

## Fiscal Policy

Has it worked?  
Is more needed?

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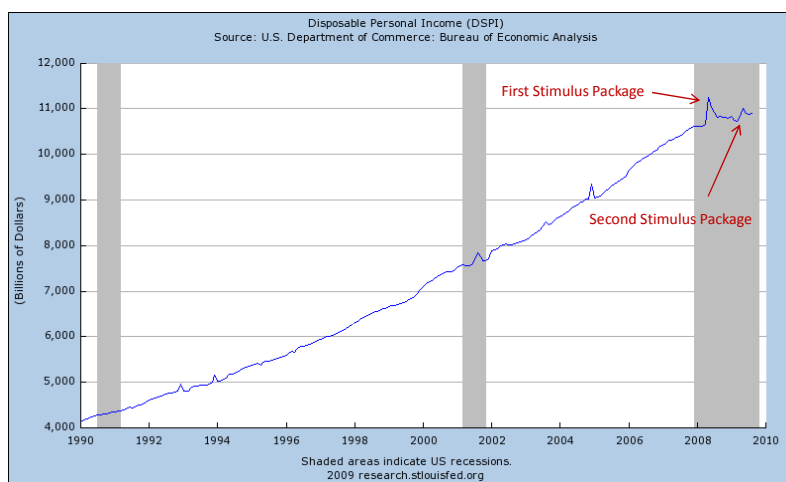
## What is Fiscal Policy?

- A text book definition would be something like: A plan for government spending and taxes designed to achieve some goal.
- So there are two components, spending (the government buying goods and services) and taxes (net of transfers).

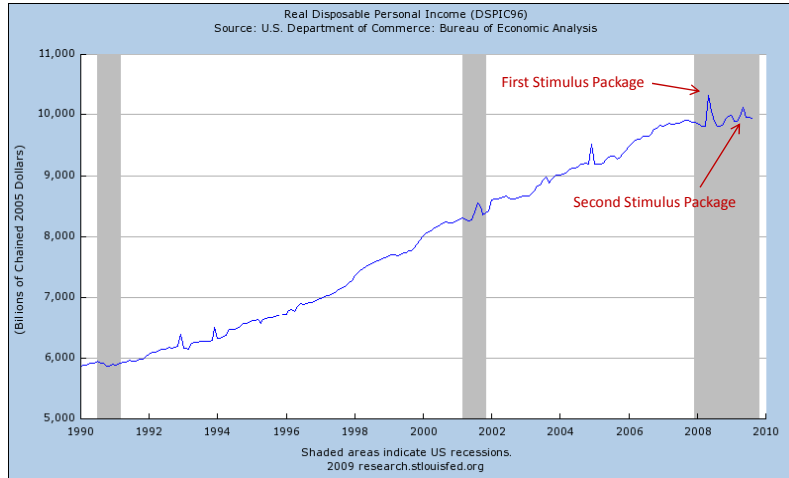
## How Does Fiscal Policy Work?

- Multiplier effects
- Government spending and tax multipliers can differ
  - Speed of impact
  - Size of impact
  - Effects on economic growth
- Graphs of Disposable Income and Government Spending

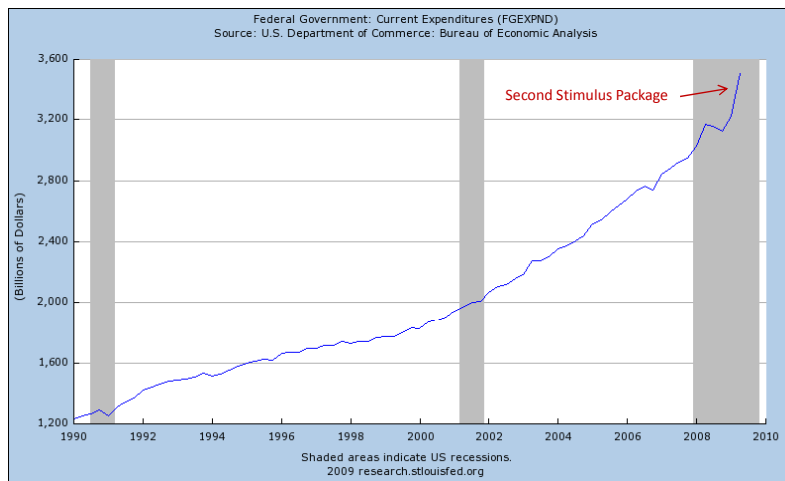
### Disposable Personal Income 1990:M1 – 2009:M8, Nominal



### Disposable Personal Income 1990:M1 – 2009:M8, Real



### Federal Government Expenditures 1990:Q1-2009:Q2



## Multiplier Estimates

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

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

<u>Quarter</u>	<u>Government Purchases</u>	<u>Tax Cuts</u>
1	1.05	0.00
2	1.24	0.49
3	1.35	0.58
4	1.44	0.66
5	1.51	0.75
6	1.53	0.84
7	1.54	0.93
8	1.57	0.99
9	1.57	0.99
10	1.57	0.99
11	1.57	0.99
12	1.57	0.99
13	1.57	0.99
14	1.57	0.99
15	1.57	0.99
16	1.55	0.98

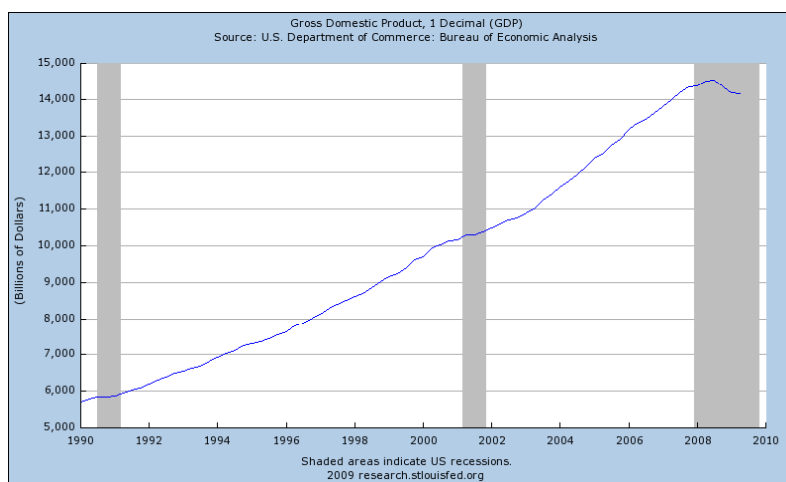
## What Can Go Wrong?

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

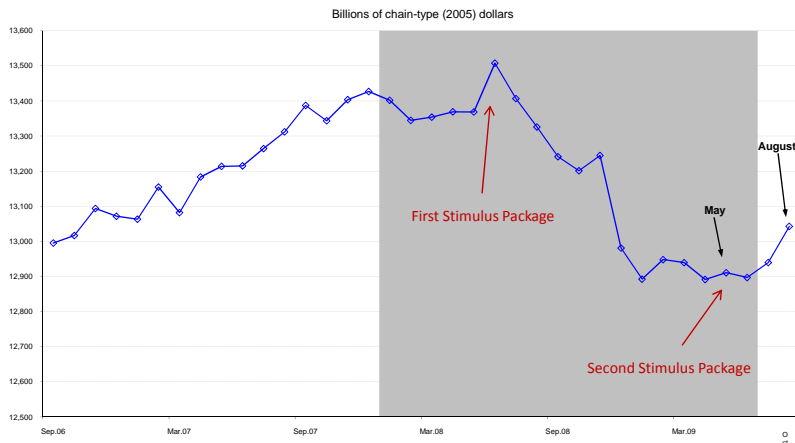
## Has it worked?

- To assess whether it has worked, need a baseline (what would have happened without policy)
- What is the baseline?
- We don't know, it must be estimated
- Estimates are model dependent
- Evidence

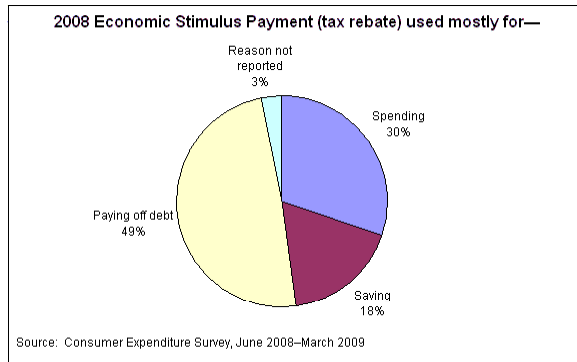
## Real GDP 1990:Q1 – 2009:Q2



### Monthly GDP Estimates (from Macro Advisers)



### Tax Rebates and Consumption



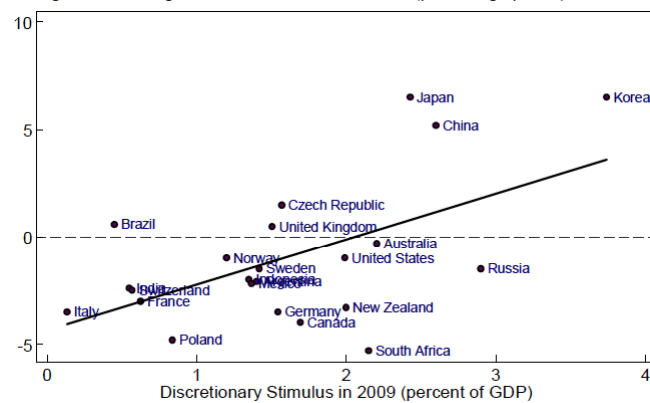
## Other Evidence?

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

## Cross-Country Evidence

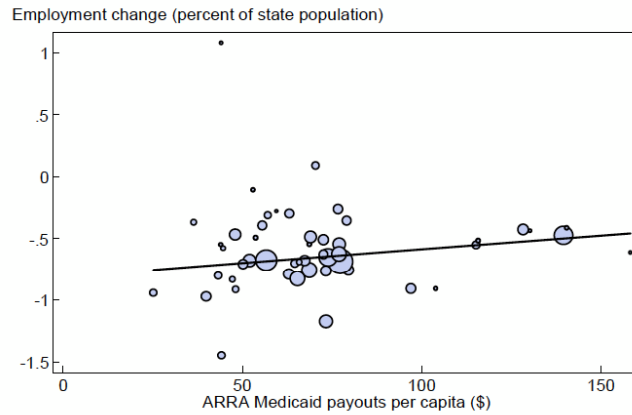
### Stimulus around the Globe

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



### States that Spent More Had a Bigger Employment Change

Employment Change and ARRA Medicaid Spending by State



### Estimated Effects of ARRA

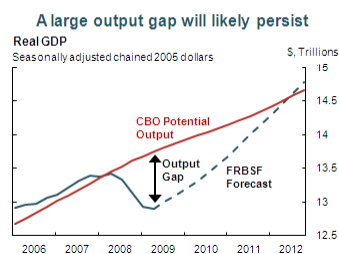
#### Contribution of the ARRA to GDP Growth in 2009:Q2

<u>Forecaster</u>	<u>Estimate (percentage points)</u>
Goldman Sachs	2.2
Economy.com	3
Macroeconomic Advisers	2

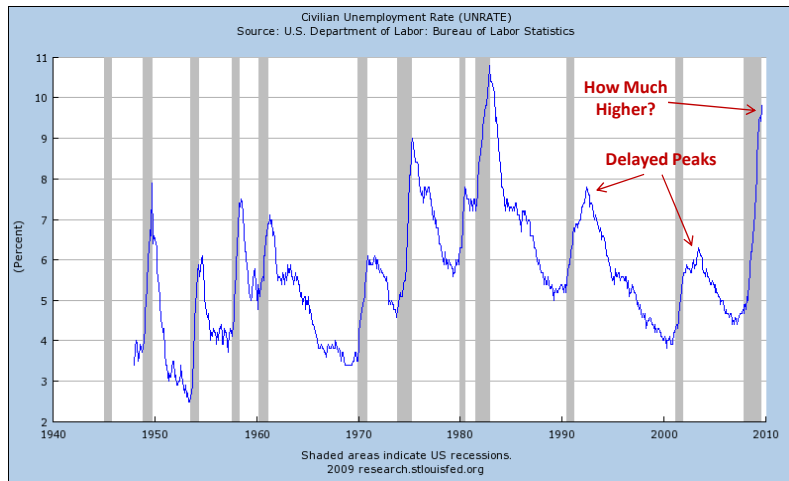
## Is More Stimulus Needed?

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

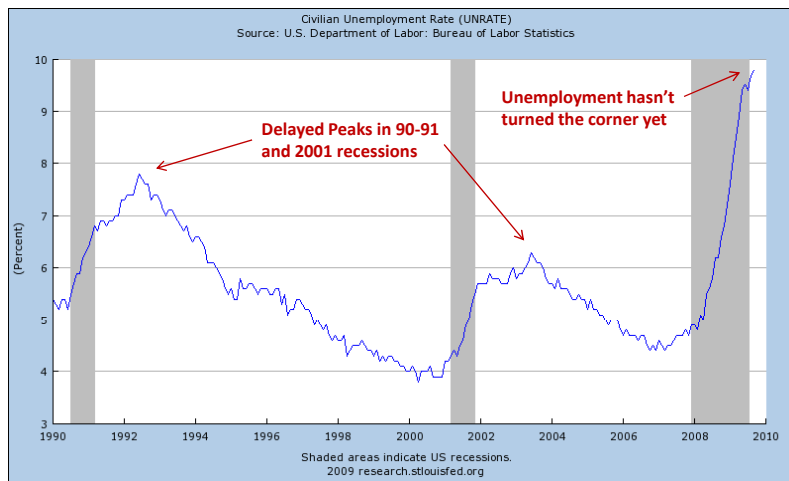
## FRBSF Estimates of Recovery Trajectory



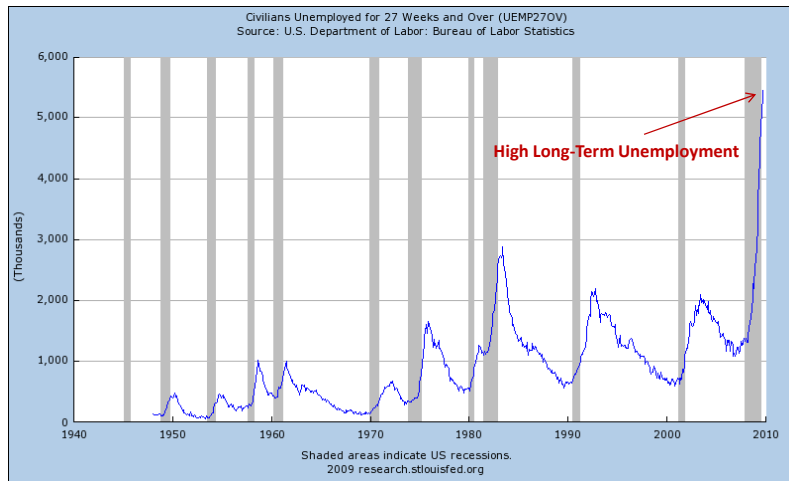
### Unemployment Lags Output



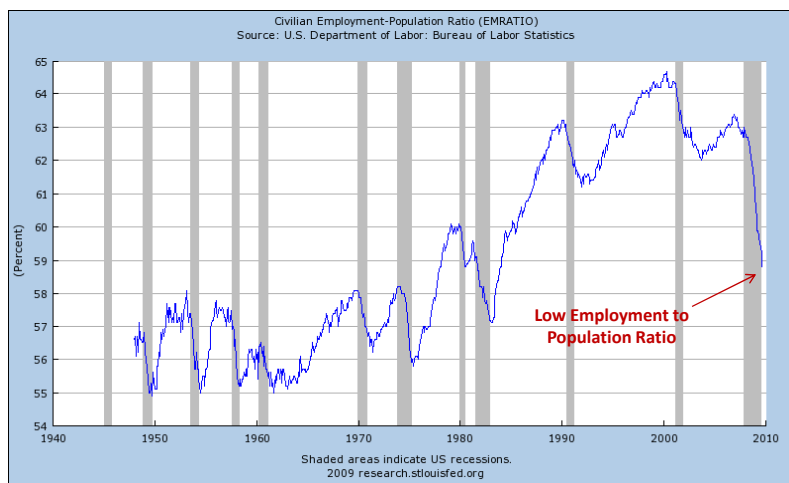
### Unemployment Since 1990



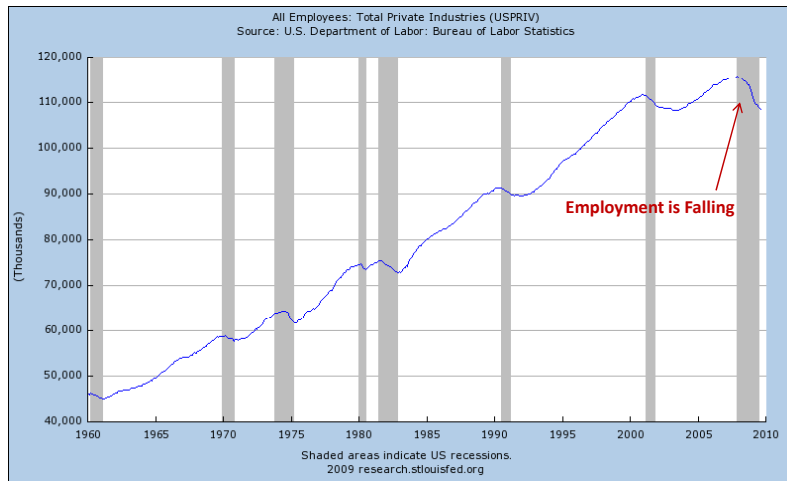
### Long-Term Unemployment



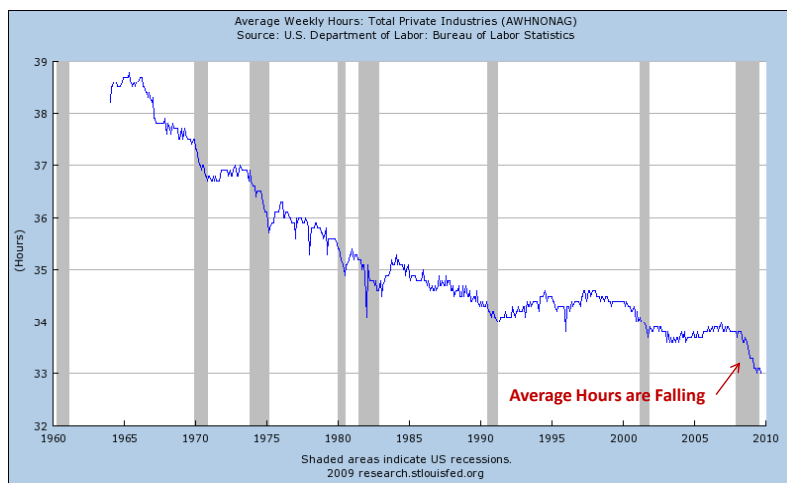
### Employment to Population Ratio



### Private Employment



### Average Weekly Hours: Private Industry



## Conclude

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