrastructure projects, designed to fuel job creation, was far below the original estimate because federal departments and agencies tasked with spending money on infrastructure and construction overwhelmingly failed to get the money out the door on time. The total amount spent only matched projections because transfer payments to states and individuals for unemployment insurance and education far exceeded initial projections.

At the end of fiscal year 2009, the Departments of Commerce, Defense, Energy, Homeland Security, Interior, and Transportation had spent less than 10 percent of their stimulus funds, far less than what was originally anticipated. In the case of the Department of Energy, the stimulus bill originally provided $38.7 billion to promote energy efficiency and develop renewable energy sources, yet only $779 million, or 2 percent, of the money was spent by September 30, less than half of what was expected. The Department of Transportation, with its particular emphasis on shovel-ready projects, spent 8 percent of its stimulus funds—only three-fourths of what it was expected to have spent by that time. Other agencies have done far worse—the National Institutes of Health and the National Science Foundation spent only 1 percent of

[1] In January 2010, CBO revised the estimate of the bill upward from $787 billion to $862 billion due to higher-than-anticipated outlays on unemployment compensation, food stamps, and Build America Bonds. Alan D. Viard called attention in July 2010 to many newspapers' continued use of the outdated CBO estimate six months after it was revised (see http://blog.american.com/?p=17572). In August, CBO revised its estimate down to $814 billion, but still $27 billion higher than the original estimate. And just last month, the agency again revised its estimate, this time to $821 billion, estimating that outlays from the ARRA in fiscal year 2011 will be $148 billion, with another $148 billion in outlays through fiscal year 2019.

[2] CBO, "A Preliminary Analysis of the President's Budget and an Update of CBO's Budget and Economic Outlook," March 2009, Table 1-3, www.cbo.gov/ftpdocs/100xx/doc10014/03-20-PresidentBudget.pdf.

their stimulus funds in the first seven months. At that rate, those agencies would take 58 years to exhaust their stimulus money.[3]

In the meantime, spending for transfer programs, especially for unemployment insurance benefits, and new and existing federal education spending, proceeded much faster in fiscal year 2009 than anticipated. States received $6.5 billion more than CBO estimated for education through the Department of Education's new State Fiscal Stabilization Fund. Spending for student financial assistance at the Department of Education also outstripped CBO's original estimate by about the same amount. Altogether, the Department of Education spent $20.6 billion by the end of fiscal year 2009, $11.7 billion more than anticipated. The Department of Labor spent $27.5 billion, exceeding CBO's original estimate by nearly $10 billion, because total unemployment benefits were substantially more than expected. The Department of Health and Human Services was the biggest spender by department, with nearly $33 billion in outlays, nearly all of it federal payments to the states to operate Medicaid, about the same amount as originally forecast.[4]

In November, CBO acknowledged the slow spending by the Departments of Transportation, Energy, and Commerce, as well as "other federal agencies" that "spent considerably more slowly than originally estimated."[5] The agency also confirmed that spending on unemployment benefits (Department of Labor) and Pell grants (Department of Education) was higher than originally projected.[6]

Spending to Date

For my testimony today, I have prepared new estimates of spending to date by various departments. According to CBO, $340 billion was spent through fiscal year 2010, and $296 billion remains unspent. This aggregate performance metric of share of funding spent is troubling, but fairly abstract—a closer examination of certain departments yields even more disturbing results.

Examples of Slow Stimulus Bill Spending

Transportation. The Department of Transportation (DOT) received the single largest amount of infrastructure spending dollars in the stimulus bill and was supposed to be home to the "shovel-ready" projects, those ready to begin within 90 days. In total, the ARRA allocated $48 billion to DOT. As of December 31, 2010, DOT had made nearly $45 billion available, almost the entire allocated amount. However, at the end of September 2009, DOT had spent only 8 percent of the $45 billion; by the end of calendar year 2009, only 18 percent; and at the end of 2010, only slightly more than half of their available funds.

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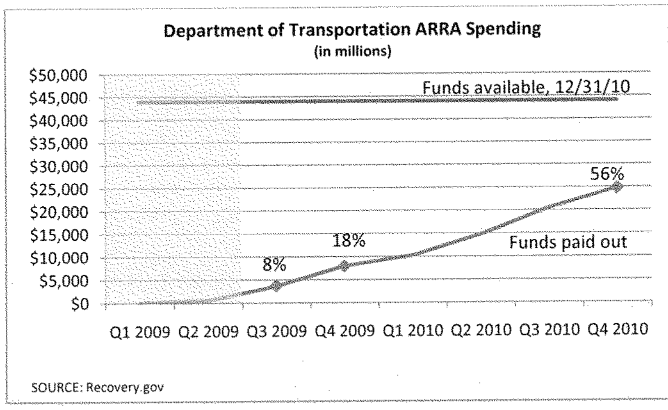
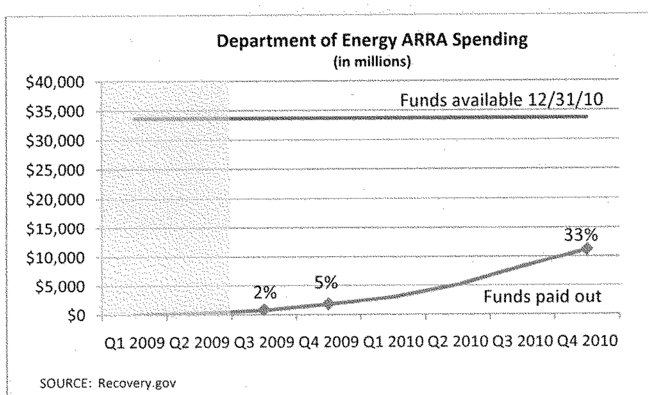
[3] Alex Brill and Rachel Forward, "About That Stimulus: The Shovel Wasn't Ready" American.com, October 27, 2009, www.american.com/archive/2009/october/about-that-stimulus-the-shovel-wasnt-ready.
[4] Ibid.
[5] CBO Director's Blog, "ARRA Spending for 2009 Close to CBO's Estimate," November 2, 2009, http://cboblog.cbo.gov/?p=409.
[6] Ibid.



Energy. Among the departments and agencies receiving more than $7 billion, the Department of Energy (DOE) is by far the worst at spending funds in a timely manner. As of December 31, 2010, DOE had made available nearly $35 billion in ARRA funds but had paid out only one-third of that amount.



Other underperforming departments and agencies. Further examples of faltering attempts to spend stimulus funds include:

- A $1.5 billion surface transportation fund controlled by the Secretary of Transportation has spent only $39 million (2.6 percent).
- The DOE account for Fossil Energy Research and Development has had $3.4 billion made available but paid out only $145 million (4.3 percent).
- The Department of Housing and Urban Development's Community Development Fund has made available $3 billion but paid out only $782 million (26 percent).
- The Department of Defense military construction budget has made $1.1 billion available but spent only $109 million (10 percent).
- $2.4 billion has been made available for distance learning, telemedicine, and broadband through the Department of Agriculture, but only $40 million (2 percent) has been spent.
- The Department of Health and Human Services has made over $1.9 billion available for the Office of National Coordinator of Health Information Technology but has spent $161 million (less than 9 percent).

Stimulus That Never Goes Away

In addition to actual stimulus spending being stretched out for years, we will see some stimulus policies for a long time to come for a different, but still troubling, reason: many of the provisions in the stimulus will not be temporary. Congress has already extended through 2012 some policies originally established or expanded in the ARRA, such as the expansion of the earned income tax credit, the creation of the American Opportunity tax credit (which replaced less generous education tax incentives), and the lower refundability threshold for the child tax credit. These extensions will increase the deficit an additional $44 billion in the next few years.[7] And Congress has already extended other ARRA provisions as well. For example, Medicaid assistance to states (FMAP) enacted in the ARRA expired in December 2010, but was subsequently extended (at less generous levels) through June 2011 at an estimated cost of $16 billion.[8] Congress has also enacted nearly $125 billion in unemployment benefits and loaned $42 billion to states for more benefits.[9]

Furthermore, the intent of the bill was clearly to create a number of permanent programs. For example, the $8 billion included in the ARRA for high-speed rail is not a sufficient amount for deployment. President Obama's fiscal year 2010 budget, released a little more than a week

[7] Joint Committee on Taxation, "Estimated Budget Effects of the 'Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010,'" December 10, 2010, www.jct.gov/publications.html?func=startdown&id=3715.
[8] CBO, "The Budget and Economic Outlook: Fiscal Years 2011 to 2021," January 2011, www.cbo.gov/ftpdocs/120xx/doc12039/01-26_FY2011Outlook.pdf.
[9] Department of Labor, Employment and Training Administration, "Trust Fund Loans," www.workforcesecurity.doleta.gov/unemploy/budget.asp.

after the bill's enactment, included an additional $5 billion for high-speed rail, and last week, the administration called for $53 billion more.

In addition, the fiscal year 2010 budget proposed making at least 37 percent of the ARRA permanent.[10] While some of those policies have expired and not been extended, the intent was clear. And some policies that have not already been extended remain in the President's budget.

Conclusion

At the time the bill was being developed, policymakers and analysts debated whether tax cuts or spending increases would be more effective. The argument advanced by some, including administration officials, was that, because people would save instead of spend money from tax cuts, the only way for the government to ensure increased aggregate demand was for the government to do the spending directly—and quickly. Therefore, "shovel ready" became the term of the hour, with proposals for such projects coming from all quarters, including a $149 billion list of 18,750 "ready to go" projects from the U.S. Conference of Mayors.[11]

As it turns out, based on the data from the last two years, the government was arguably no better at spending money than taxpayers would have been. Of course, the reasons are quite different. Taxpayers may save tax breaks because of personal economic insecurity or fear of future, offsetting tax hikes. Government didn't spend more simply because of red tape, indecision, or the long-term nature of many projects funded in the bill. In addition to the departments described above, the Departments of Commerce, Defense, and Homeland Security and the GSA and a number of smaller agencies were particularly poor performers. In October, President Obama, faced with myriad delayed infrastructure projects, finally admitted that "there's no such thing as shovel-ready projects."[12]

Of course, some funds were quickly dispensed, including additional cash payments to Social Security beneficiaries, unemployment benefits from the Department of Labor, and transfers to the states from the Department of Health and Human Services.

By now, prospects are not as bleak as they were two years ago. The recession has technically ended. The labor market, while dismal, has stopped deteriorating. The stock market has rebounded, and consumer spending is on the rise. Now, it is reasonable to conclude, is not the time for a stimulus. Yet, ironically enough, it will be a challenge to stop the massive spending that was so slow to start up two years ago.

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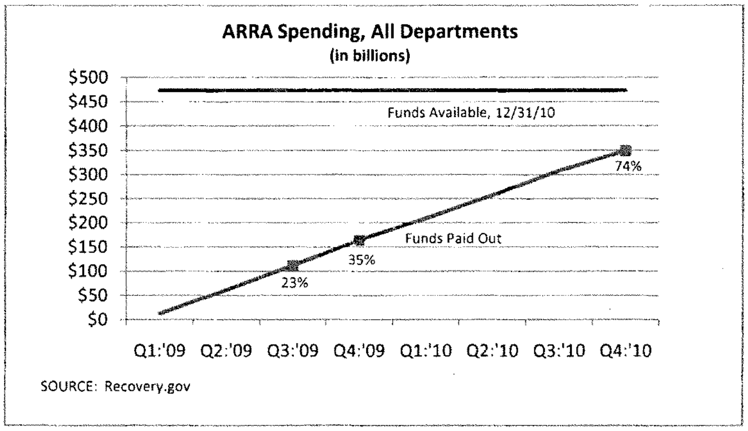
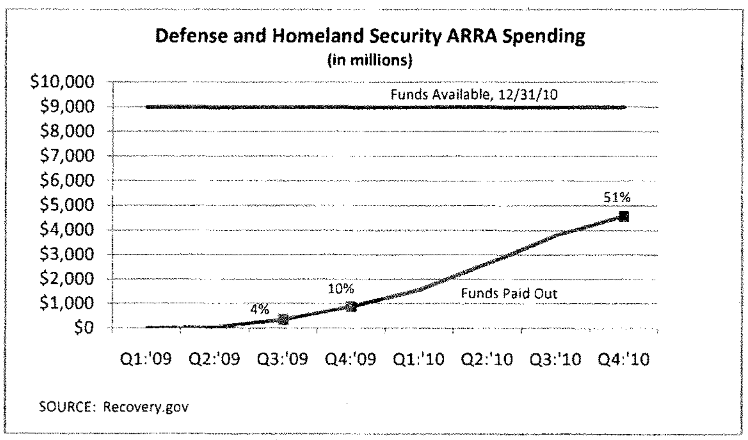
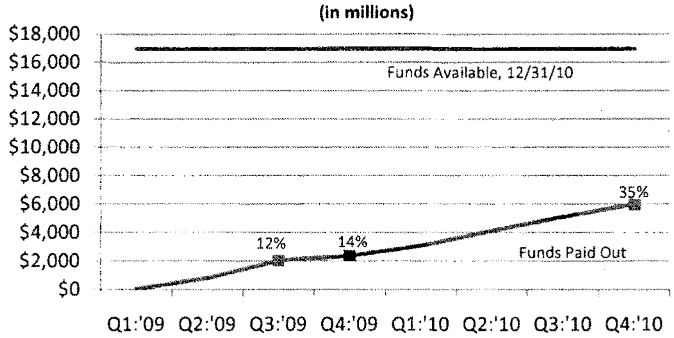
[10] Alex Brill and Amy Roden, "A Sickening Deficit," Forbes.com, October 19, 2009, www.aei.org/article/101184.
[11] Jennifer Levitz and Philip Shishkin, "Stimulus Brings Out City Wish Lists: Neon for Vegas, Harleys for Shreveport," *Wall Street Journal*, February 4, 2009, http://online.wsj.com/article/SB123369271403544637.html.
[12] Michael D. Shear, "Obama Lesson: 'Shovel Ready' Not So Ready," *New York Times* Caucus blog, October 14, 2010, http://thecaucus.blogs.nytimes.com/2010/10/15/obama-lesson-shovel-ready-not-so-ready.

Appendix: American Recovery and Reinvestment Act of 2009: Select Spending Data



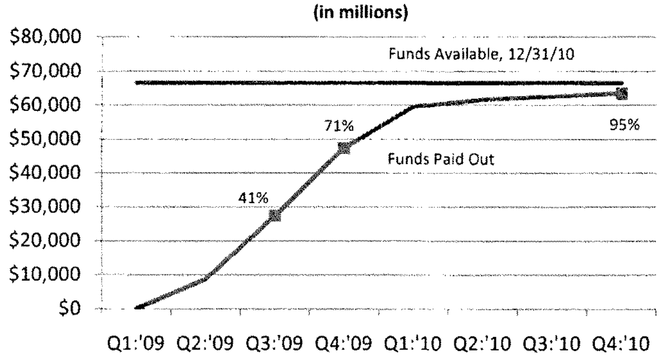


Commerce and Justice Departments and GSA ARRA Spending
(in millions)



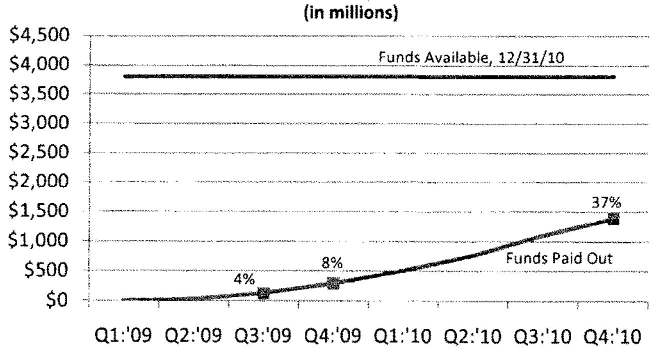
SOURCE: Recovery.gov

Labor Department ARRA Spending
(in millions)



SOURCE: Recovery.gov

Other ARRA Spending
(in millions)



SOURCE: Recovery.gov
NOTE: Includes Department of State, FCC, NEA, NSF, USAID, and CNCS funding

Mr. JORDAN. Thank you, Mr. Brill.
Mr. Busch.

STATEMENT OF ANDREW B. BUSCH

Mr. BUSCH. Thank you, Subcommittee Chairman Jordan and Ranking Member Kucinich. I want to thank you for the opportunity to appear today.

I was born in Ohio, I just was there recently and frequently speak, I was at the city of Galena, they had an economist briefing there recently. So it is always great, always great to be in front of fellow Ohioans.

I just want to share my views regarding the American Recovery and Reinvestment Act of 2009, specifically the results 2 years after enactment on the economy and the financial markets. As you may know, I am the Bank of Montreal's global currency and public policy strategist. I have worked in the financial markets since 1984.

So my role is to analyze factors influencing the financial markets and provide guidance to our clients on the potential outcomes of policy. I have had the distinct pleasure of writing commentary on a daily basis since 1999, and wrote throughout the financial crisis of 2008.

So reform and oversight of our Nation's programs to create economic growth and financial stability are critically important, obviously. Bank of Montreal thanks you, Mr. Chairman, and all the members of the committee for their upcoming work on these topics over the next 2 years.

To reclaim its position of financial and economic leadership, the United States needs to understand the short-term and long-term impacts of the American Recovery and Reinvestment Act of 2009. So for the financial markets, the ARRA Act was at best an economic disappointment; at worst a potential fiscal disaster.

In the fall of 2008, the economy and the financial markets were in the midst of turmoil, generating from the failure of Lehman Brothers, the Federal Government takeover of Fannie Mae and Freddie Mac and the collapse of the subprime loan markets. This created an environment of fear and uncertainty in the financial markets that led investors pulling out of their funds in risky assets and placing them into the safe havens of U.S. Treasury securities.

By the end of 2008, both the Dow Jones industrial average and the yield on the U.S. 10-year note fell by nearly 50 percent. This extreme panic led to spreads between U.S. Treasury securities and other market securities, such as high yield, investment grade debt and large bank debt, to widen significantly and rapidly. As an example of the panic, the commercial paper market nearly froze completely when the primary reserve fund broke the $1 barrier. At this time, many large corporations lost the ability to fund themselves using this critical market. The entire financial system appeared to be at risk of seizing up, and was in need of stabilization. The economy was deteriorating rapidly, as businesses were unable to either receive credit from their bank or tap the debt markets for funding.

One of the key questions before President-Elect Obama and the incoming Congress was how to stimulate the economy in the most efficient and timely way. In late December 2008, the financial markets reacted positively upon hearing the news that a large stimulus package was being discussed and debated in Washington, DC. At that time, the news flow varied from a package between $500 billion to $700 billion, which included tax cuts and new spending programs.

Contributing to the market optimism was the description of the package by then-Chair nominee designate, Council of Economic Advisor Christine Romer and office of the Vice-President Elect Jared Bernstein. This is the Job Impact of the American Recovery and Reinvestment Plan. So in the report of January 10, 2009, Romer and Bernstein laid out their findings and expectations for economic growth for a $775 billion program.

It is critical to understand that the market's expectations for economic and employment growth from the plan were raised due to these findings. They estimated that the aggregate effect of the recovery package on Q4 2010 GDP would be to increase it from $11,770 odd trillion to $12 trillion, $2.2 trillion. They stated the effect of the package would increase GDP by 3.7 percent and increase jobs by nearly 3.7 million.

They went on further to predict that the plan would make the unemployment rate 7 percent by Q4 2010 from the 8.8 percent that would result in the absence of the plan. The authors predicted a 678,000 increase in construction jobs, using calculations and estimates of effects on industry by economic Mark Zandi. His report was The Economic Impact of a $600 Billion Fiscal Stimulus Package, Moodys.com, obviously, in November 2008.

Since the housing sector was a key variable in the financial crisis, the return of jobs to this sector was particularly optimistic and appealing to the markets. At that time, there were many factors influencing the financial markets. However, this outlook was a contributing factor toward the rally in the U.S. stock markets that took the Dow up almost 13 percent in December. Subsequently, the markets became skeptical of the predicted outcomes by Romer and Bernstein, as newspapers, bloggers, research began to break down the sections of the plan, the costs of the plan, and the potential increase in the fiscal deficits.

The sovereign U.S. credit default swap price rose from 20 in October to 59.7, a stunning 300 percent increase. So the honeymoon for the stock markets was over, and they slid until March, when the Federal Reserve chairman appeared on 60 Minutes and stated that no major financial institution would fail.

I will just submit the rest, and move on.

[The prepared statement of Mr. Busch follows:]

Chairman Issa, Ranking Member Cummings, subcommittee Chairman Jordan and Ranking Member Kucinich, thank you for the opportunity to participate in today's hearing and to share my views regarding the American Recovery and Reinvestment Act of 2009 and, specifically, the results two years after its enactment on the economy and the financial markets.

As you may know, I am the Bank of Montreal's Global Currency and Public Policy Strategist. I have worked in the financial markets since 1984. My role is to analyze the factors influencing the financial markets and provide guidance to our global clients on the potential outcomes of policy. I have had the distinct pleasure of writing commentary on a daily basis since 1999 and wrote daily throughout the crisis of 2008.

Reform and oversight of our nation's programs to create economic growth and financial stability are critically important. Bank of Montreal thanks you, Mr. Chairman, and all the members of the Committee for their upcoming work on these topics over the next two years. To reclaim its position of financial and economic leadership, the United States needs understand the short term and long term impacts from the American Recovery and Reinvestment Act of 2009.

For the financial markets, the American Recovery and Reinvestment act was at best an economic disappointment and at worst a potential fiscal disaster. In the fall of 2008, the economy and the financial markets were in the midst of turmoil generated from the failure of Lehman Brothers, the federal government take-over of Fannie Mae and Freddie Mac and the collapse of the subprime loan markets.

This created an environment of fear and uncertainty in the financial markets that led to investors pulling their funds out of risky assets and placing them into the safe havens of US Treasury securities. By the end of 2008, both the Dow Jones industrial average and the yield of the US Treasury 10 year note fell nearly 50 percent.

The extreme panic led to spreads between US Treasury securities and other market securities such as high yield, investment grade debt or large bank debt to widen significantly and rapidly. As an example of the panic, the commercial paper market nearly froze completely when the Primary Reserve Fund broke the $1 barrier. At this time, many large corporations lost the ability to fund themselves using this critical market. The entire financial system appeared to be at risk of seizing up and was in need of stabilization. The economy was deteriorating rapidly as businesses were unable to either receive credit from their bank or tap the debt markets for funding.

One of the key questions before President-elect Obama and Congress was how to stimulate the economy in the most efficient and timely way. In late December of 2008, the financial markets reacted positively upon hearing news that a large stimulus package was being discussed and debated in Washington, D. C.

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In their report of January 10, 2009, Romer and Bernstein laid out their findings and expectations for economic growth for a $775 billion program. It is critical to understand that the market's expectations for economic and employment growth from the plan were raised due to these findings. They estimated that the aggregate effect of the recovery package on Q42010 GDP would be to increase it from $11,770, 133,876 to $12,203,137,550,000. They stated that the effect of the package would increase GDP by 3.7% and increase jobs by 3,675,000.

They went further to predict that the plan would make the unemployment rate 7.0% by Q4 2010 from the 8.8% that would result in the absence of the plan. The authors predicted a 678,000 increase in construction jobs using calculations and estimates of effects by industry from economist Mark Zandi ("The Economic Impact of a $600 Billion Fiscal Stimulus Package," Moody's economy.com, November 28, 2008.) Since the housing sector was a key variable in the financial crisis, the return of jobs to this sector was particularly optimistic and appealing for the markets. At that time, there were many factors influencing the financial markets. However, this outlook was one of the contributing factors toward the rally in U.S. stock markets that took the Dow up almost 13%.

Subsequently, the markets became skeptical of the predicted outcomes by Romer and Bernstein as newspapers, bloggers and research began to break down the sections of the plan, the costs and the potential increase in fiscal deficits. The sovereign United States credit default swap price rose from 20 in October to a high of 59.7 in February: a stunning 300% increase. The honeymoon for the stock markets was over and they slid until March when Federal Reserve chairman appeared on 60 Minutes and stated that no major financial institution would fail.

Ultimately, the American Recovery and Reinvestment Act of 2009 did not meet its predicted goal for unemployment. It failed to return the unemployment rate to 7.0% and ended 2010 at 9.4%. While this is disappointing and disheartening to the eight million people who have lost their jobs in this recession, a major issue is yet to come: how to pay for the program when the US is currently borrowing approximately forty cents for every dollar it spends? One of the key points not addressed by Romer and Bernstein was the negative impact on the federal budget deficit and the increase in debt by the US government.

Had the financial crisis occurred in 2001-2003, the potential fallout from enacting a $787 billion bill would not have been nearly as detrimental as the US federal budget deficit/GDP ratio was 3.5% (fiscal year 2003-04). However, this bill and its spending helped create the largest multi-year deficits in our nation's history. The US federal budget deficit/GDP ratio was 9.9% in FY2009 and 10.6% in FY2010. ARRA has also contributed to the national debt rising to nearly 100% of GDP. This 100% level is critical as research by Carmen Reinhart and Kenneth Rogoff has shown that when a country reaches 90% debt-to-GDP that economic growth begins to suffer.

Aside from the safe haven status, the attractiveness of the nation's debt for investors begins to decline as well due to questions over the ability to service that debt. The European debt crisis has been a wake-up call for sovereign debt issuers that investors will punish those that over-spend. In 2010, Portugal, Ireland, Italy, Greece and Spain have all seen their debt shunned by the international markets and seen their debt servicing costs soar. It is likely that Greece would have defaulted on their debt had they not been assisted by the ECB, the EU and the IMF. The ratings agencies are now turning their focus to the United States and have grown increasingly concerned over the deficits and debt levels.

On January 28th, Moody's Investors Service said it may need to place a "negative" outlook on the Aaa rating of U.S. debt sooner than anticipated as the country's budget deficit widens (Bloomberg). "Although no rating action is contemplated at this time, the time frame for possible future actions appears to be shortening, and the probability of assigning a negative outlook in the coming two years is rising," wrote Steven Hess, a senior credit officer in New York and the author of the report. The rating remains "stable," according to the report."

While the American Recovering and Reinvestment Act is not the sole contributor to the budget deficit and debt increases, it certainly has helped create the conditions by which a ratings agency is now indicating a downgrade to its outlook for the country. If not addressed, this would potentially begin a downward spiral of negative investor sentiment, higher US borrowing costs, higher debt, a run on the US dollar and lower economic growth.

Mr. Chairman, Americans are justifiably questioning the efficiency and efficacy of the American Recovery and Reinvestment Act to create jobs and economic growth. The targets for 7.0 unemployment and adding $0.5 trillion to the nations GDP were missed. Worse, the $787 billion plan had to borrow heavily to finance it. This has increased the US budget deficit and increased the debt load of the country. In turn, this is calling into question the nation's Aaa rating and could create a negative spiral downwards for the economy. While current US CDS is relatively low, the United States credit default swap price has risen from a low of 36 in October to a high of 50.7 at the beginning of February as investors increased by almost forty percent the cost of insuring risk of a country default.

More fundamentally, the goal of stimulating the economy via government spending should be viewed skeptically as modeling is "subject to substantial margins of error" according to footnote number 2 in Romer and Bernstein.

Again, thank you for the opportunity to appear before the Committee today.

Mr. JORDAN. I appreciate that testimony, Mr. Busch. You can finish up when we get to questions.

Mr. Edwards.

STATEMENT OF CHRIS EDWARDS

Mr. EDWARDS. Thank you, Mr. Chairman and ranking member, for allowing me to testify today on the stimulus and Federal spending.

There has been a huge increase in Federal spending over the last decade, under President Clinton from 18 percent to 25 percent today. Part of that, of course, was the $800 billion stimulus, which sadly, I believe, was a very costly, Keynesian policy failure.

I note that the amount of Keynesian stimulus in the economy in recent years wasn't just the $800 billion. It was the total amount of deficit spending in recent years: half a trillion in 2008, and about one a half trillion for the three subsequent years. So that is about $5 trillion of so-called Keynesian stimulus and yet we still have very high unemployment and a recovery that is more sluggish than in previous recoveries.

Now, economists continue to debate how much of a sort of a sugar high you can get from this sort of Keynesian stimulus in the short term. There is no doubt in the long term that this will damage the economy. Why? Because all that Government spending reduces private spending.

And there are two basic causes of damaged caused by the spending. One, you are transferring resources from the more productive private economy to the less productive Government sector of the economy. There is all kinds of evidence for that. We have a Web site at Cato, downsizinggoverment.org. We go through every Department, we talk about the various failures of all the programs.

But second, transferring money from the private to the public is not cost-less. It causes what economists have called deadweight losses, the extraction, the forcible extraction of the funds from the private sector through taxation causes these deadweight losses. So for example, President Obama, let's say he wants to spend $10 billion more on high speed rail, the cost to the economy is not $10 billion, it is $15 billion or $20 billion. Martin Feldstein says that every dollar the Government spends causes $2 of private sector damage.

The sad reality is, the United States is not a small Government country any more. OECD data shows us a total Federal-State-local spending now at 42 percent of GDP. In my testimony, I show that ratio over the last couple of decades. The United States used to be substantially lower than other OECD countries. The gap has been closing. And I fear that we are just going to become another sort of stagnant European welfare state if we keep all this spending going.

Let me jump quickly to State and local spending, because a big stated cost for the stimulus package was to help State and local governments who were struggling with the recession. We have been bombarded with news stories in the last couple of years about how State budgets have been supposedly devastated and radically slashed. The reality is really different, and I have Department of Commerce data in my testimony that shows total State and local spending has not been cut at all through the whole recession. It rose rapidly from 2000 to 2008, it was exactly flat in 2009, started rising again in 2010. Total State-local spending was, as a share of the economy, was actually up over the last decade.

So despite two recessions this last decade, State and local spending is actually higher than it has ever been.

So there is a real State budget crisis, and that is ahead, as you know. The bond debt has been growing rapidly in the States, they have huge pension and unfunded health care obligations.

But here is a key point, I think, from a Federal policymaker's perspective. The States are in radically different positions with regard to their budget gaps, with regard to their bond debt. Some States, like Nebraska, have virtually no borrowing, no bonds. Other States, like Massachusetts, have huge amount of borrowing.

Pension obligations, some States, like Ohio, are very high unfunded pension obligations. Other States, it is quite low. So the States are in radically different positions here. I think this is one of the problems with Federal bailouts and Federal aid, is that it is very unfair, and I think bad economics, to punish the well-managed frugal States for the benefit of the poorly run and spendthrift States.

So on the one hand, I am not for Federal bailouts. But as a last point, the Federal Government has and continues to impose lots of costs on State governments, most recently with the health care plan, before that with the No Child Left Behind law. All those regulations and costs are poured down on the State governments, which I think is bad Economics and also unfair.

That is the end of my comments, and thank you.

[The prepared statement of Mr. Edwards follows:]

EPI TESTIMONY

TESTIMONY GIVEN BY

Josh Bivens
Economist
Economic Policy Institute

IN A HEARING BEFORE THE
SUBCOMMITTEE FOR REGULATORY AFFAIRS,
COMMITTEE FOR GOVERNMENT OVERSIGHT,
US HOUSE OF REPRESENTATIVES

"The Stimulus: Two Years Later"

Wednesday, February 16, 2011

Economic Policy Institute • 1333 H Street NW, Suite 300, Washington, D.C. 20005 • (202) 775-8810
www.EPI.org

Thank you Chairman Jordan and members of the subcommittee for the opportunity to testify today. I am Josh Bivens, a macroeconomist at the Economic Policy Institute in Washington, DC. In assessing the economic impact of the American Recovery and Reinvestment Act (ARRA, the Recovery Act henceforth) I'd like to make four arguments today, and they mirror the arguments I've made when testifying about its impact in the past.

-First, the Recovery Act was badly needed. The American economy at the end of 2008 and the beginning of 2009 was essentially in freefall and all other policy tools that had been tried had little effect in arresting the decline.

-Second, it worked roughly as advertised. By the middle of 2010 (its period of peak effectiveness) it had created up to 5 million full-time equivalent jobs and kept the unemployment rate from flirting with 12% at the labor market's trough. Today, absent the impact of the Act the unemployment rate would surely remain in double-digits. That said, the economy needed many more jobs than this - the economic crisis that it was meant to address called for much stronger medicine than the Recovery Act could by itself provide.

-Third, while it was as effective as advertised, it was significantly cheaper than advertised. While the sticker-price of the Recovery Act (estimated at $787 billion when passed and boosted to $862 billion) is often characterized in press accounts as enormous, it was less than half as large as the tax cuts enacted during the 2000s, smaller than the cost of wars in Iraq and Afghanistan, and, most importantly, small relative to the economic shock it was meant to absorb. Further, because it spurred economic activity and tax collections and reduced the need for safety net spending, its net budgetary impact was likely well under its headline cost.

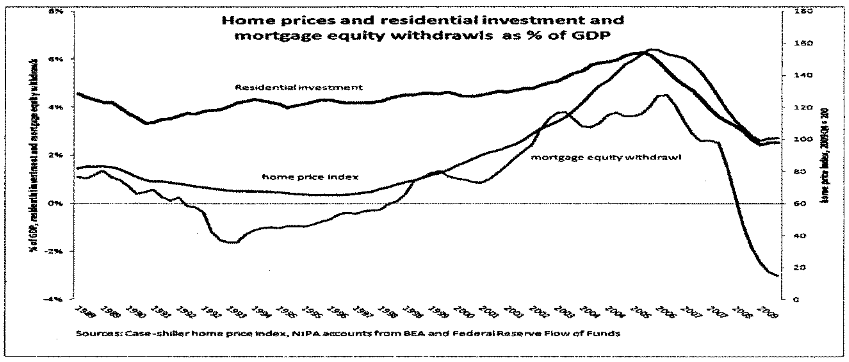
-Fourth, lessons learned from the passage of the Recovery Act should be heeded: More fiscal support should be provided to prop up the economy and spur a genuine recovery in the jobs-market. While the economy today would be worse off if the Recovery Act had not been passed, unemployment still sits at 9.0% today and will almost surely rise above 9.5% over the coming year, returning to pre-recession levels only several years from now (in 2016, if the Congressional Budget Office (CBO) forecast is right) unless more fiscal support is provided.

It was needed

The root of the current recession is simple to identify: the bursting of the housing bubble and its fallout. Between 1997 and 2006, the real price of homes in the U.S. economy, which had been roughly flat for many decades, roughly doubled. Given that the stock of housing in the U.S. is enormous, this led to a huge increase in wealth. Because so few influential economists correctly pointed out that this wealth increase was sure to be ephemeral, U.S. households began borrowing against the value of their homes to support current consumption. When the housing bubble popped, these same households realized that meeting long-run wealth targets (planning for retirement or sending their kids to college) could no longer be financed out of rising housing wealth, so they began saving. As households began saving, businesses, seeing a threat to new sales, stopped investing to expand their own capacity.

This negative shock to private sector spending was enormous – between the end of 2006 and the beginning of 2009, the private sector went from borrowing 3.6% of GDP to saving 5.6% of GDP. This 9.2% swing in private sector spending was a larger economic shock than the one that led to the Great Depression. **Figure A** below shows two concrete measures of this fallout: mortgage equity withdrawals that allowed households to extract wealth out of their homes and increase their purchasing and residential investment – the economic activity generated by the act of building homes. Both are expressed as shares of GDP, both soared during the housing bubble, and both collapsed when this bubble burst.

Figure A



Luckily, the U.S. economy is different now than compared to the 1930s. In particular, today's economy has a larger public sector and one that contains many "automatic stabilizers" – including progressive tax collections that fall more rapidly than private sector incomes and safety net spending (like unemployment insurance and food stamps and Medicaid) that provides increased transfers to households when the economy slows. These automatic stabilizers kicked in as private spending slowed. This led to a purely mechanical rise in the deficit – roughly $329 billion of the increase in the deficit between 2007 and 2009 can in fact be attributed to this purely mechanical effect of automatic stabilizers, according to the Congressional Budget Office.

And this large increase in the deficit was a very good thing. The increase in public spending power leaned hard against the rapid decline in private spending power, and contributed to keeping the economy from entering another Depression.

Of course, the increase in the deficit was not the only thing that helped support the economy – at the same time the Federal Reserve was aggressively fighting the downturn by cutting interest rates and supplying liquidity to the financial sector.

Still, automatic stabilizers and Federal Reserve action were not enough to forestall a rapid economic deterioration. By March 2009 – the first month after the Recovery Act passed, the economy had seen monthly job-loss that averaged 712,000 *in each of the previous 6 months,* despite the fact that the short-term interest rates controlled by the Federal Reserve had been consistently reduced for 20 months – and had been below 1% since October 2008.

When an economy continues to spiral downward even when the monetary authority has reached the limit of what conventional policy can do to arrest the fall, it is often referred to as a liquidity trap.

Essentially, the economy "needs" short-term interest rates that are steeply negative in order to boost business investment and consumer spending on durables sufficiently to exit the recession. But, interest rates cannot go below zero. Even worse, as the economy suffers from a dearth of spending, this creates pressure for disinflation – as firms cannot sell output and new jobs are scarce, prices and wages are all-but-impossible to raise. This disinflation actually raises the "real", or inflation-adjusted, interest rates facing businesses and consumers, even as the Fed's control over nominal rates is bound at zero.

In short, because the primary tool that national policymakers use to fight recessions – lowering short-term interest rates - had been rendered ineffective, something else had to be done. This something was the Recovery Act, a deficit-financed combination of a roughly equal measure of tax cuts, transfer payments and direct government grants to support demand for goods and services and blunt the recession.[1]

It should be remembered that the size and composition of the Recovery Act was a compromise. Many, including myself, thought the overall size of the package would be too small to bring the economy back to recovery without further action. Many (also including myself) also thought tax cuts had too large a weight in the final package and that many of them (particularly the fix to the alternative minimum tax, or AMT) were ill-suited for short-term stimulus. Because of these compromises on the size and composition of the Act, many believed that it would not be sufficient by itself to provide the economic boost needed to the get the American job-market back to health in an acceptably rapid time-frame.

All this said, passage of the Recovery Act was a serious response to the nation's economic crisis, and even with its somewhat-compromised composition, its forecasted impact was large – the best estimates were that it would create between 2-4 million jobs and boost GDP by roughly 2 - 4% over the first 2 years of its implementation.

It worked

And this estimate has been spot-on. For those most convinced by appeals to authority let's start with what private sector macroeconomic forecasters say about the Recovery Act. These are, remember, people whose salary relies on being closer than their competitors in forecasting economic trends. As a group, they are in near-universal agreement in their central estimates that the Recovery Act added roughly 3 percent to GDP by the middle of 2010 and that it created or saved between 2-4 million jobs. The non-partisan Congressional Budget Office (CBO) concurs, calculating that the Recovery Act contributed between $240 billion to $645 billion to the economy by the middle of 2010, creating or saving up to 5.2 million full-time equivalent jobs at its peak and keeping the unemployment rate up to 2 points lower than it would have been in the absence of the act. **Figure B** below provides a range of forecasters' average estimates of the Recovery Act's effect on GDP and jobs.

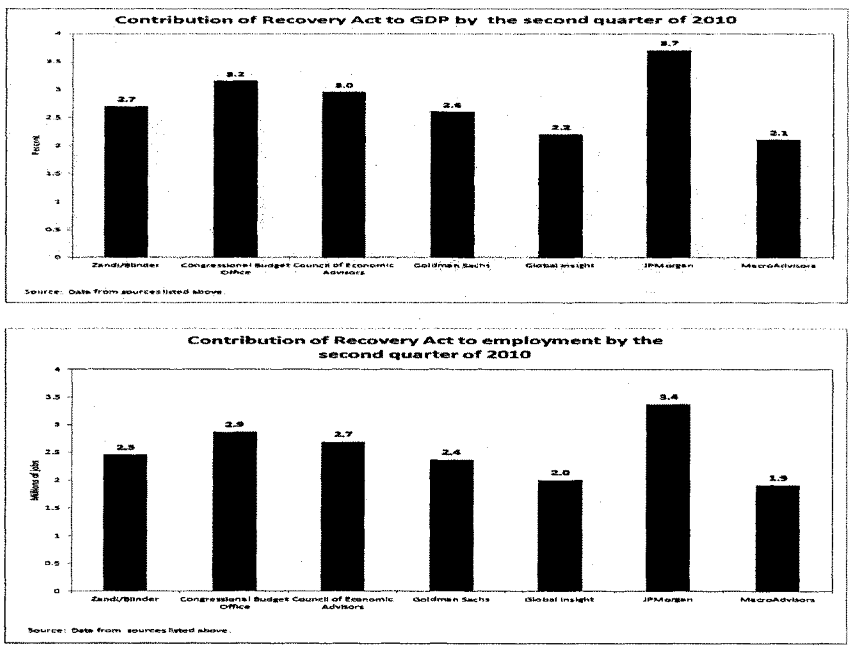
There are a number of factors that explain the near-unanimity among forecasters who have examined the impact of ARRA.

First, it is firmly in line with what mainstream economic theory teaches is the likely effect of deficit-financed tax cuts, transfers and spending in an economy that has high unemployment even in the presence of rock-bottom interest rates (i.e., is in a liquidity trap). The effect of increasing deficits to

[1] While tax cuts represented just over a quarter of the 10-year cost of the Act, they were a much heavier percentage in the first 2 years, as some of the cuts in those years were counter-balanced with small tax increases in the later years of the Act.

finance tax cuts, transfers and spending in a *healthy* economy is ambiguous and there are many complications to assessing it. However, in a liquidity trap these complications fade away and the impact of these policy maneuvers become quite straightforward; they unambiguously push the economy closer to its potential, lowering the unemployment rate.

Figure B: Estimates of the effect of the ARRA by mid-2010



Second, the timing of the Recovery Act coincides perfectly with the halt in the downward spiral of both economic output and employment.[2] In the 3 quarters before the Act began paying out significant funds, gross domestic product *contracted* at an average annualized rate of -5.2% while in the 3 quarters after its effect began the economy *grew* at an average annualized rate of 2%.

In the 6 months before the Recovery Act took effect, average monthly employment declined by 712,000 while in the 6 months after its passage it average declines fell nearly in half to 386,000. By June of 2010

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[2] In what follows I date the effect of the Recovery Act as beginning April 1, 2009. While it was passed in late February and some money was spent before this, April 2009 is the first month that saw significant amounts of money being spent.

(again, the peak effectiveness of the Act) sector job-growth had averaged 110,000 for the first half of that year (private-sector job growth had averaged 71,000, the gap between public and private was mostly explained by the rise in hiring necessitated by the decennial census).

Figures C and D show growth in GDP and employment, respectively, in the periods before and after the onset of Recovery Act spending. The pattern is clear – the downward spiral is stopped and even reversed almost immediately after the onset of the Act.

Figure C: GDP growth before and after the ARRA

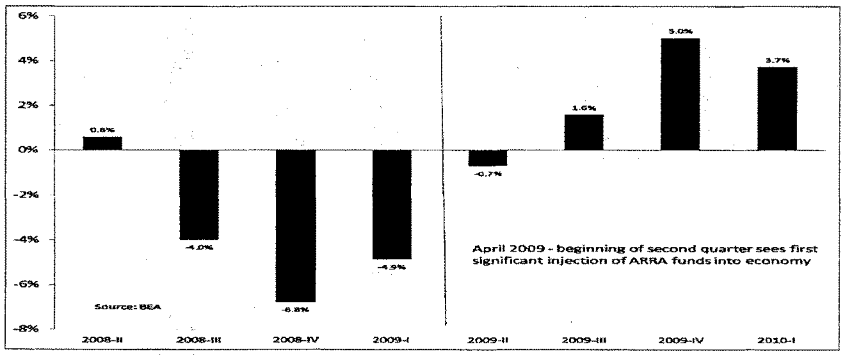
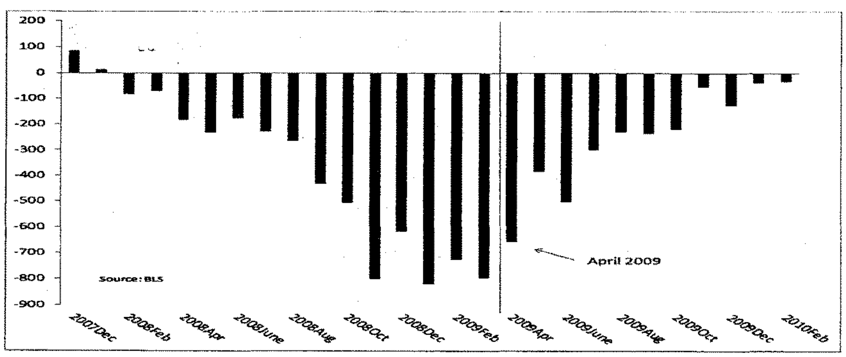


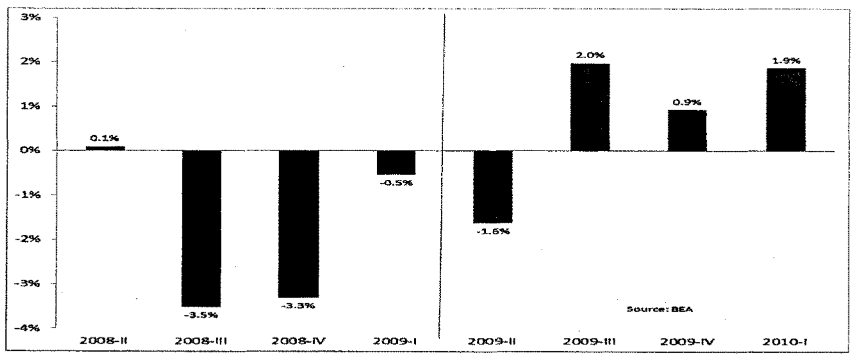
Figure D: Employment growth before and after the ARRA



Third, the turnaround in GDP growth between the 3 quarters before and the 3 quarters after the passage of the Recovery Act was driven predominantly by a reversal in consumer spending. This portion of GDP (accounting for almost 70% of the total) contracted at an annualized rate of -2.4% in the 3 quarters before the Act and actually grew by 0.4% in the 3 quarters after the Act's passage. Contrary to most descriptions of the Recovery Act as a boom for government spending, this boost to private-sector spending power is *actually* exactly what one would have expected if it was working.

Two-thirds of the Act's provisions (the tax cuts and transfer payments) go directly to boosting the purchasing power of households, not to directly purchasing goods and services for the government. This boost to household disposable income helped to arrest the steep fall in consumer spending.[3] **Figure E** shows the before and after Recovery Act comparisons of consumption spending.

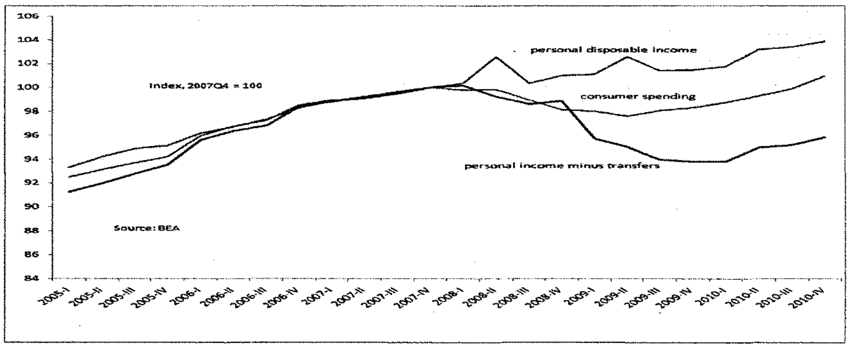
Figure E: Before/after the ARRA, Consumer spending



If one looks at total personal incomes (wages, profits, rental payments) and strips out the influence of government transfers, one can get a decent proxy for how robustly the private sector is generating income growth for households. This measure, personal income minus transfers, fell by over 8% from peak to trough during the recession – the largest decline since World War II. Yet, consumer spending fell by less than a third as much – less than 3%. The wedge between these two can largely be explained by looking at personal *disposable* incomes – incomes after-taxes and after-transfers. This measure actually never fell more than 2% peak-to-trough during the recession and is actually a bit higher today than it was before the recession. This is largely due to the Recovery Act, though some of this is also the automatic stabilizers mentioned earlier. **Figure F** shows each of these series in the period before and after the recession began, with each normalized at 100 in the last quarter before the recession hit.

[3] See the appendix to this report for evidence that the Recovery Act actually has not led to outsized growth in government expenditures.

Figure F: Personal income minus transfers, disposable personal income and consumer spending



This evidence – the preponderance of opinion of macroeconomic forecasters, the timing of the Recovery Act taking effect and the reversal of the downward spiral in the middle of 2009, and the very large footprint of the Recovery Act provisions on personal disposable income and its correlation with consumer spending – adds up to an overwhelming case that the Recovery Act worked as advertised. Essentially, without it, the average estimate is that GDP would be about $500 billion lower today, there would more than 3 million fewer jobs in the economy (and about 5 million fewer full-time equivalent jobs) and the unemployment rate would be roughly 1.5% higher *even with fewer Americans in the labor force.* While there remains much to be done to make sure that all Americans looking for a job have a decent chance of finding one, it is clear that we would be digging out of a much deeper hole today had the Recovery Act not passed.

It was cheaper than advertised

Besides a general misunderstanding about its effectiveness, the primary resistance to providing more fiscal stimulus to today's economy, even in the face of historically high unemployment, is concerns about the federal budget deficit. This section will argue that in the context of the nation's *actual* challenge concerning the national debt – budget deficits that are forecast to rise in coming decades even during periods of healthy economic growth – the costs of the Recovery Act and further fiscal support to the economy are minimal. It further argues that a broader view of the Act's costs – not just its cost in terms of the federal budget but in terms of *overall* economic opportunity costs – show that these costs are actually negative; that is the Act resulted in greater, not less, private investment and employment.

It is clear that the country faces long-run budget challenges that will require policy action in coming decades. A close look at the economics, however, shows that these budget challenges have nothing to do with the Recovery Act that was passed nor would they be appreciably exacerbated at all if more fiscal support was provided to the economy today.

For example, the Recovery Act added between 0.1 to 0.2% to the long-run (50-year) fiscal gap.[4] If one is a true budget pessimist and believes that the alternative fiscal scenario identified by CBO in their latest report on the long-run budget outlook is a good forecast of the most likely trajectory of deficits (I'm not, for the record, such a pessimist) then this would imply that the Recovery Act was responsible for less than about 1-2% of the long-run fiscal gap facing the country.

The reason for this non-effect of the Recovery Act on long-run budget challenges is simple: the Act is temporary and the main drivers of long-run deficits remain rising health care costs and low revenues as a share of GDP.

Another reason why the Recovery Act was cheap (and why further fiscal action aimed at spurring the economy would be cheap) is that its headline cost ($787 billion in the case of Recovery Act) is actual far greater than its actual net impact on the budget deficit. Because the Recovery Act saved jobs and wage incomes, it generated new tax revenue. And because it kept people working, it kept them out of public safety net programs.

Data from the Congressional Budget Office (CBO) suggests that each $1 increase in GDP relative to potential yields a $0.35 decrease in the deficit as revenues rise and spending falls. Taking the CBO estimate that the Recovery Act led to GDP by the middle of 2010 that was roughly $500 billion higher than it would have been otherwise, this implies that the economic activity spurred by the Recovery Act recouped roughly $175 billion – *well over a third* the spending that had occurred to that point. In short, well-designed policies aimed at spurring economic activity come with a *built-in and significant* offset to their total costs.

This exercise also drives home the importance of designing stimulus packages well. Take the high and low-end of Recovery Act provisions in terms of bang-for-buck provided by Moody's Economy.com. If the entire Act consisted of provisions with a bang-for-buck as low as that provided by corporate tax cuts or providing the opportunity of businesses to "carryback" past losses against future taxes, the budget offset provided by the Act would be less than $80 billion. If instead the entire Act consisted of provisions with bang-for-buck comparable to safety net expansions and infrastructure spending, the budget offset approaches $400 billion. Simple design of stimulus packages can make their final impact on the deficit differ by literally hundreds of billions of dollars. Besides just not providing effective stimulus, the less well-designed parts of the Act should have been excluded on the basis of fiscal responsibility.

It has been rightly pointed out by some that one could overstate the degree to which additional support would provide built-in offsets to its net addition the national debt. In a given year, it is highly unlikely that economic multipliers are large enough to allow additional fiscal support to be entirely self-financing. Because of this, many commentators have warned against supporters of more support engaging in hyperbole similar to that of supply-side tax advocates who claim that cutting tax rates can spur enough economic activity to bring in sufficient additional revenue so as to make these rate-cuts self-financing.

[4] The fiscal gap is a short-hand measure of the long-run fiscal imbalance. Essentially, it tells one how much some combination of tax increases and/or spending cuts (expressed as a share of GDP, enacted immediately, would be needed to close the long-run budget deficits.

While this caution may be useful, it should be made clear that the case for full self-financing over time of temporary fiscal support in an economy stuck in a liquidity trap is actually not totally implausible, while the prospect of self-financing permanent cuts in tax rates is indeed totally implausible.

If fiscal support pushes the economy back to levels of GDP that are characterized by full-employment much quicker than in the absence of this support, then it is indeed possible for it to be all-but-totally self-financing. The economists' jargon for this is avoiding hysteresis in labor and product markets, but the insight is pretty simple – if fiscal support generates additional economic activity not only in the year of its implementation but also allows the economy to much more quickly reach its potential – this represents multiple years of additional revenue and less safety net spending and could indeed lower overall ratios of debts and deficits to GDP.

How likely such a full offset is depends largely on how effectively the fiscal support is structured and how much time it shaves off the wait for the economy to regain its potential. Given that many of the mechanisms that tend to push recessed economies back to trend levels seem weak or inoperative in the current economy, it seems quite likely to me that the net fiscal cost of particularly well-structured fiscal support is essentially zero over the medium and long-term. And it is budget deficits over this medium and long-term which are forecast to rise even during times of healthy economic growth that are the proper focus of concern.

Besides having a minimal impact on the stock of outstanding national debt, the Recovery Act was financed in an economic context of historically low long-term interest rates for government debt. These low rates are no fluke – they are low precisely because private spending and borrowing is at historic lows (i.e., the recession). Further fiscal support could also be financed at very low rates, as excess capacity and little competition for loanable funds continues to characterize the economy. Additionally, upward interest rate pressure stemming from Federal Reserve actions is extremely unlikely, given both the weakness of the overall economy and their stated intention to keep rates low until the economy has begun a robust recovery.

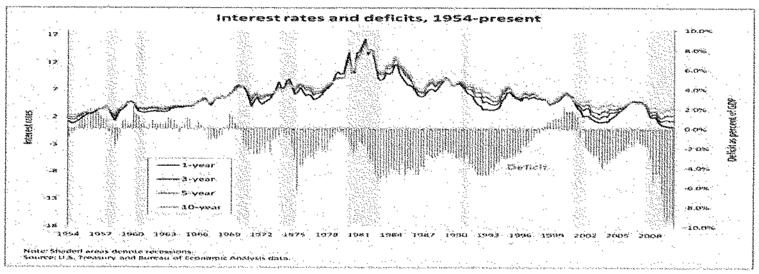
While low interest rates contribute much to the relative cheapness of the Recovery Act, they also provide the clearest indication that the Act is also cheap in its broader economic opportunity costs. The most well-pedigreed argument against increasing budget deficits in healthy economies is the fear that increased government borrowing causes interest rates to rise as public demand competes with private demand for fixed savings of households and businesses. These rising interest rates spurred by growing deficits results in private investment "crowding out" private capital formation and the lower value of the private capital stock leads to lower future growth. When economic commentators make arguments disparaging the ability of the Recovery Act (or government spending of any kind) to create jobs, they generally make variants of this crowding-out argument.

The general failure of interest rates to rise in response to the increase in budget deficits, and to the Recovery Act in particular, is a prime piece of evidence that no crowding out of private investment is occurring, making the Recovery Act not just cheap, but essentially free in terms of its overall economic opportunity cost.[5] This is, again, not unexpected. Economic theory teaches that increased public

[5] There is an additional channel through which increasing federal budget deficits in a healthy economy can lead to slower domestic income growth – if the increased borrowing spurred by them leads to greater borrowing from foreign investors. Very few (if any) detractors of the Recovery Act have made the argument that this has happened –

borrowing during a liquidity trap does not crowd-out private sector activity. **Figure G** shows the relationship between deficits, interest rates and recessions. It shows clearly that during recessions deficits rise (both due to automatic stabilizers as well as policy responses) while interest rates fall (in part due to Federal Reserve efforts to fight the recession but also because private demand for new loanable funds fall).

Figure G: Budget deficits and recessions



It is worth stressing this "crowding out" mechanism, given that many Recovery Act detractors have pointed to very low rates of overall investment as some sign that private activity is being stunted by increased public sector activity. The textbook presentation of the effects of fiscal policy *requires* higher interest rates as the mechanism through which private investment may be stunted by increased public borrowing in a healthy economy. Without the rise in interest rates, there is no way to link increased public borrowing and lower private investment.

Many Recovery Act detractors have ignored this portion of standard economic theory and instead invoked vague "uncertainty" created by the Act (as well as other policy actions of the Obama administration in particular) as reasons for continued sluggish economic growth, especially uncertainty of businesses.

It should be noted that these uncertainty-based arguments have very little evidence on their side. For one, business investment in equipment and software is actually the best-performing part of the overall economy for more than the past year. If entrepreneurs are truly scared by the actions of the Obama administration they have a strange way of showing it: real investment in equipment and software is up by an average annual rate of 16.2% for the past 5 quarters (though admittedly it did slow a bit in the last quarter of 2010).

Further, the very large falls in business investment at the end of 2008 and beginning of 2009 are easy to explain without resorting to psychological channels. Numerous academic studies suggest that the prime determinant of private investment is in fact the simple state of the economy. Given that the end of 2008 and beginning of 2009 were the sharpest fall in economic activity in generations, it is far from surprising that investment spending fell quickly.

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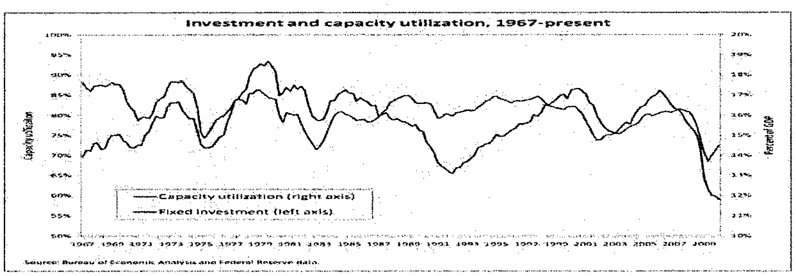
and correctly so. The mechanism for this channel to work would have to be a rise in the trade deficit. But, the trade deficit fell significantly over the course of this recession.

The capacity utilization rate (think of this as the employment rate of factories instead of people) reached historic lows during that episode of freefall. With current capacity far from being fully utilized, why would businesses seek to spend money to build more of this capacity? **Figure H** demonstrates the tight relationship between capacity utilization and investment as a share of GDP.

Figure H: Investment and capacity utilization



Additionally, it should be remembered that investment in structures, both residential and non-residential, is an important component (just under half) of overall investment. Given the massive overbuilding in the residential housing sector for the past decade and the sharply rising vacancy rates in commercial real estate, it is again hard to imagine why businesses would seek to expand investments in structures and it does not take recourse to "uncertainty" to see that this should be the case.

Given that overall economic activity is a prime determinant of private investment and that the Recovery Act assuredly spurred greater activity, it is very likely that the Recovery Act actually "crowded in" private investment – actually made the fall-off in private investment *less steep* that it would have been absent the Act's effects. Evidence for this can be seen in a number of papers that find very large multiplier effects of fiscal support when an economy is a liquidity trap.[6]

Finally, as a side-note, it should be pointed out that the case for "uncertainty" keeping businesses from making new employee-hires is similarly lacking in evidence. For one, growth of temporary employment is actually lagging previous recoveries – if one imagined that there was sufficient demand in the economy to entice firms into producing more but that they did not want to make permanent commitments to staffing-up due to "uncertainty", there would be a large increase in temp-hiring. By the same logic, one would expect average hours per employee to be trending rapidly upward if firms saw demand for their products but did not want to add to head-count. While hours have recovered some of the precipitous fall they saw during the worst of the recession, they remain below pre-recession averages. In short, the case for demand *not* being a problem but policy uncertainty restraining new hires looks awfully weak.

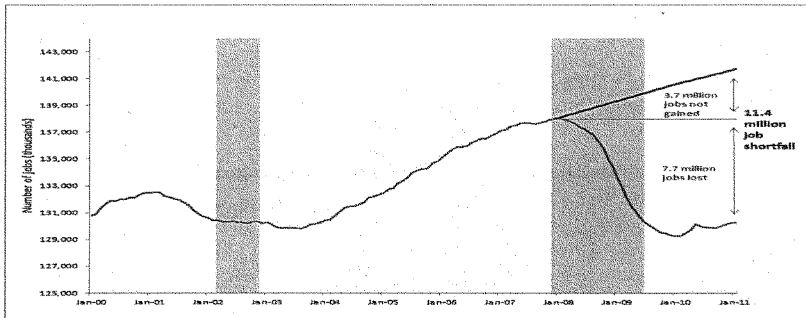
[6] See Eggerston (2010), Woodford (2009) and Hall (2009) for representatives of this finding.

It should be repeated

So, while the Recovery Act saved the U.S. economy from a worse economic fate – today's economic fate is still poor. Today's unemployment rate stands at 9.0% and a series of economic overhangs – the overhang of average hours decline, the overhang of the "missing labor force" (the 2 million workers who withdrew from the labor force since the recession began and who will certainly return looking for work in coming years), and the overhang of business and consumer debt that will keep spending in both sectors cautious in coming years – mean that, absent further support to the economy, it will take an agonizingly long time to bring it down to levels seen before the recession began. For example, the Congressional Budget Office (CBO) has forecast the unemployment rate will average 7.4% for the full-year in 2013 – this is higher than the peak rate reached during the recession and jobless recovery in the early 2000s recession and nearly as high as the 7.8% peak rate reached during the early 1990s recession.

Figure I documents how many jobs are needed to return the unemployment rate even just to its rather undistinguished level of December 2007.

Figure I: How many jobs needed to return to December 2007 unemployment?



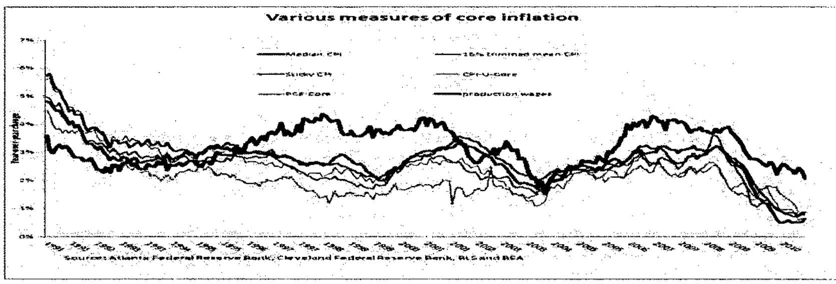
Note: Shaded areas denote recession.
Source: EPI analysis of Bureau of Labor Statistics data.

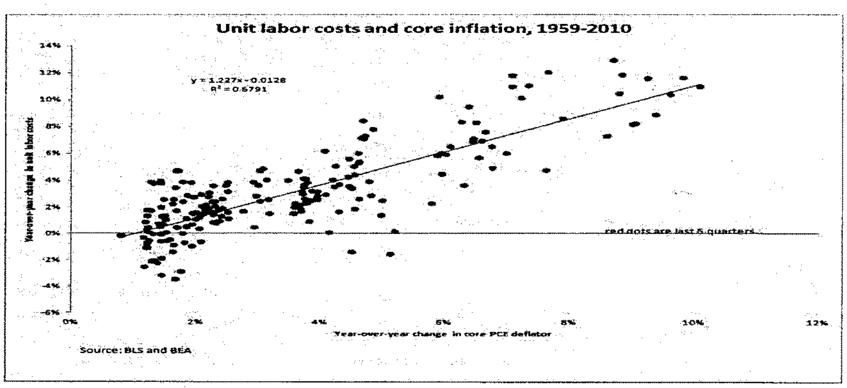
Further, even this grim forecast for unemployment assumes the economy grows consistently in the next couple of years. Given recent headwinds that have picked up steam in the past few months, even this cannot be assured. Most worrisome, home prices have begun falling again – and this development was not expected or factored into the majority of Blue-chip forecasts – it is a clear downside surprise. Further, many of the major trading partners of the United States have embraced fiscal austerity; the UK economy actually shrank in the last quarter of year. In short, net exports will likely not be a source of strength moving forward in the recovery (though it should be noted that they were a useful shock absorber during the recession and added a bit to growth in the last quarter of 2010).

Lastly, economic data in the form of rapidly decelerating prices and wages is also sending strong signals that excess capacity in the economy is threatening to grow again. Essentially all indicators of overall price pressure in the economy show rapidly decelerating price growth, and several show outright deflation (falling prices) in recent months. **Figure J** shows some of these.

These falling wages and prices are not just a *symptom* of poor economic performance (although they are indeed this); this disinflation also *causes* real interest rates to rise just when we want them to fall. In short, this disinflation not only signals slower growth, it also adds to the growth headwinds facing the economy.

Figure J: Various measures of core price and wage inflation





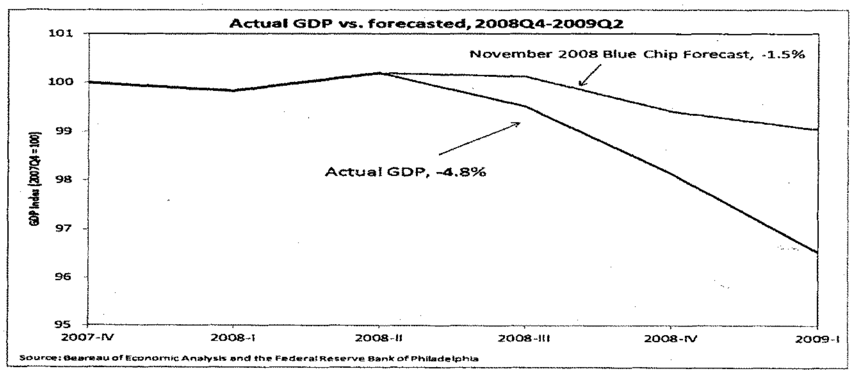
Finally, the boost to growth provided by the Recovery Act is gone. Because the pace of the Act's spend-out has been greatly reduced, it has contributed next-to-nothing to growth in the last quarter of 2010. There is an irony here – many of Act's critics argued that it would not be "timely" enough to fight the Recession (we all remember the controversy over just how "shovel-ready" infrastructure projects could really be), but instead the real problem with the Act was that its effect wasn't long-lived enough to provide the bridge the economy needed over the enormous job-chasm inflicted by the Great Recession.

A couple of notes on Romer-Bernstein

A facile debating technique used by those contending that the Recovery Act did nothing invokes the Obama administration's forecast (authored by Bernstein and Romer) that the unemployment rate would rise to roughly 9% if the Recovery Act was not passed, but would not reach 8% if it was enacted– a forecast which even its makers would now acknowledge greatly underestimated the size of the private-sector spending shock hitting the economy in late 2008 and early 2009. When unemployment peaked at 10.1% *after* its passage, critics pounced, with some claiming that the Act had even somehow made things worse.

The problem with this interpretation is that it fails to consider the fact that it was not the Recovery Act that failed, but rather the imagination of economic forecasters (both within as well as *outside* the Obama administration) about how much damage would be inflicted on the economy by the failure of both regulators and the entire financial sector to contain the massive housing bubble. **Figure K** shows the simple average of the Blue-Chip consensus forecast for GDP growth in early 2009, as well as the *actual* path of GDP.

Figure K: Blue-chip forecast



The 3.3% difference between the forecast GDP growth rate and what actually occurred translates into roughly a 1.5% higher unemployment rate – essentially the difference between the Romer/Bernstein forecast of the trajectory of unemployment with the passage ARRA and what actually occurred.

Further, it's worth noting that just between December 2008 (when Romer and Bernstein published their document) and March 2009 (the month after the ARRA was passed), the economy lost nearly 3 million jobs. In essence, the 2% gap in what they projected the unemployment rate would be if ARRA passed and what eventually transpired can be explained by the historic hemorrhaging of jobs that happened *after their report was published and before the Act began paying out money.* In fact, by April 2009, the first month that saw serious money being dispersed by the ARRA, unemployment was already 8.9%.

In short, it's clear that what is wrong with the Romer/Bernstein is simply their forecast of just how bad the economy was in early 2009, not in the likely impact of the ARRA. In fact, as noted above, the consensus among those who earn their money by doing economic forecasts is that the *difference* between an economy with and without the Recovery Act is that by the middle of 2010 *the economy had roughly 3-4 million jobs more than it would have had if the Act had not passed.*

A good metaphor for this controversy is the temperature in a log cabin on a cold winter's night. Say that the weather forecast is for the temperature to reach 30 degrees. To stay warm, you decide to burn three logs in the fireplace. You do the math (and chemistry) and calculate that burning these three logs will generate enough heat to bring the inside of the cabin to 50 degrees – or 20 degrees warmer than the ambient temperature.

But the forecast is wrong – and instead temperatures plummet to 10 degrees and burning the logs only results in a cabin temperature of 30 degrees. Has log-burning failed as a strategy to generate heat? Of course not. Has your estimate of the effectiveness of log-burning been wildly wrong? Nope – it was exactly right – it added 20 degrees to the ambient temperature. The only lesson to be learned from this is a simple one: since the weather turned out worse than expected, you needed more logs.

Conclusion

The Recovery Act worked largely as advertised, creating nearly 5 million full-time equivalent jobs in the economy when such growth was desperately needed. However, its effect has passed – and millions of jobs remain desperately needed.

It seems amazing now, but 30 months ago Congress acted quickly to pass a $160 billion stimulus package to avoid the prospect of unemployment rising from 5 to 6%. The unemployment rate now stands at 9.0% and further fiscal support beyond 2011 does not seem to be forthcoming. A real jobs debate would take into account the extensive research that argues for the effectiveness of the ARRA.

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Mr. JORDAN. Thank you, Mr. Edwards.
Dr. Bivens.

STATEMENT OF JOSH BIVENS

Mr. BIVENS. I would like to thank the chairman and the members of the committee for inviting me today.

I am going to start with a quick overview of the origins of what we now call the Great Recession and the rationale for the Recovery Act, and then just provide a little bit of overview of my assessment of it.

Sometimes the origins of recessions are hard to see. Not so with what we call the Great Recession. Between 1997 and 2006, the real price of homes roughly doubled. They had been roughly stable for almost 100 years before. Because the stock of housing in the United States is enormous, this added greatly to the wealth of American households, and housing wealth and the debt associated with it, as well as huge activity in the homebuilding sector, was the foundation for the 2000's business cycle.

This was obviously unsustainable. Home prices fell by about 30 percent between 2006 and 2009. This erased about $7 trillion to $8 trillion in wealth from American households' balance sheets, and consumer spending, just as predicted by a long range of economic theory and evidence, collapsed. Homebuilding collapsed, residential investment took about 3 percentage points off GDP, as homebuilders realized they had built too much during the 2000's.

These initial shocks to spending then cascaded throughout the economy. Businesses stopped investing because customers were not coming through the door. Why would you build another factory when the factory you have is producing output that is not selling?

So essentially, the economy suffered a shock to aggregate demand. To deny this, to say that was not the essential problem, you have to answer the question, then, why did almost 9 million people lose their jobs in a 2-year period. American workers didn't wake up January 2008 with no skills. American factories didn't become obsolete in a month. American managers didn't forget how to organize production. We didn't suffer from an inability to supply goods and services, we suffered from an inability to demand them. And to be clear, I am using demand in an economist's way, desire backed by purchasing power. Purchasing power was gone. It was erased by the housing bubble.

So by most measures, the shock to private sector spending caused by the bursting housing bubble was bigger than the one that led to the Great Depression. We didn't have a Great Depression mostly because we now have a central bank that leans much more aggressively against private sector spending shocks, and we allow budget deficits to rise to finance public spending to stem the gap caused by retreating private spending, when you are in a recession. So that was a big reason why we did not see the economy spiral into a depression.

ARRA was part of that, pushing back against the shock to private sector spending. In my judgment, it worked largely as advertised. We have a gross domestic product that is probably about $500 billion higher today than it would have been if we had not passed it. We probably have about 5 million full-time equivalent jobs that we would not have had at ARRA not passed.

And this judgment is based on three considerations. First, virtually all private sector forecasting firms, people whose money depends on being more correct about short-term economic trends, say that ARRA added a lot to output and employment.

Second, these effects are in line with what research says you should expect from doing something like ARRA in an economic environment like we have seen for the past couple of years, very high unemployment, very low interest rates, very low inflation. When one looks at research that says fiscal support cannot help the economy, it invariably is looking at the wrong episodes. Like the previous panel talked about looking at the 1970's and World War II, Government spending didn't help.

Well, it wasn't supposed to help in those episodes. You did not have very high unemployment along with very low inflation and very low interest rates in those episodes. When you look at episodes like what we have seen for the past 2 years, fiscal support works.

Third, the timing was right. Basically GDP contracted at about a 5 percent annual rate in the 9-months before the act was passed. It grew at roughly 2 percent—I am sorry, contracted at 5 percent before it was passed, grew by 2 percent in the 9-months after it. Same thing for employment growth.

And then also contrary to a lot of what has been written, it helped arrest the decline in consumer spending. That is exactly what you would expect, given that two-thirds of the act was tax cuts and transfer payments to individuals.

Last, just a couple of words on the really easy debating point deployed against ARRA, the sort of ritual trotting out of the Romer-Bernstein forecast. An earlier panel said that people who say that the Romer-Bernstein forecast was wrong just because they underestimated how bad the economic shock was said, there is no evidence for that, you can't prove it. Of course you can prove it. You can look at what economic forecasters were saying at the time.

And I actually had a figure, I am not sure if we are able to blow it up or not, it is in my testimony, it shows the consensus blue chip forecast for what was going to happen in that sort of 6 month period in late 2008, early 2009. The blue chip consensus was GDP would contract by 1½ percent. It actually contracted by closer to 5 percent. That gap between the blue chip forecast of what was going to happen and what actually happened equals about 2 percentage points of unemployment. In short, the difference in the forecast in Romer-Bernstein for what actually happened versus what they forecast to happen with ARRA is because they followed the consensus forecast about the underlying health of the economy. It does not affect their estimate of how effective ARRA was.

We would have about 3 to 4 million fewer jobs, had we not passed ARRA. And the fact that they underestimated the degree of the private sector spending shock that was hitting the economy in real time doesn't affect that.

So essentially, I think the Recovery Act worked largely as advertised. I think the biggest problem with it, its boost to the economy is gone. By the first quarter of 2011, it is adding zero to economic growth, and yet we still have 9 percent unemployment.

Thank you. I would be happy to answer any questions.

[The prepared statement of Mr. Bivens follows:]

The Stimulus Bill and Government Spending

Statement of Chris Edwards, Director of Tax Policy Studies, Cato Institute,

before the House Committee on Oversight and Government Reform,

Subcommittee on Regulatory Affairs, Stimulus Oversight, and Government Spending

February 16, 2011

Mr. Chairman and members of the committee, thank you for inviting me to testify today regarding government spending and the 2009 stimulus bill. My comments will focus on the need to control federal spending, but I will also discuss state government budgets, as the states were major recipients of stimulus funding.

Short-Run "Sugar High" and Long-Run Damage

Federal spending has soared over the past decade. As a share of gross domestic product, spending grew from 18.2 percent in fiscal 2001 to 24.7 percent by fiscal 2011. The causes of this expansion include the costs of overseas wars, growing entitlement programs, rising spending on domestic programs such as education, and the 2009 stimulus bill.

Two years after passage of the $821 billion stimulus package, it appears to have been a very expensive failure of Keynesian fiscal policy.[1] Note that the total Keynesian stimulus in recent years included deficit spending of $459 billion in FY2008, $1.4 trillion in FY2009, $1.3 trillion in FY2010, and $1.5 trillion in FY2011. Despite all that deficit spending, U.S. unemployment remains stuck at high levels and the recovery is sluggish compared to prior recoveries.

Economists debate how much of a "sugar high" increased government spending can provide to the economy in the short-run. Obama administration economists think that the Keynesian "multipliers" from spending are large, but many macroeconomists think that they are small because added government spending mainly just displaces private-sector activities.[2]

In the long-run, there is little doubt that additional government spending reduces our standard of living because of the build-up of debt. Future taxpayers will bear the burden of the $821 billion stimulus plus hundreds of billions of dollars in related interest costs. Harvard's Robert Barro has calculated that the future damage caused by the 2009 stimulus bill substantially outweighed any short-term benefits it may have had.[3]

Keynesian fiscal policy, which has dominated Washington in recent years, has pushed the nation closer to a financial and economic disaster in the years ahead. Keynesianism is an economic dead-end, and it should be abandoned. Policymakers should change their focus from short-term fiscal manipulations to long-term spending control.

Long-Run Costs of Government Spending

The federal government will spend $3.7 trillion this year financed by a huge extraction of resources from current and future taxpayers. That extraction comes at a large cost. The resources consumed by the government cannot be used to produce goods in the private sector. For example, the engineers working on a $1 billion government high-speed rail scheme are precluded from building goods to satisfy real consumer needs in the marketplace. Policymakers tout the jobs created by the $1 billion of spending, but they usually overlook the $1 billion of private activities that are displaced.

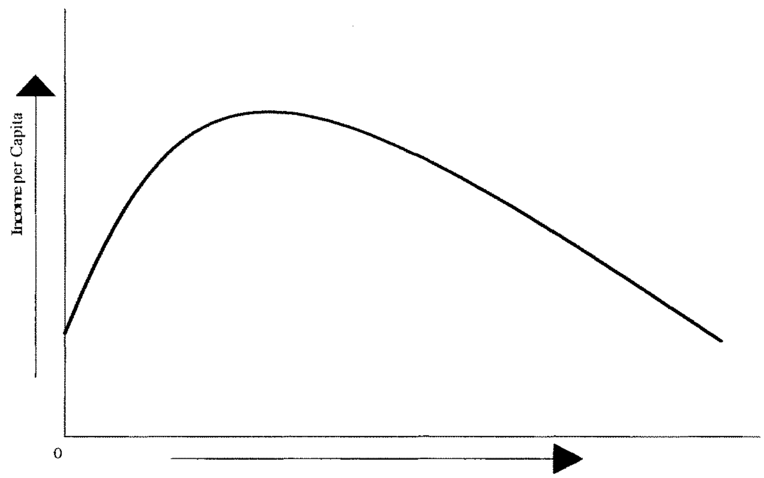
The private sector would actually lose more than $1 billion in this example. That is because government spending and taxing creates "deadweight losses," which are costs caused by distortions to working, investment, entrepreneurship, and other productive activities. Economists provide a range of estimates for the size of deadweight losses. The CBO says that "typical estimates of the economic cost of a dollar of tax revenue range from 20 cents to 60 cents over and above the revenue raised."[4] Economist Martin Feldstein concludes that "the deadweight burden caused by incremental taxation ... may exceed one dollar per dollar of revenue raised, making the cost of incremental governmental spending more than two dollars for each dollar of government spending."[5] Thus, a $1 billion high-speed rail scheme would cost the private economy $2 billion or more.

When it intervenes in markets, the government uses a "leaky bucket" because of the damage it causes on both the tax and spending sides. Economist Michael Boskin explains: "The cost to the economy of each additional tax dollar is about $1.40 to $1.50. Now that tax dollar ... is put into a bucket. Some of it leaks out in overhead, waste, and so on. In a well-managed program, the government may spend 80 or 90 cents of that dollar on achieving its goals. Inefficient programs would be much lower, $.30 or $.40 on the dollar."[6]

The larger the government grows, the leakier the bucket becomes because tax distortions rise rapidly as tax rates rise and spending is allocated to activities with ever lower returns.[7] Figure 1 illustrates the consequences of the government's leaky bucket. On the left-hand side of the figure, tax rates are low and the government initially delivers important public goods such as crime reduction and the enforcement of contracts. Those activities create high rate of returns, so per-capita incomes initially rise as the government grows.

As government expands further, however, it engages in less and less productive activities. The marginal return from government spending falls and then turns negative. On the right-hand side of the figure, average incomes fall as the government expands. Government in the United States is almost certainly on the right-hand side of this figure—it has expanded far beyond the optimal point that maximizes the nation's well-being. For evidence, see www.downsizinggovernment.org, which catalogs the ongoing failures of many federal government agencies.

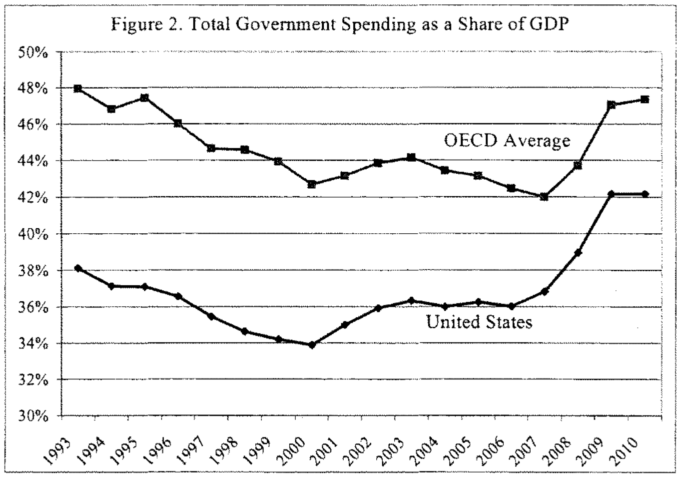
Figure 1. The Size of the Government and Average Incomes



Policymakers should think about these realities when they are presented with new ideas for spending. For example, in his State of the Union address, President Obama promoted new government "investment" spending. But given how much the government already spends and the large distortions created by the tax system at the margin, it is extremely unlikely that the government could find new projects with sufficiently high returns to make them worthwhile.

The sad reality is that United States is no longer a small-government nation, as revealed by data from the Organization for Economic Cooperation and Development.[8] The OECD calculates that total federal, state, and local government spending in the United States in 2010 was 42 percent. For many years, America had about a 10 percentage point government size advantage compared to the OECD average, but that advantage has now shrunk to just 5 percentage points, as shown in Figure 2.

Historically, America's robust economic growth and high living standards were built on our relatively smaller government than Europe and elsewhere. But if we continue down the current high-spending path, we will become just another sluggish welfare state. Projections by the Congressional Budget Office under its "alternative fiscal scenario," show that federal spending will climb by another 11 percentage points of GDP by 2035 unless we make major reforms.[9] Such a spending expansion would doom young people to unbearable levels of taxation and an economy with few opportunities and little innovation.



Source: OECD Economic Outlook Database, Annex Table 25.

We need major federal spending cuts. We should cut entitlements, domestic spending, and defense. I've proposed cuts at www.downsizinggovernment.org to balance the federal budget by 2020. And I've suggested that Congress cap the annual growth in total federal outlays to help force ongoing efforts to cut costs.[10]

Some economists argue that spending cuts would hurt the economy, but the Canadian reforms of the 1990s show that the opposite is true.[11] In the early 1990s, overspending had pushed the size of government in Canada to more than 50 percent of GDP and debt was soaring. But the federal government reversed course and chopped 10 percent from total spending in two years—equivalent to Congress cutting spending by $370 billion. The government held spending at roughly the lower level for a few more years, and overall government spending in Canada fell by 10 percentage points of GDP.[12]

As spending was cut, the Canadian economy boomed for 15 years until it was hit by the recent U.S.-caused recession.[13] As spending came down, the Canadian government helped spur economic growth with pro-market reforms such as free trade, corporate tax cuts, and privatization. The Canadian model of spending cuts and microeconomic reforms to boost growth would be an excellent model for U.S. policymakers to follow.

In sum, policymakers should reject the idea that added spending is good and beneficial for the economy. It isn't. In recent decades, the federal government has expanded into hundreds of areas that would be better left to state and local governments, businesses, charities, and individuals. That expansion is sucking the life out of the private economy and creating a top-down bureaucratic society. Cutting federal spending would spur economic growth and enhance personal freedom by dispersing excessive power from Washington.

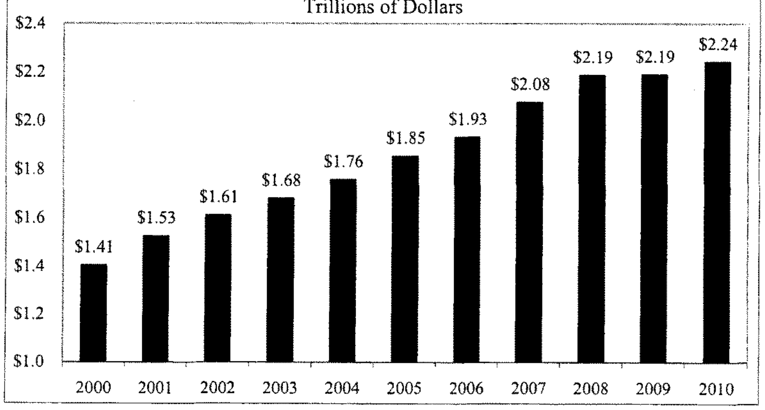
Aid to the States Should be Cut, Not Increased

The 2009 stimulus bill included substantial aid to state and local governments. The view was that the states were hard hit by the recession and they needed emergency federal help. In recent years, news stories have suggested that state budgets have been radically slashed in devastating ways.

The reality is different. Overall state and local government spending has not been slashed. Most states did have to tighten their belts during the recession, but that is entirely reasonable as families and businesses had to do the same. Furthermore, recent belt-tightening came after years of robust state spending growth.

Figure 3 shows that total state and local government spending rose 55 percent between 2000 to 2008, based on Bureau of Economic Analysis data.[14] State and local spending leveled out in 2009, and then it started growing again in 2010. It is true that a number of states, such as California, have dug themselves into deep fiscal holes, but overall state revenues and spending are now rising again as the economy expands. As a share of GDP, total state and local spending increased over the last decade—from 14.1 percent in 2000 to 15.3 percent in 2010, according to the BEA.

Figure 3. Total State and Local Government Spending
Trillions of Dollars



Source: Bureau of Economic Analysis, National Income and Product Accounts, Table 3.3. Calendar years.

Looking ahead, Congress should repeal any remaining stimulus funding to help reduce the federal deficit. Then Congress should start cutting the.entire aid-to-state system, which costs federal taxpayers about $650 billion a year. The system is hugely bureaucratic, stifles state policy diversity, and encourages overspending by every level of government.[15]

Some groups are pointing to large "budget gap" figures to suggest that the states have a short-term fiscal crisis. The Center on Budget and Policy Priorities, for example, claims that the states face a $125 billion budget gap, even though tax revenues are growing.[16] But such "gaps" are speculative numbers, not hard data. If a state expects revenues and spending to rise 7 percent, but then a new forecast shows revenues rising only 3 percent, the state is said to have a 4 percent "gap" or "shortfall." But spending is still rising by 3 percent, which is not a crisis. Budget gap estimates are partly artifacts of faulty economic forecasting and an inability of states to respond flexibly to changing circumstances.

The real state budget crisis is not these short-term gaps, but the longer-term problem of soaring debt and unfunded obligations in state retirement plans. State and local bond debt more than doubled over the last decade from $1.20 trillion to $2.42 trillion, according to the Federal Reserve Board.[17] Unfunded obligations in state and local defined benefit pension plans are more than $3 trillion when realistic accounting methods are used.[18] The states also have huge funding gaps in their retirement health plans of at least $1.4 trillion.[19]

Defined benefit pension plans have become a unique luxury of the public sector. DB plans are available to 84 percent of state and local workers, but to just 21 percent of private workers.[20] Furthermore, public sector plans are generally more generous than the remaining private-sector plans.[21] The good news is that a number of states are starting to tackle the high costs of these government employee benefits.

From a federal perspective, the thing to note is that the 50 states are in quite different fiscal positions. For example, a report by Moody's shows that state-level debt varies from more than 8 percent of state GDP in Hawaii and Massachusetts to near zero in Iowa, Wyoming, and Nebraska.[22] There are also large differences between the states in pension funding gaps.[23] Part of these fiscal differences likely stem from the wide variations in public sector unionization between the states.[24]

The states have chosen different paths, and they are free to do so in our federal system. Over time, we can hope that the spendthrift states can learn policy lessons from the more frugal states. The important thing is that federal policymakers avoid any further bail-outs of the states because that would simply reward the mismanaged states at the expense of the others. State policymakers have the power to solve their own fiscal problems without federal intervention.

Thank you for holding these important hearings.

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[1] The "stimulus" bill was the American Recovery and Reinvestment Act of 2009. For an updated estimate of the bill's cost, see Congressional Budget Office, "The Budget and Economic Outlook," January 2011, p. 12.
[2] See, for example, Robert J. Barro, "Government Spending Is No Free Lunch," *Wall Street Journal,* January 22, 2009; John F. Cogan and John B. Taylor, "The Obama Stimulus Impact? Zero," *Wall Street Journal*, December 9, 2010; John H. Cochrane, "Fiscal Stimulus, Fiscal Inflation, or Fiscal Fallacies," University of Chicago Booth School of Business, February 27, 2009,
[3] Robert J. Barro, "The Stimulus Evidence One Year Later," *Wall Street Journal*, February 23, 2010.
[4] Congressional Budget Office, "Budget Options," February 2001, p. 381.
[5] Martin Feldstein, "How Big Should Government Be?" *National Tax Journal*, Volume 50, no. 2, June 1997, pp. 197-213.
[6] Michael Boskin, "A Framework for the Tax Reform Debate," in *Frontiers of Tax Reform,* ed. Michael Boskin (Stanford: Hoover Institution, 1996), p. 14.
[7] Regarding taxes, deadweight losses rise more than proportionally as tax rates rise.
[8] Organization for Economic Cooperation and Development, "Economic Outlook Database," December 2010, Annex Table 25. For OECD countries, I calculated the unweighted average.
[9] Congressional Budget Office, "The Long-Range Budget Outlook," June 2010, p. 7.
[10] See www.cato-at-liberty.org/swap-debt-limit-for-cut-and-cap.
[11] See www.cato-at-liberty.org/cutting-government-the-canadian-way and www.cato-at-liberty.org/canadas-spending-cuts-and-economic-growth.
[12] See www.oecd.org/dataoecd/5/51/2483816.xls.
[13] See www.oecd.org/dataoecd/6/27/2483806.xls.
[14] U.S. Bureau of Economic Analysis, National Income and Product Accounts, Tables 3.3 and 6.2D.
[15] Chris Edwards, "Federal Aid-to-State Programs Top 1,100," Cato Institute Tax and Budget Bulletin no. 63, February 2011.
[16] Elizabeth McNichol, Phil Oliff, and Nicholas Johnson, "States Continue to Feel Recession's Impact," Center on Budget and Policy Priorities, January 21, 2011.
[17] Federal Reserve Board, *Flow of Funds Accounts of the United States* (Washington: Federal Reserve Board of Governors, December 2010), Table D.3.
[18] Robert Novy-Marx and Joshua D. Rauh, "The Liabilities and Risks of State-Sponsored Pension Plans," *Journal of Economic Perspectives* 23, no. 4 (2009): 191–210.
[19] Chris Edwards and Jagadeesh Gokhale, "Unfunded State and Local Health Costs: $1.4 Trillion," Cato Institute Tax and Budget Bulletin no. 40, October 2006.
[20] Chris Edwards, "Employee Compensation in State and Local Governments," Cato Institute Tax and Budget Bulletin no. 59, January 2010.
[21] Pew Center on the States, *Promises with a Price: Public Sector Retirement Benefits* (Philadelphia: The Pew Charitable Trusts, 2007), p. 11.
[22] Moody's Investors Service, "2010 State Debt Medians Report," May 2010, Table 5.
[23] www.aei.org/docLib/2010RPOno1g.pdf.
[24] Chris Edwards, "Public Sector Unions," Cato Institute Tax and Budget Bulletin no. 61, March 2010.

Mr. JORDAN. I thank the gentlemen for their testimony.

Let me start with Mr. Brill. I was intrigued by your comment that, whether you embrace the multiplier effect doctrine or not, it seemed to me your testimony's conclusion was, it really doesn't matter, because the bureaucracy was so inefficient at actually allocating the dollars, moving the dollars out, that was a problem as well with this stimulus bill. Am I correct, and can you elaborate?

Mr. BRILL. That is correct. Admittedly, some dollars did move quickly. Things were you simply needed to print a check or transfer funds, those payments did occur relatively quickly, and it is noted in my testimony.

However, an enormous percentage of the dollars, and when we think about enacting legislation and the cost-effectiveness of that bill, that legislation, an enormous amount of the money was delayed. It was delayed because, quite simply, the Government, while it is good at spending money, turns out not to be very good at spending it very quickly. So there are numerous departments that have engaged in large, complex projects that require permitting, consideration, architectural designs and other things. To get those dollars spent will take years.

Some of that was understood at the beginning. That doesn't make it OK. Of course, CBO did note that this bill will have budgetary effects throughout the decade. But what we see at this point is how many programs have really yet to even begin.

Mr. JORDAN. And frankly, there is a continuation of them in the budget proposal that we got Monday from the President. I think of one example that jumps out in my mind is the so-called high speed rail, which I think is just not effective, not where we need to go. But there is a continuation of this in the current budget.

Mr. BRILL. Absolutely. A number of policies, I am less specific with a specific review in the current budget, although high speed rail is a perfect example. From the budget that came out in conjunction with the stimulus bill, over a third of those policies that the President asked to make permanent, in other words, he was seeding in the bill long-term permanent spending policies.

Mr. JORDAN. Thank you, Mr. Brill.

Mr. Edwards, I was intrigued by your testimony, when you got into the States and the different situations they face. I was wondering if you could elaborate. When I look at what some States are doing versus the choices made by others, the most obvious example to me right now is New Jersey versus Illinois. New Jersey where the Governor came in and said, we are not going to raise taxes, we are going to reduce spending and we are going to try to create a climate which I would argue is conducive to economic growth, versus what they are doing in Illinois, which is raising taxes significantly.

Can you elaborate on the choices being made there and those two models, or those two decisions by Governors and the legislatures in those States?

Mr. EDWARDS. Right. I mean, we do have a Federal system, the States should be allowed to go in their own direction, that is great. That is one reason why I don't like the Federal intervention downwards, either spending or regulation. Because I think it stifles good diversity in the States. We want the States to try different things, with their education systems and investment and all kinds of stuff, so that hopefully, if New Jersey is moving ahead with public sector union reforms, that is great. That can provide a good model for other States. So I like that diversity.

But it is also true that the Federal Government imposes a lot of these costs, like with the health care law and the No Child Left Behind Law that I think are really damaging.

Mr. JORDAN. Mr. Bivens, I want to give you a chance to participate here as well. If I understood your testimony, basically it would have been worse had we not done what was done in 2009. Obviously I disagree, and I think much of the panel disagrees. And I would argue, just based on the stated goals of the authors of the policy, who again failed to be with us this morning, we didn't meet the goals they said. I understand your comments and your testimony, well, they were using faulty data or data that wasn't up to speed at the time they made the decision.

But the idea that we are going to spend $800 billion of taxpayer money and the promise was to keep unemployment at a certain rate and it would be even lower today, I still am struck by, I guess I still reach the same conclusion that I think frankly most Americans have reached, which is the only thing we got from the stimulus was 3 years of record deficits and the highest level of national debt we have ever experienced.

Mr. BIVENS. I would say what the real promise of the Romer-Bernstein report was that we would have 3 to 4 million more jobs than the economy would have produced had we not done it. In that one, I think their judgment is right and it is supported by the CBO and other forecasters.

And just one other point, too, just between December 2008 when they wrote that report and March 2009, the month after ARRA was passed, the economy lost 3 million jobs in those 3 months. That is essentially that 2 percentage point unemployment gap between what they predicted and what happened right there. The fact that they did not realize that they were sitting on sort of an exploding private sector economy around them, I think it doesn't speak greatly of their economic forecasting ability, but nobody got that in real terms.

But that does not change the effectiveness of the policy, or their evaluation of it.

Mr. JORDAN. And that is my point. They were pretty darned specific in the number of jobs that would be, well, I will say it this way, where employment would be. They were specific down to 137.6 million. They were specific. So at least you would be critical of the fact that they made these specific projections, at a minimum, you would be critical of that?

Mr. BIVENS. That is right. I would be more critical that they took the blue chip consensus as a given and as a good forecast, when it clearly wasn't. I don't think they were trying to break any new ground in forecasting, I think they were just trying to take off the shelf, these are reasonable things people will not argue with this forecast. And the thing they grabbed that people would not argue with turned out to be very wrong. Because frankly, most of the profession was caught very flat-footed by how bad the recession was.

Mr. JORDAN. Let me give you one quick question on that, Mr. Bivens. As an economist who supports the stimulus, if you were involved in putting this together, don't you think, wouldn't you want to come in front of a panel in Congress looking at your work product and defend it?

Mr. BIVENS. Sure, yes. Obviously the stakes for me are a lot lower, so I don't know how it would have turned out if I had been an architect of it. But yes, I think there is ample reason to defend the stimulus package on its merits, and I think it should be done.

Mr. JORDAN. Mr. Edwards, then I will move to Mr. Kucinich.

Mr. EDWARDS. Mr. John Taylor had a very good paragraph in his written testimony where he basically said, the problem with a lot of these macro models is that they assume the results that, the results are assumed, they are programmed in. So if you have a Keynesian macro model and you have a big increase in Government spending, the result is already baked in the cake that you are going to get GDP larger. And he says this is true with both the CBO model and Mark Zandi's model and other sorts of models.

I agree with Russ Roberts that we should be very suspicious of all these macro models, frankly. They are wrong, time and time again.

Mr. JORDAN. And the model to look at, frankly, is what happened. The best evidence is what actually took place, is look at the facts. Thank you.

We will go now to 5 minutes for the ranking member, Mr. Kucinich.

Mr. KUCINICH. Just building on what Mr. Edwards said about the macro models, Mr. Chairman, the Romer-Bernstein report was released a month before the Recovery Act was signed into law. What is interesting is that they had a qualification in this report, "It should be understood that all of the estimates presented in this memo are subject to significant margins of error. The uncertainty is surely higher than normal now, because the current recession is unusual, both in its fundamental causes and its severity."

So they qualified what they were saying. I think it is important that we know that, since we are focusing on that report.

I also want to say in relationship to what Mr. Brill said about high speed rail, I think it would be important for this committee to look into the relationship between commerce and transportation's role in increasing the efficiency of commerce or not. I think it is very important that we get into that, so we don't just reject out of hand certain approaches that could actually end up helping the economy. I think high speed rail is one of those discussions we ought to have.

Now, Dr. Bivens, in your written testimony——

Mr. BRILL. Could I comment on that?

Mr. KUCINICH. I have to get this question to Dr. Bivens, but thank you. Dr. Bivens, in your written testimony you state that "private sector macroeconomic forecasters are in near-universal agreement" about the positive impacts the ARRA has had on gross domestic product growth and on unemployment. We know that the non-partisan Congressional Budget Office agrees. We know that private economists like Mark Zandi agree. We know that organizations like the Center on Budget and Policy Priorities, as well as your organization, the EPI, agree.

Can you explain why so many forecasters agree about the positive results of the stimulus?

Mr. BIVENS. Yes, like I said quickly in my testimony, it is in line with a long line of research that looks at the efficacy of fiscal support provided to economies that look like the U.S. economy today, characterized by very high unemployment, very low rates of inflation, very low interest rates. When you provide fiscal support in an environment like that, the research shows that it works very well.

And I will say one thing, this idea that the results are baked into all these models, that is actually not true. These multipliers are not taken from the air, these multipliers come out of the data, when people look at the effect of fiscal support done in environments like we have today. They look at the historical record, they say, when you provided this fiscal support when unemployment was high and inflation and interest rates were low, what happened? And you use those multipliers estimated from real data. They are not plucked from the air.

Mr. KUCINICH. You characterized the Recovery Act as small, relative to the economic shock it was meant to absorb. If the stimulus was larger, do you think the unemployment rate would be lower than it actually is today?

Mr. BIVENS. Absolutely.

Mr. KUCINICH. What step does Congress need to take, in your opinion, to get more Americans back to work?

Mr. BIVENS. I think it needs to look at those parts of the Recovery Act that worked very well and continue or expand them.

Mr. KUCINICH. For example?

Mr. BIVENS. Unemployment insurance. The fact that has been extended for another 13 months as part of the deal, that is a very good thing. It is going to support a lot of jobs. I would look at some of the other safety net programs, food stamps are very good, economic stimulus, let alone.

Mr. KUCINICH. Explain why that is.

Mr. BIVENS. Essentially, the goal of economic stimulus is to get money spending quickly throughout the economy. And people who get food stamps and people who receive unemployment insurance are by definition people who are cash-strapped, they are not going to sock it away in savings, they need to spend it on necessities in the here and now. So the money circulates through the economy very quickly.

I would also say I think the infrastructure spending, which has taken a big longer to get online, that is actually a good thing. We have 9 percent unemployment today. The idea that we have missed the boat on infrastructure spending, helping the economy if a project rolls out next month, we haven't missed the boat. We are going to have very high unemployment for a very long time. The CBO says we don't get back to pre-recession unemployment until 2016. So the idea that some of these projects are still coming online I think is a very good thing.

Mr. KUCINICH. And in line with that, where Mr. Brill talked about how it takes a while for Government spending to actually get into the system, would you say that if the Government were to plan a massive rebuilding of America's infrastructure, beginning, let's say, this year, with the aim at putting Americans back to work, would you think that kind of an approach, which would parallel what happened during the New Deal with the WPA, that kind of an approach would benefit the economy, would stimulate the economy, would prime the pump of the economy and enable people to get back to work?

Mr. BIVENS. Yes. I think it would be very good in the short term, and I think it would add to productivity growth, even in the long term, and make us grow faster even when the recession is over.

Mr. KUCINICH. Thank you, Mr. Chairman. I think one of the things that we can do in our collaboration on this subcommittee is to bring people together to find out how we can create jobs to get America back to work. I look forward to working with you in that. I thank the witnesses.

Mr. JORDAN. I thank the gentleman.

I now yield to the gentlelady from New York, Ms. Buerkle.

Ms. BUERKLE. Thank you, Mr. Chairman.

Thank you all for being here this morning. A couple of questions, sort of out of context. First of all, Mr. Brill, you talked about the slowness at which the money was spent. I wondered if you had any ideas as to why it happened that way.

And then beyond that, and this is to anyone on the panel, is there a way to know how much stimulus money remains unspent at this time?

Mr. BRILL. Thank you. I think that there are a number of reasons that large amounts of the money remain unspent. Just as a point of reference, the CBO estimated last month that in the current fiscal year, fiscal year 2011, there will be $148 billion in stimulus funding, and over the remaining years of the budget window, there will be another $148 billion in fiscal stimulus spending.

The reasons for the delays I think are numerous. It depends likely agency by agency or department by Department. Many of these programs are large, complex building projects, where simply, to get the project designed and approved, put online, permitting requirements that were necessary, environmental assessments that were necessary in order for certain construction projects to begin, takes a lot of time. There are some projects that are in the midst of being completed, bridges half built. And there are certainly billions of dollars in other projects that have not yet even begun.

Ms. BUERKLE. So your estimate for the amount right now that is unspent of the stimulus money?

Mr. BRILL. Beyond the current fiscal year, is $148 billion and to be spent in this current year, an additional $148 billion. So some of that $148 billion is, we are midway into the fiscal year, so I would ballpark it at about $200 billion in unspent dollars.

Ms. BUERKLE. Thank you.

Does anyone else have a comment regarding any estimate, unspent stimulus moneys?

Dr. Bivens, my question to you, we have heard several times throughout the course of the morning that perhaps the stimulus, the amount of the stimulus wasn't enough, and that was the reason why we did not see the robust economic recovery that we had hoped for. My question to you is, if the intention was to keep unemployment, say, at 6 or 7 percent, what would that amount, what should the amount of the stimulus have been? What could we have spent to achieve that rate of unemployment?

Mr. BIVENS. To achieve that rate of unemployment, it may have been impossible to ever keep unemployment going above 7 percent, given the quickness and the severity of the shock from the housing bubble. That said, I think the economy could have easily absorbed a stimulus package almost twice as big, say, $1½ trillion, without running into the remotest risk of, say, overheating the economy or providing too much support or doing anything like sparking higher inflation or high interest rates, which is supposed to be the downside of doing too much fiscal support. We could have had a stimulus package twice as big and not even flirted with any of those troubles.

Mr. EDWARDS. Can I make a comment on that? One of the problems I see with this sort of Keynesian stimulus approach is that economists like Mark Zandi and others, they say, oh, we supported this big stimulus and it has gotten the Government much deeper into debt, which is going to create this giant burden in the future on young people. At the same time, people like Mr. Zandi are saying, oh, we need a plan to reduce spending and get these deficits under control, we need a credible plan to reduce these deficits.

If you are a Keynesian economist, you can never have a credible plan to reduce deficits, because we might have a recession again in 2013 or 2014, and what would Mr. Zandi want? He would want another trillion dollar stimulus. You can go on this endless cycle, stimulus, stimulus, stimulus. I think it is a complete dead end. I think there is a giant moral judgment being made that for some reason, Congress thought that goosing people's income and consumption now during this recession was a lot more valuable than the damage and harm that is going to be done by young people with this heavy burden of taxes and deadweight losses and interest payments that they are going to have to bear.

So a short-term goose for long-term pain, I don't think that Congress should be in the business of making that sort of value judgment.

Ms. BUERKLE. Thank you very much. I yield back.

Mr. JORDAN. I Thank the gentlelady.

The gentleman from Idaho, Mr. Labrador, is recognized.

Mr. LABRADOR. Mr. Busch, we keep hearing about this consensus among the forecasters. Do you agree with Dr. Bivens that there is a consensus amongst the forecasters that the stimulus had a net positive effect? In your opinion, were financial markets aided by the stimulus?

Mr. BUSCH. Right, I think there is a consensus among Keynesian economists that it had an effect. One of the things I wanted to point out, and I am sorry I screwed up my testimony, but one of the things I would like to see, if we are to believe Romer's model and the way that they formulated it, why don't we extend it further and look at her research that she did on taxes? Because if you look at the stimulus bill and you say, well, we spent $800 billion, that is great, it does this and this and this, but you don't tell the whole story. That money has to come from some place.

If we use Romer's research and let's say, the United States borrows 40 cents on every dollar. So that means of $800 billion, you are looking at the borrowing of $280 billion. And if it is a negative three to one, you are back to $600 billion, and you are only going to use $200 billion of the $800 billion as any kind of stimulus.

I would love to see that in bills put forward into Congress. Any time you are looking at spending, have the effect of how much you are going to borrow to pay for this and what the downside in taxes is going to be. Because I think that would really focus and clarify for a lot of the members the impacts.

So I would disagree, again, with the Keynesians, that is what they argue, they only fail because we didn't spend enough. The financial markets looked at it this way, that way more than what Congress did, there were beneficial effects from what the Federal Reserve did on a short-term basis. But both what Congress has done and what the Federal Reserve has done come with costs. Congress obviously has to find a way to pay for what they did. The Federal Reserve will find a cost in inflation very soon, if not already, by what they are doing.

Mr. LABRADOR. Mr. Brill, do you have any comments about that?

Mr. BRILL. I would just add the fact that the argument that was put forth in the but-for case is a tricky one. It is actually a tricky one on both sides. I think that we shouldn't have too high expectations for economists to be good fortune tellers, especially at turning points in the economy. But the lesson from that, I think, is that Congress needs to be wary. We live in a world where there are business cycles, and there will be a recovery and there will be a future recession. When we come to the next point where economists are concerned about the economy, and it seems that we are in recession, there will be calls again for fiscal stimulus.

We should keep in mind that it is difficult to predict what the future course of the economy is going to be. Therefore, it is difficult for Congress to craft policies, both to envision the right policy as well as for the executive branch to execute on those policies. As was discussed in the previous panel, stable fiscal policy, policies that have low tax rates, low marginal tax rates, and stable low spending rates, not policies that have huge, ballooning deficits like the ones we face, are the ones that are likely to minimize the business cycle risks that we face.

Mr. LABRADOR. Dr. Bivens, is there a moment where we are spending too much? You are saying, I was really surprised to hear that unemployment insurance and food stamps actually creates jobs. That to me was pretty incredible to hear. Is there a moment that we spend too much money on these things? Because I think if we are spending $100 billion, if we create so many jobs, why not spent $1 trillion? Why not spend $5 trillion? If spending Government money is creating jobs, then let's spend it all.

Mr. BIVENS. That is pretty easy. You reach the limit when you run the risk of overheating the economy by sparking inflation or high interest rates. That is the textbook case for macroeconomics, you provide fiscal support until you run the risk of overheating the economy in that way. And we are in no danger of doing that. Core rates of inflation are at 60-year lows. Interest rates are at 60-year lows. We are just running into none of the danger signs of having done anything like too much.

So $5 trillion, yes, I think that would be too much. I think in terms of the current political debate, we are in absolutely zero danger of doing too much and overheating the economy through too much fiscal support.

Mr. BUSCH. Could I just make one quick comment on that?

Mr. JORDAN. Sure.

Mr. BUSCH. Greece felt the same way at some point. And I think that is really the issue. At some point, the financial markets are not going to allow the United States to borrow indefinitely at the rates that they are. So if you try to expand and again, expand budget deficits, at some point they are going to turn on you. And again, the United States is borrowing at exceptionally low interest rates. That could change, as we have seen since November when interest rates have gone up 100 basis points.

Mr. JORDAN. And if you question the Federal Reserve chairman, he would indicate that they can pull back at the appropriate time. I think that is a big if. But that is the argument that you hear, and I would assume Dr. Bivens would say that.

But again, I think that is scary, when you are looking at a handful of people who think they can out-guess and out-perform and guess and have the right timing and beat the market and figure out ahead of the—I just think that is a scary place to go.

One last thing, if I could. Mr. Brill, you gave a $200 and some billion figure. The facts that we are getting, or the numbers we are getting on stimulus dollars that have not been spent are much less than that. We are hearing 92 percent of the stimulus dollars are out the door.

So I assume some of those moneys are already-obligated dollars, but haven't been out the door, but they are already in contract? Tell me, if you would, where you are getting that number, real quickly.

Mr. BRILL. Sure, exactly, the difference being the allocated funds versus dollars spent. So the Government has successfully decided what to do with most of the money, 2 years after enactment.

Mr. JORDAN. But hasn't written a check?

Mr. BRILL. But hasn't actually written the check.

Mr. JORDAN. Thank you.

I want to thank the witnesses for your insight, and appreciate your spending some time with us.

We are adjourned.

[Whereupon, at 12:05 p.m., the committee was adjourned.]

[The prepared statement of Hon. Ann Marie Buerkle follows:]

Subcommittee on Regulatory Affairs, Stimulus Oversight and Government Spending

"The Stimulus: Two Years Later"

February 16, 2011

U.S. Representative Ann Marie Buerkle, Vice-Chairman

February 16, 2011

In a February 5, 2009 Washington Post op-ed, President Obama wrote that his stimulus program would "create or save more than 3 million jobs over the next two years, ..., ignite spending by businesses and consumers alike, and take steps to strengthen our country for years to come." ("The Action Americans Need").

When he wrote that piece two years ago, unemployment stood at 8.2 percent. It has now been over 9 percent for more than 20 months. Instead of saving or creating 3 million jobs, 3 million more Americans are out of work. Rather than strengthening our country, the national debt has ballooned by more than 30 percent since that op-ed. The unchecked growth in government is leading to budget deficits that are crippling the economy, usurping individual freedom and displacing private sector initiative.

So much for predictions.

There was always something fundamentally flawed with the notion that removing close to $1 trillion dollars from the private sector economy through taxes and deficit spending to be redistributed by the government back to the private sector, and even worse to states and localities for make work projects, would somehow stimulate that from which it came. Removing water from one end of a swimming pool and pouring it in the other end will not raise the overall water level - no matter how large the bucket.

I look forward to today's testimony, not only to assess the stimulus program two years later, but to learn what could have been done differently and what should be done going forward to produce an economic climate for true job creation.