

Fiscal Intervention and Recovery in the United States (and Nevada)

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Putting the Rise and Fall of GDP into Real Per-capita Terms

	2007:4	2009:2	2011:2	2007-09 Change	2009-11 Change	2007-11 Change
Gross Domestic Product (billions)	14,253	13,854	14,997	-2.8%	8.2%	5.2%
GDP Deflator (2005=100)	107	110	113	2.5%	3.2%	5.7%
Population (millions)	303	307	312	1.3%	1.7%	3.0%
Real Per-capita GDP (2005 dollars)	\$43,956	\$41,163	\$42,469	-6.4%	3.2%	-3.4%

The "recession" officially ended in mid-2009, when real GDP stopped falling. But real GDP has yet to catch up to where we were in mid-2007, and we are still 3.4% below 2007 in real per-capita terms.

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Interpreting the Numbers

It helps to remind ourselves of what is normal:

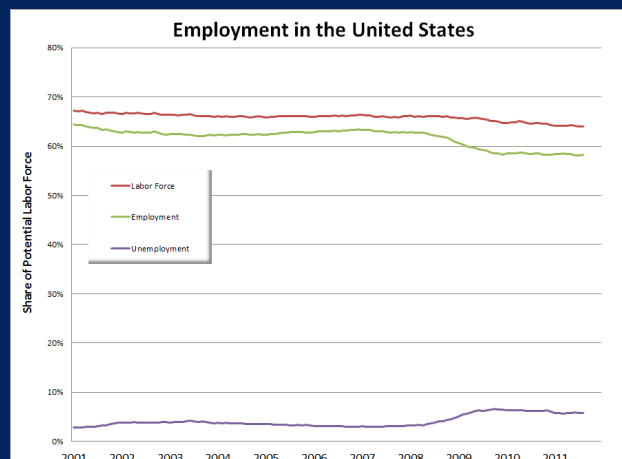
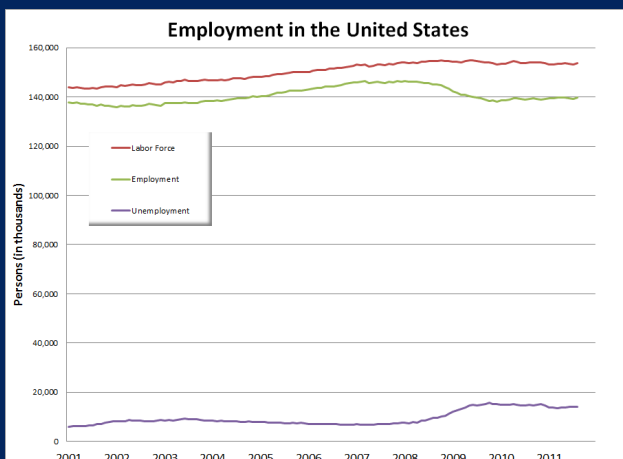
<u>Average Annual Rates of Change:</u>	<u>1999-2007</u>	<u>2007-2011</u>
Nominal GDP Growth	5.1%	1.5%
Price Inflation (GDP Deflator)	2.6%	1.6%
Population Growth	1.0%	0.8%
Growth in Real Per-capita GDP	1.4%	-1.0%

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Eight Million Jobs Lost



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Unraveling the Mythology

“It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so.” – Mark Twain

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Myth 1: *This was a normal recession that government intervention made worse.*

- This was a depression averted, not a recession extended.
- Depressions are serious recessions caused by financial crises. They tend to be associated with price deflation and interest rates near the zero lower bound.
- Government may have failed to do enough, but acts of omission are not the same as acts of commission.

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The Great “Balance-Sheet” Recession

- Depressions were common in U.S. before 1945, deeper and longer.
- A recession caused by a financial crisis leads government to become the borrower of last resort (Minsky).
- A “balance sheet” recession causes banks to collect reserves to offset bad debt, rather than lend (Koo).
- Internationally, recessions caused by financial crises tend to be more severe, though fiscal intervention may reduce severity. After seven years, on average, GDP is still down 10% or more.

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Myth 2: The U.S. government tried fiscal policy to stimulate the economy, and it failed.

- A fiscal policy intervention attempts to make up for decreased private demand by increasing government demand.
- After 2007, the federal government did increase the goods and services it purchased, mostly due to the 2008 Surge in Iraq.
- The increase in federal purchases was canceled out by the decrease in state and local government purchases. Real per-capita government purchases fell from 2007 to 2011.

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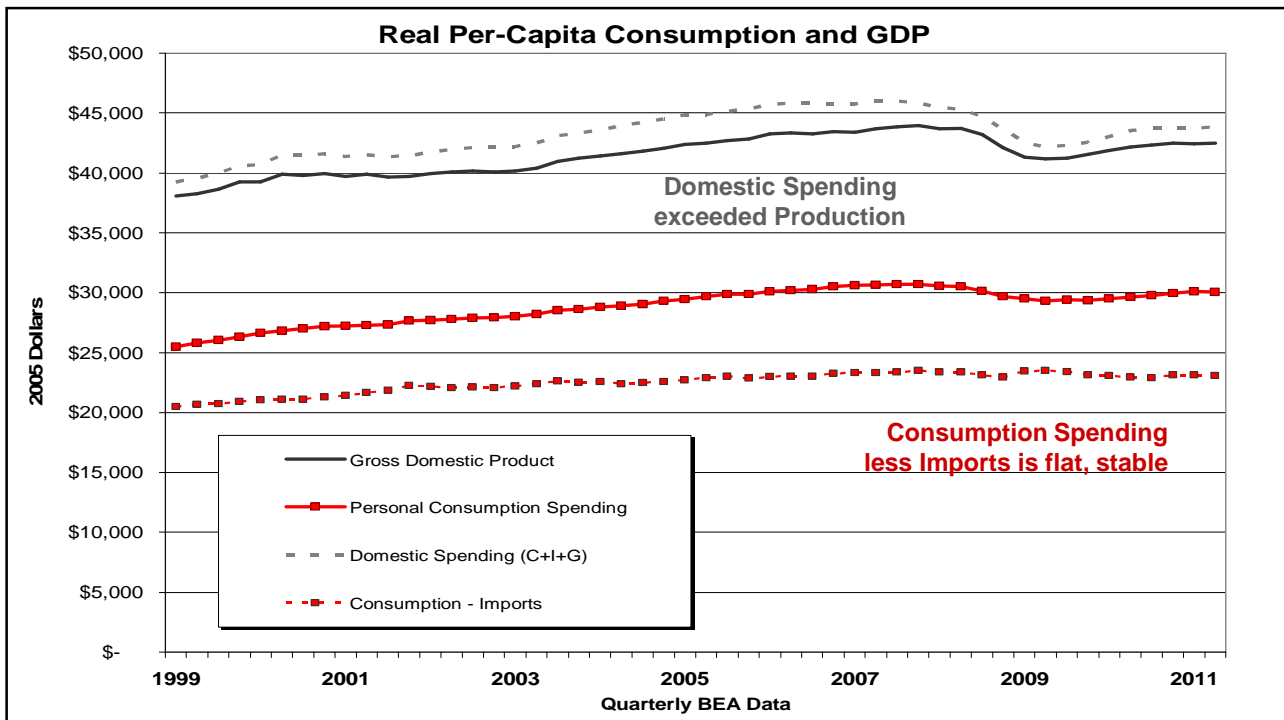
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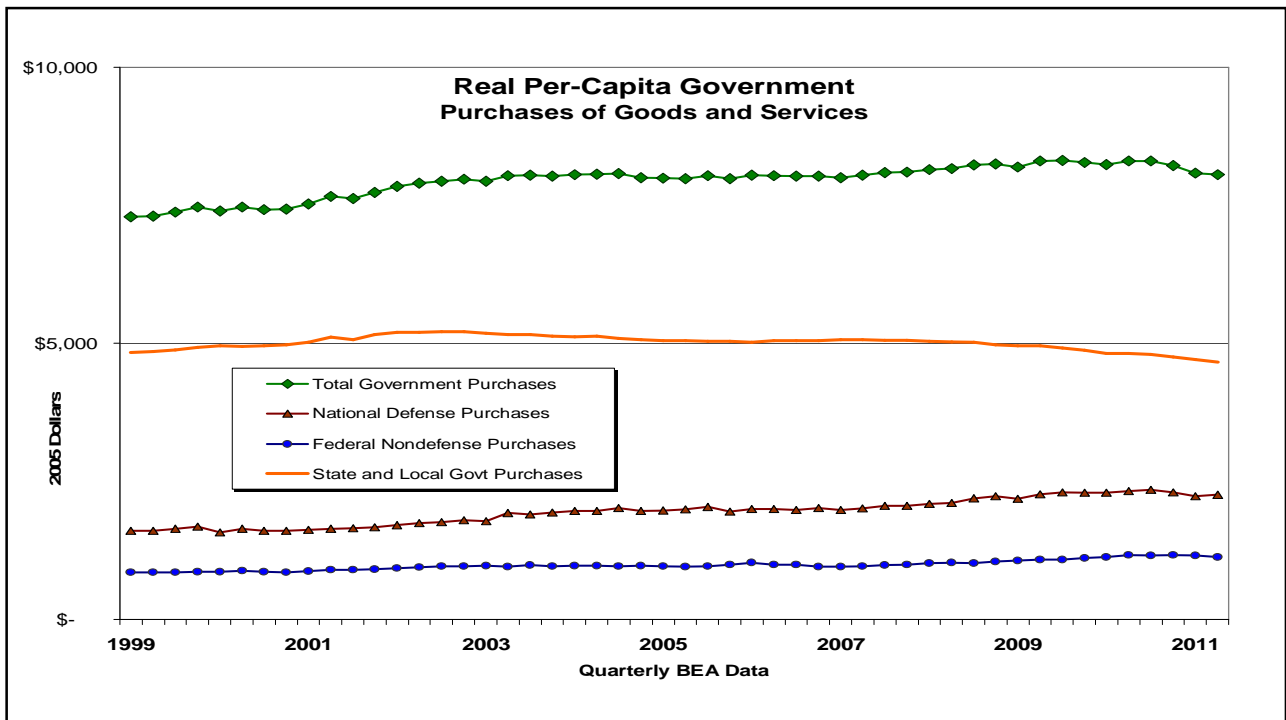
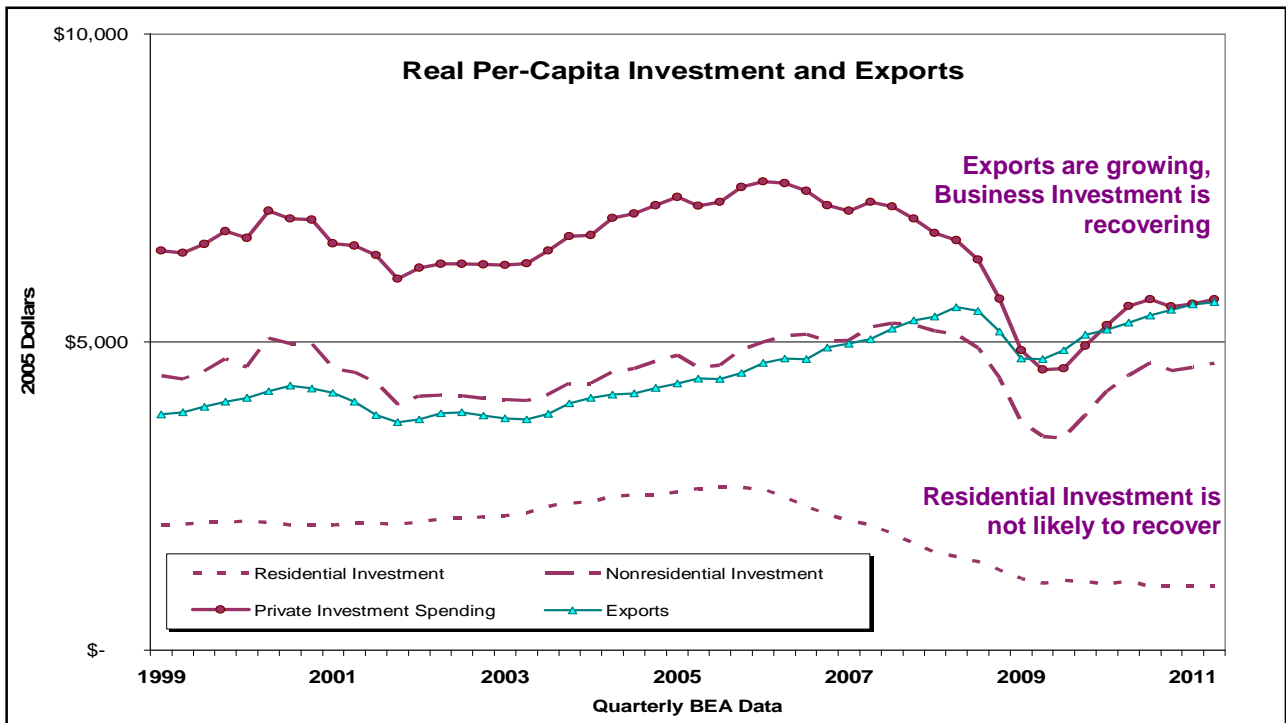


Consumption and Investment sank, Trade too. Federal Government purchases rose, but State & Local Government spending fell.

Billions of 2005 Dollars	2007:4	2009:2	2011:2	2007-09 Change	2009-11 Change	2007-11 Change
Gross Domestic Product	13,326	12,641	13,261	-5.1%	4.9%	-0.5%
Personal Consumption	9,313	8,999	9,387	-3.4%	4.3%	0.8%
Residential Investment	523	334	324	-36.1%	-3.1%	-38.1%
Nonresidential Investment	1,600	1,063	1,454	-33.6%	36.8%	-9.1%
Exports	1,622	1,449	1,763	-10.6%	21.6%	8.7%
Imports	2,187	1,781	2,184	-18.5%	22.6%	-0.1%
National Defense Purchases	622	696	706	11.8%	1.5%	13.4%
Fed. Nondefense Purchases	300	333	353	11.2%	5.7%	17.6%
State & Local Govt Purchases	1,533	1,521	1,456	-0.8%	-4.3%	-5.0%

Remember, population grew 3.0% from 2007-2011.





Total Government Purchases fell, while Transfer Payments jumped.

<i>Real Dollars Per Capita</i>	2000:4	2007:4	2009:2	2011:2	2007-09 Change	2009-11 Change	2007-11 Change
National Defense Purchases	1,577	2,011	2,193	2,196	9.1%	0.1%	9.2%
Federal Nondefense Purchases	866	949	1,039	1,075	9.6%	3.4%	13.3%
State and Local Govt Purchases	4,985	5,139	5,058	4,763	<u>-1.6%</u>	<u>-5.8%</u>	<u>-7.3%</u>
Total Government Purchases	7,427	8,099	8,290	8,033	2.4%	-3.1%	-0.8%
Transfers (Net)	5,074	5,263	6,039	6,430	<u>14.7%</u>	<u>6.5%</u>	<u>22.2%</u>
Total Government Expenditures	12,501	13,362	14,329	14,463	7.2%	0.9%	8.2%
Total Government Revenues	13,351	12,482	10,412	10,991	-16.6%	5.6%	-11.9%
Net Surplus/Deficit	849	-880	-3,917	-3,472			

Why *did* government spending increase?

- The increase in *net* government spending is entirely due to increased transfer payments. The lion's share of this was due to increased spending on unemployment benefits.

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Nominal Change in Federal Budget, 2007-2010

Budget Function Area	Change in Millions	Real Growth Per Capita
Income Security	256,235	+59%
National Defense	142,315	+18%
Social Security	120,584	+13%
Healthcare	102,672	+30%
Medicare	76,229	+12%
<u>Everything Else</u>	<u>29,492</u>	<u>-2%</u>
Change in total outlays	727,527	+18%

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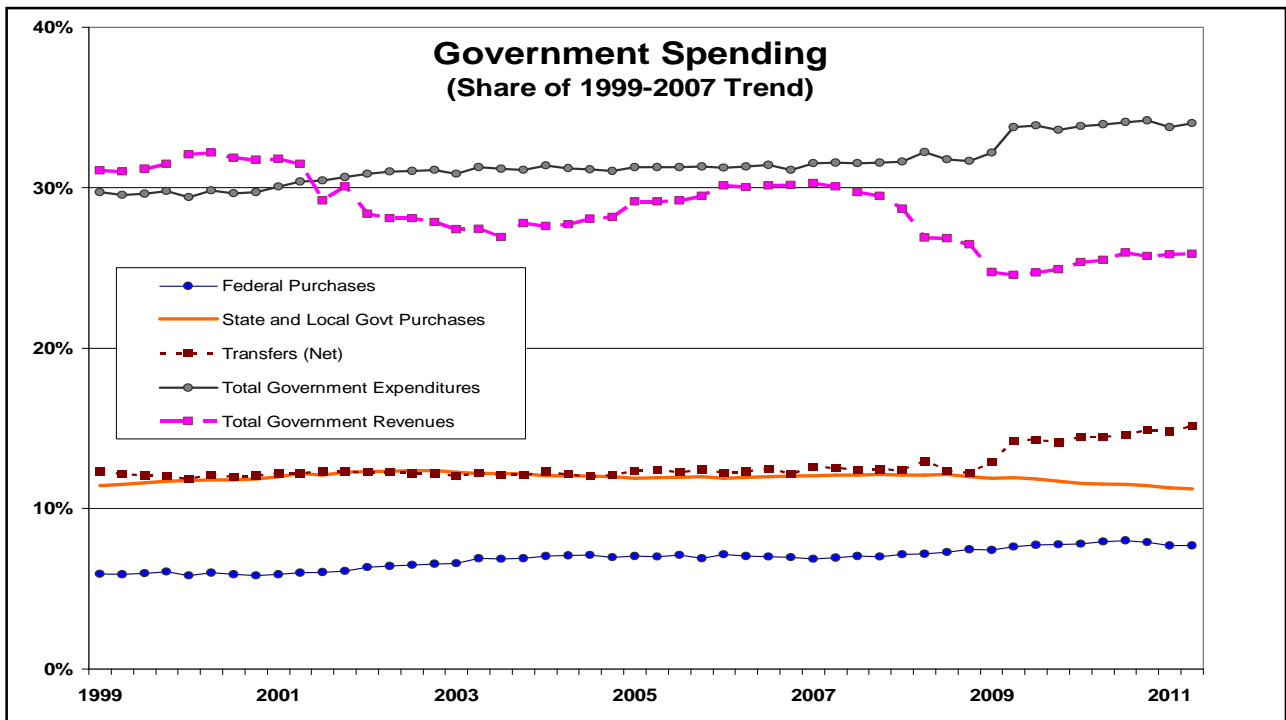
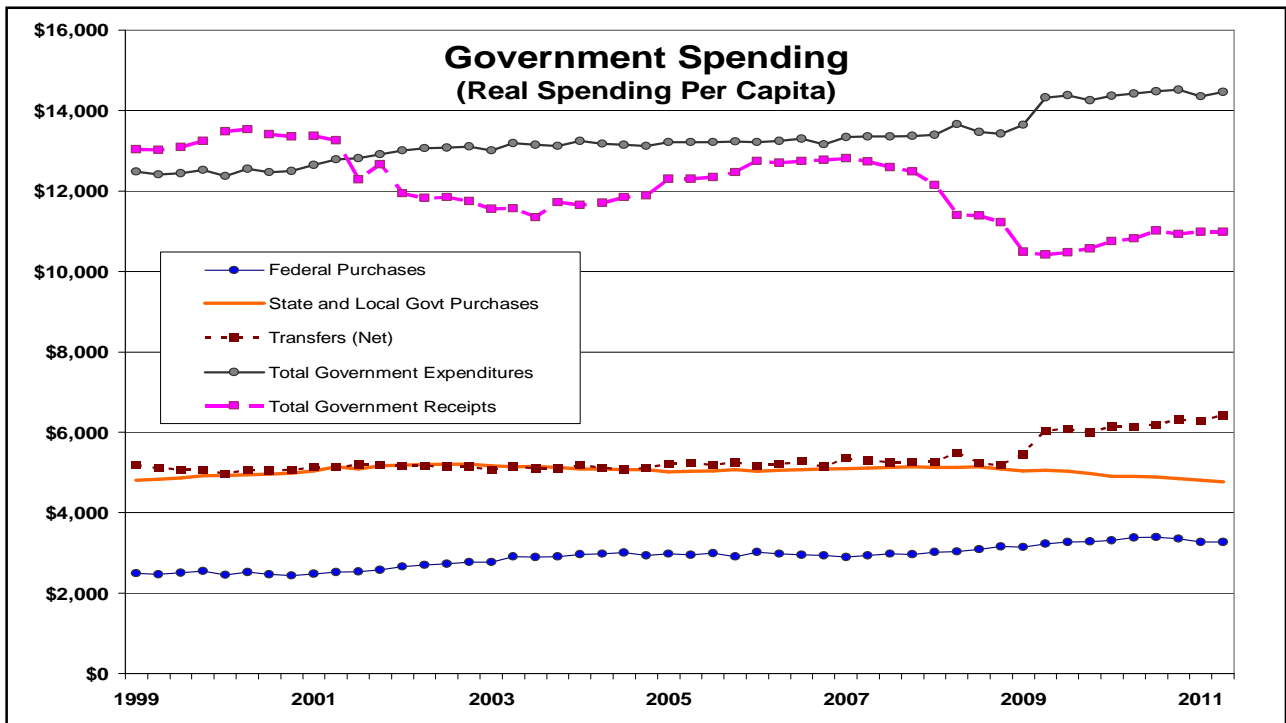
Myth 3: *The Budget deficit resulted primarily from increased government spending.*

- Perhaps if you divide by GDP, but GDP fell: ratios look bigger.
- Whether you measure it in real per-capita terms or divided by the 1999-2007 trend in GDP, the decrease in taxes collected was much larger than the increase in transfer payments.
- Taxes collected fell due to:
 - 1) the 2001-2003 tax cuts,
 - 2) the recession, and
 - 3) the 2008 ESA and the 2009 ARRA.

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How Quickly Can Things Change?

In Jan. 2001, Alan Greenspan testified,

“The most recent projections from the OMB indicate that, if current policies remain in place, the total unified *surplus* will reach \$800 billion in fiscal year 2011... despite the budgetary pressures from the aging of the baby-boom generation, especially on the major health programs.” He urged Congress not to pay off the entire federal debt.

- With good (or bad) policies, things can turn around within a few years.
- The U.S. has had a privileged position for decades, in terms of our disproportionate share of world GDP and the primacy of our financial markets. This is not sustainable even in the best of circumstances.

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How does the U.S. compare?

- In 1996, U.S. government outlays were 35% of GDP, lowest of any OECD country (OECD average was 48%).
- In 2009, outlays were 38% (EU average grew from 46-51%).
- In the U.S., only 15% of the labor force is employed by government – less than 2% by the federal government (not including less than 1% on active duty), most of the rest in local government. This is much less than most developed economies.

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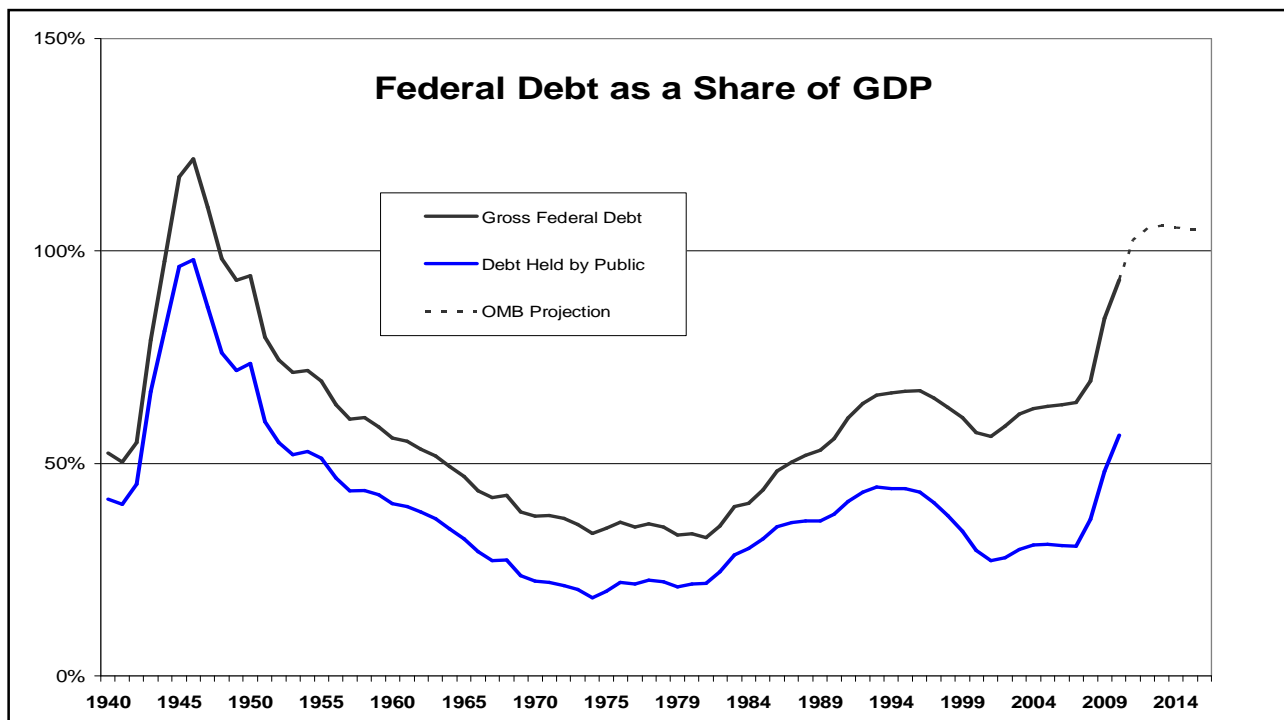


Myth 4: *The growth of the federal debt is unprecedented, at least in peacetime.*

- We are not in peacetime.
- As a percentage of GDP, the growth in the federal debt from 2007-2010 is less than the growth from 1981-1993. It is only larger if we include the increase from 2001-2007 and the projections for the next few years.
- The debt includes what we owe to government agencies (mostly the Social Security Administration) and the Federal Reserve System. The debt held by the public is about half as much (half of *that* is owed to foreigners).

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Myth 5: *Borrowing is bad.*

- Borrowing for investment makes sense, if the return on investment exceeds the cost of borrowing: the Federal government can now borrow at 2% for 10 years.
- Borrowing in bad times, to smooth out consumption, makes sense.
- Borrowing in good times for consumption is dumb.
- Many of the same voices opposed to borrowing now were silent before 2007, while we were funding two wars while cutting taxes and borrowing from abroad. Why?

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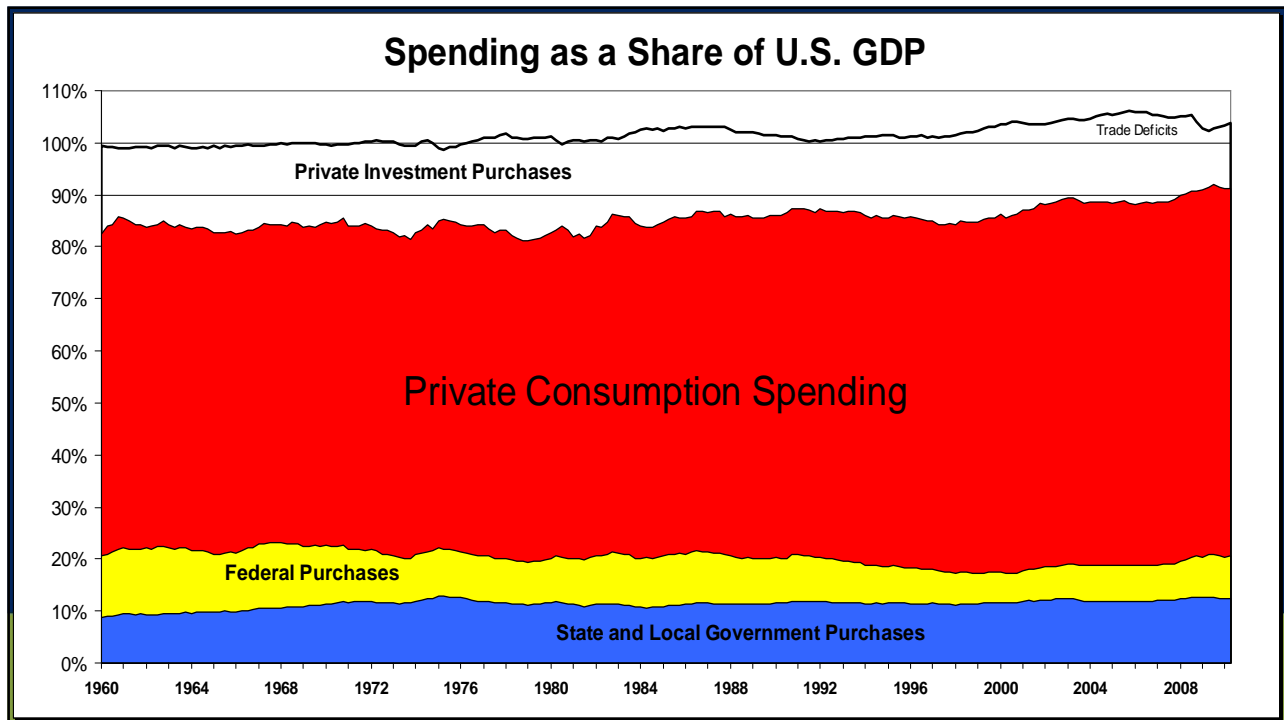


Myth 6: *We need to recover back to where we were.*

- There is a conflict between the short-run goal of stabilizing the economy and fighting unemployment, and the long-run goal of having a sustainable economy.
- Through 2007, Americans saved too little and consumed too much. We borrowed from abroad, causing trade deficits.
- We don't want consumption to fall – that makes income fall too – but we don't want it to be our engine of recovery either.

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What Should We Do?

- First, get real. Distorting facts may make you politically popular, but it doesn't help us find answers that work. Hyperpartisanship is ruining our country.
- We need investment (both public and private), in factories, infrastructure and education.
- We need banks to start lending again; exports to catch up with imports; the federal debt to stop growing faster than the economy; and finally, we need confidence.

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Promoting Exports?

- Exports are growing, and we need that to continue.
- We also need to restrain import growth. However, this must be done through increasing savings and devaluing the Dollar, not protectionism.
- Protectionism decreases imports, but also decreases exports. The result is worldwide economic contraction.
- This will be difficult as long as the world economy struggles: the Great Recession exposed many problems abroad, and these ripples keep coming back.

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What Have We Tried?

- American Stimulus Act (Bush, Spring 2008)
- Emergency Economic Stabilization Act (Bush, Fall 2008)
- American Recovery and Reinvestment Act (Obama, Spring 2009)
- Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act (Obama-GOP Deal, Dec. 2010)
- Federal Reserve Bank's monetary interventions
- Currently Proposed: American Jobs Act

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Fiscal Intervention

- Economic Stimulus Act of Feb. 2008:
 - Tax rebates for 2008, estimated \$150B cost (about 1% of GDP) in 2008.
- American Recovery and Reinvestment Act of 2009:
 - Estimated \$800B cost over several years, with less than \$200B spent in FY 2009, and \$400B in FY 2010 (about 3% of GDP).
 - About 40% in tax credits, 30% in state fiscal support, and 30% in infrastructure investment (education, energy, health care) plus some extended benefit support.
 - Some parts were more effective than others, but there is a big difference between slowing the decline and turning the whole ship around.

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Bank Bailouts

- Emergency Economic Stabilization Act:
 - \$700 billion authorized in October 2008. Only \$550B used.
 - TARP funds began with plan for purchase of troubled MBS, but changed to an equity purchases approach, with restrictions over executive pay.
 - \$270B went to AIG, GM, Wells Fargo, Citigroup, BoA, JPMorgan Chase, Morgan Stanley, and Goldman Sachs.
 - \$27B went to over 600 banks (\$300K-\$968M)
 - Majority has already been paid back, with interest.

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Monetary Policy

- Bernanke Doctrine: Avoiding deflation at all costs.
- Fed tripled the Monetary Base because banks stopped lending: deposit expansion multiplier fell by more than half.
- Fed purchases other assets, not just government bonds.
- Federal funds rate near zero, interest paid on reserves.
- QE1, QE2, and QE3 – active monetary expansion, not passive.
- Operation Twist – shifting portfolio to long-run bonds.
- The Opposite of Hyperinflation.

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Did the Stimulus Work?

- YES, as a parachute, not a rocket. The damage done to the financial sector should have caused a much worse recession, but the economy stopped shrinking in mid 2009, and deflation was avoided. Still, infrastructure spending was too slow, and extending tax cuts had very little bang for the buck.
- State and local spending cuts, however, have canceled out most of the federal government's stimulus. Those revenues are starting to stabilize, so future cuts won't likely be as dramatic.

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Is cutting taxes again a good idea?



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Current Stimulus?

- The Obama-GOP Deal: extending Bush tax cuts for two more years (\$240 billion) and adjusting AMT (\$140 billion) in exchange for extending unemployment benefits and cuts in payroll tax (\$170 billion).
- Current Obama proposals: extending payroll tax cuts, for workers and firms; other tax breaks for investing, hiring new workers, veterans, long-term unemployed; national infrastructure bank; school infrastructure, et cetera (\$450 b). To be paid for by eliminating Bush tax cuts for the wealthy.

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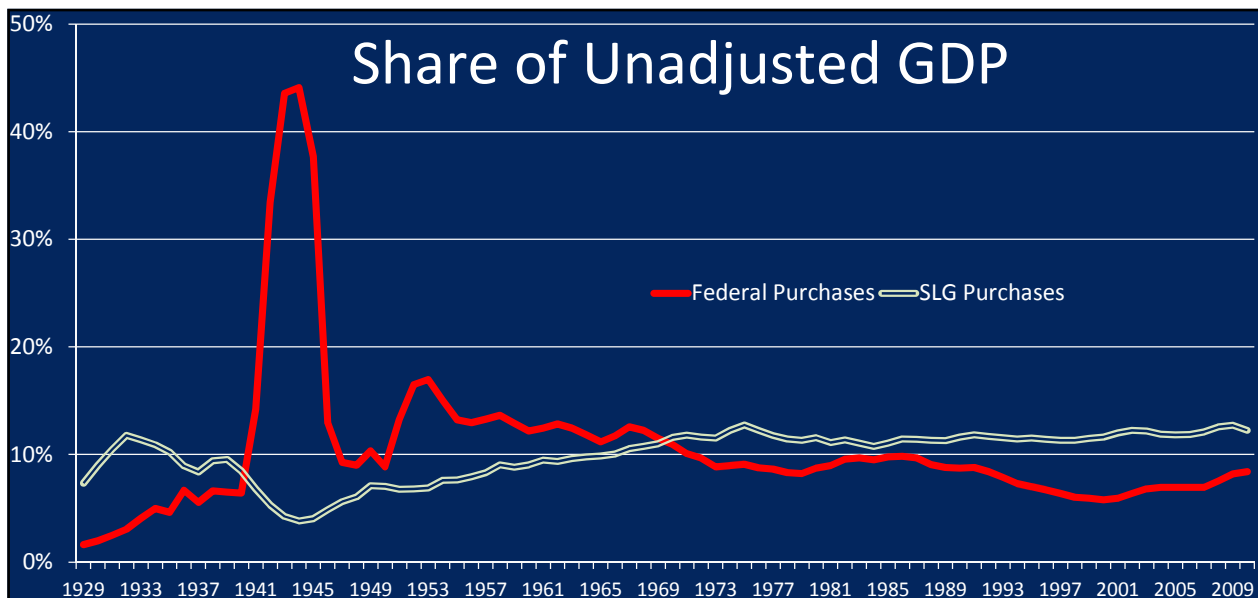


Fifty Herbert Hoovers

- State and local governments are often ignored.
- SLGs purchase more goods and services, and employ more people, than the federal government.
- Most SLGs have balanced budget requirements, which means they must either cut spending or raise taxes during recessions.
- SLG financial crises lag the rest of the economy.
- Estimates: cuts to SLG lead to twice the fall in GSP the next year.

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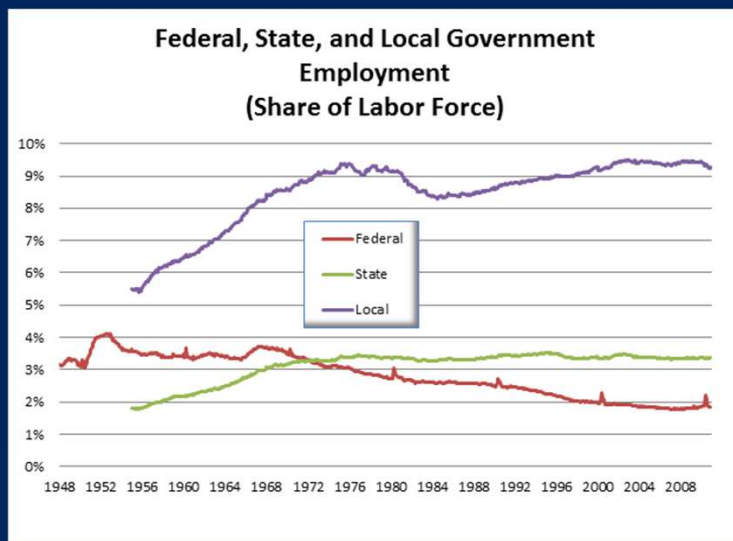
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Spending cuts have more effect than tax increases.

It should therefore be no surprise that when SLGs are cutting as the Feds are spending, the economy does not recover very fast.

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What happened to Nevada?

- Gaming was a sustainable model, until monopoly ended.
- Las Vegas maintained growth by building new properties, but gaming/hotels/tourism still a falling share of state economy.
- Rapid construction was not sustainable: building homes for other construction workers, dependent on California bubble.
- Low educational attainment: supply and demand.
- Relatively undiversified economy: little public investment.
- State and local government revenues reliant on gaming tax, narrow-based sales tax.

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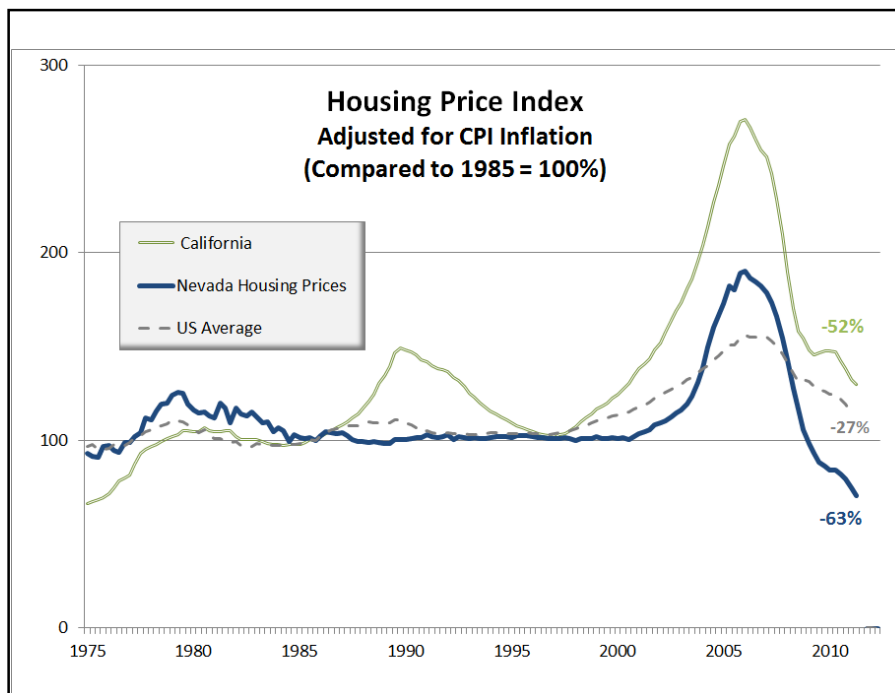


Nevada's Economy

- Housing prices fell more than elsewhere, most mortgages underwater.
- Personal income had been growing by 8% per year for previous decade. It declined by 6% from 2008:1-2009:1, and has been flat since.
- Gaming in long-run decline – 17% of GSP in 1980s, 10% in 2007, 8% in 2009.
- Construction boomed from 1997-2006, became largest share of any state.
- Unemployment highest in country.

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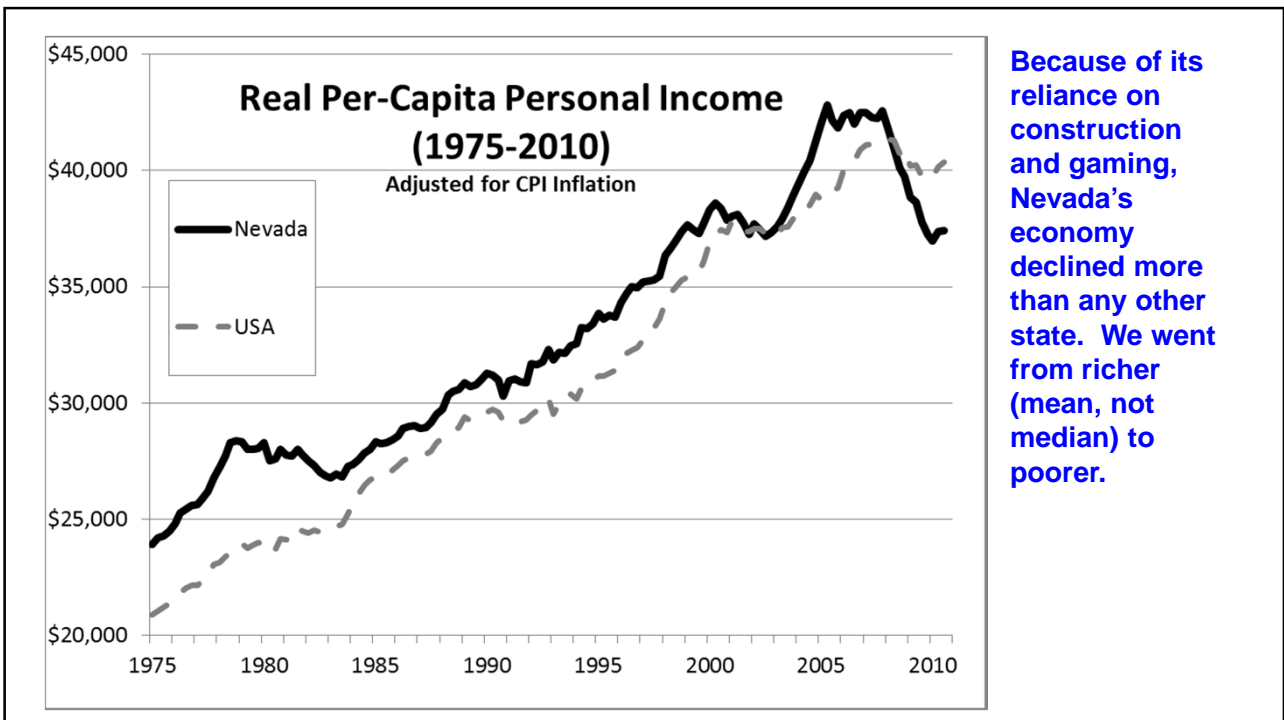
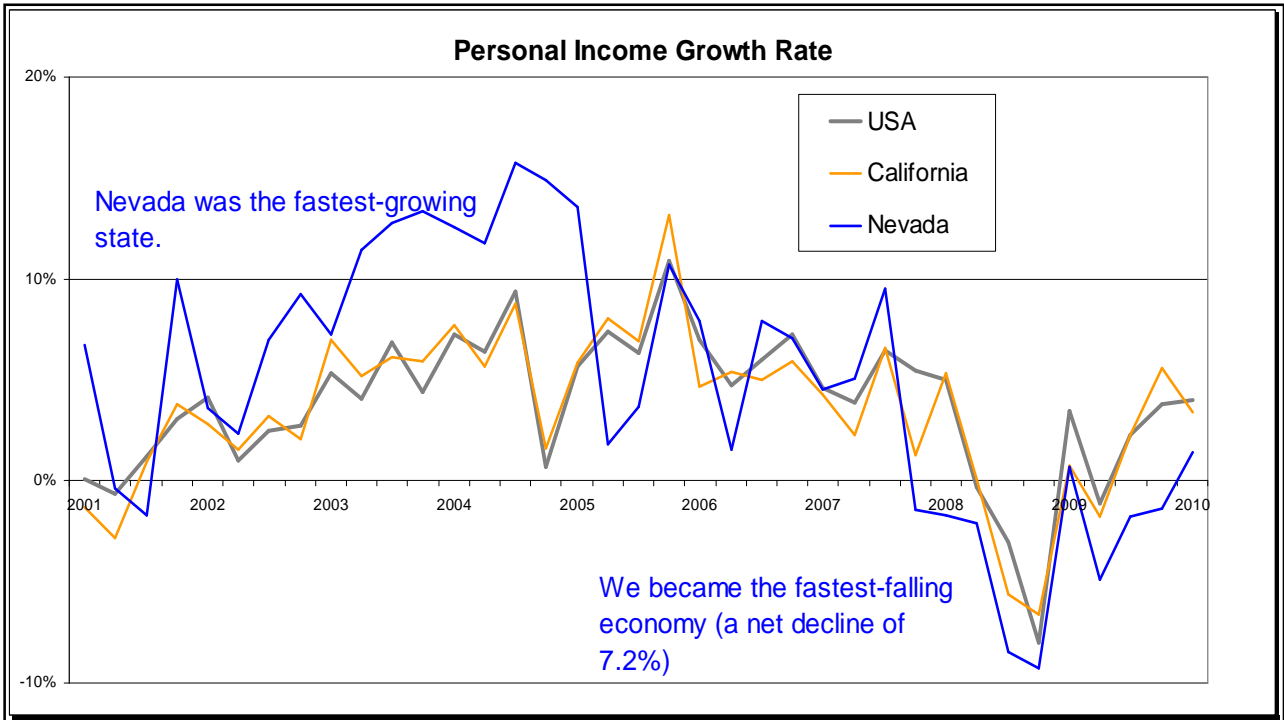
Nevada lagged California, and our initial housing stock was smaller.

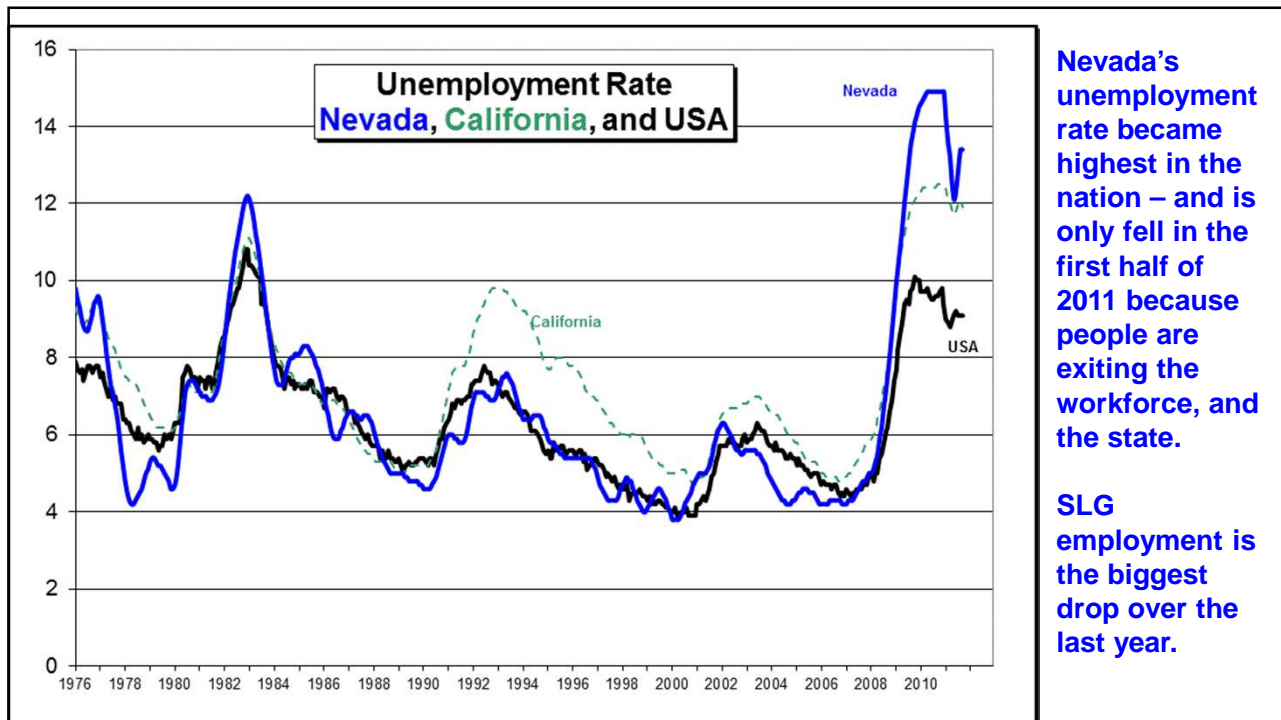
They came here looking for deals.

Our construction sector was the country's largest.

Underwater mortgages:

- USA 23%
- CAL 33%
- NEV 66%





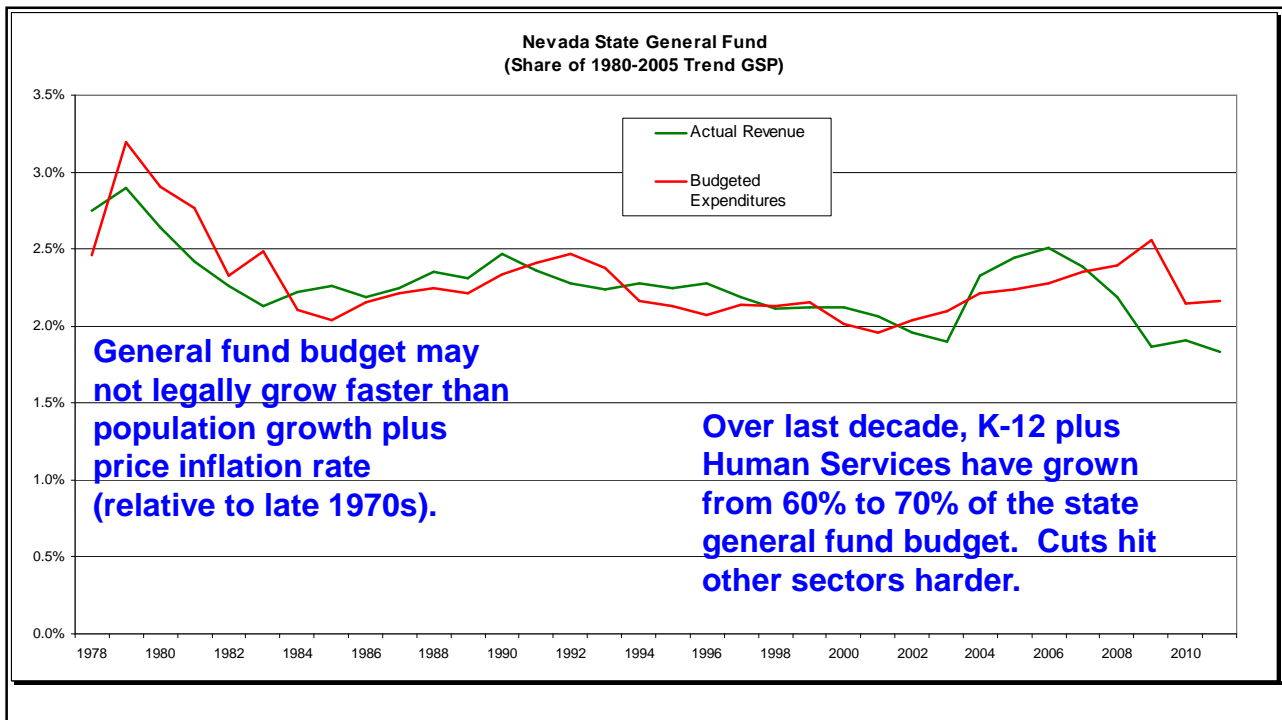
Nevada's Fiscal Crisis

- Economic Forum revenue projections lower for 2009-2011 biennium than for 2007-2009.
- Sales tax revenues continued to fall.
- Gaming win continued to fall:
 - +8.4% in 2006, +1.8% in 2007 (was \$12.8 billion).
 - 9.7% in 2008, -10.4% in 2009 (now \$10.4 billion).
- Cuts of 8% to state budgets in 2008.
- Legislative Cuts of 12% to NSHE budget for 2009-2011 biennium, net of ARRA funding.

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Components of the Budget

- The state budget consists of the General Fund, plus other funds that are either paid for through special taxes (e.g., the highway fund) or through federal funding or matching (e.g., Medicaid).
- In the General Fund:
 - K-12 – grew from 35% of 2000-01 budget to 40% of 2010-11 budget.
 - Human Services – grew from 25% to 31%.
 - NSHE – stable at 19% (about 0.6% of GSP) until 2008, now 15%.
 - UNR's share of NSHE budget fell from 45% to 32%.
 - Public Safety – fell from 12% to 10%, now 7%.
 - Everything else fell from 10% to 7% of budget.

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How does Nevada compare?

- Nevada has the second-lowest tax burden in the country (Alaska's was lowest, but their expenditures were much higher), and we export taxes to tourists.
- Nevada has the smallest general fund in the country, as a share of GSP – less than 2.5%.
- Nevada's state government spent 6.4% of GSP in total, lowest in the country.
- Combining state and local government spending, Nevada spent 12.4% in 2005, 38th in per-capita terms, 48th as a share of GSP.

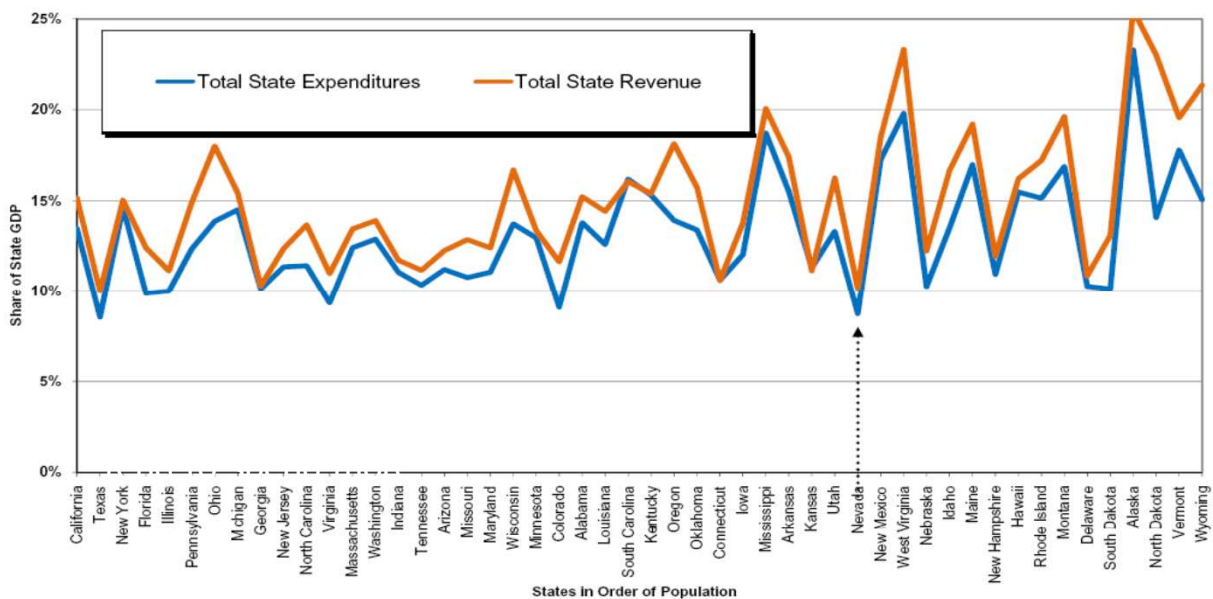
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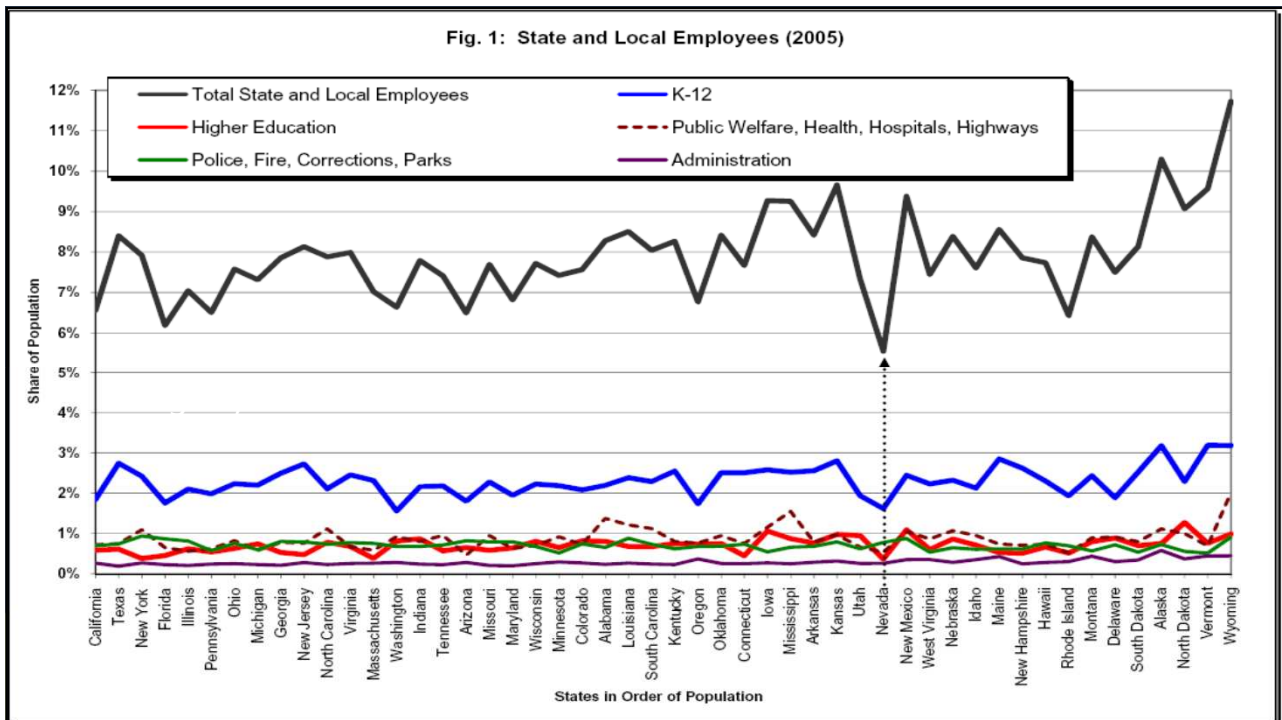
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Fig. 2: State Budgets (2004)





SLG Wages and Benefits

- Before the fiscal crisis began, Nevada's state employees earned slightly more than the national average – but cost of living was about 10% higher than average.
- Nevada's city and county employees earned more than 10% above national average, but K-12 teachers earn close to median.
- University of Nevada, Reno paid the average salary for comparable universities. Currently less than national average.
- Are benefits comparable?

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Is Nevada especially generous to Higher Education?

- The state pays a greater share of higher education than in most states – but state law (NRS 396.540) says it should be free for most Nevadans.
- The state spends a larger portion of the general fund on higher education than in most states – but that general fund is small, and there are few true private universities that compete for students.
- *Just because a poor man spends more of his money on food does not mean he eats better.*

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