THE ECONOMIC CLUB

OF WASHINGTON, D.C.

Excerpts from the Signature Event featuring The Honorable Christina Romer, Chair, Council of Economic Advisers

August 6, 2009

The Recovery Act provided $787 billion of tax cuts and government spending or roughly 5% of GDP, making it the boldest counter-cyclical fiscal stimulus in American history. It was a central piece of the Administration's wide-ranging program to rescue the economy from the worst recession since the Great Depression and to build the foundation for a stronger, more durable prosperity.

The Recovery Act, together with the actions taken by the Treasury and the Federal Reserve to stabilize financial markets and the housing sector, is helping to slow the decline and change the trajectory of the economy. It's providing a crucial lift to aggregate demand at a time when the economy needs it most. And we anticipate that the effects will build through the end of this year and the beginning of the next.

The U.S. economy slipped into a recession in December of 2007. The initial downturn was relatively mild. Real GDP declined at an annual rate of just 0.7% in the first quarter of 2008, and job loss was about 100,000 per month. Indeed, a well-timed, temporary tax rebate that began going out in late April 2008 contributed to positive GDP growth in the second quarter of last year. Unfortunately, worsening declines in house and stock prices late last summer led to a fall in consumer spending and sent shockwaves through our financial system. The collapse of Lehman Brothers last September set off a genuine financial panic and led to a devastating freezing up of our financial systems and a collapse of lending.

. . . the fiscal stimulus that the Administration worked with Congress to create was not only bold but well-conceived. The President aimed for a package that was large and got good employment bang for the fiscal buck. It was designed to provide this for at least 2 years because we knew the economy was likely to face an extended period of weakness. And the President insisted that the spending be genuinely useful. At a time when the budget deficit was already large, we could not afford to create jobs by digging ditches and filling them in. Government spending had to satisfy genuine needs and leave us with useful public investment.

. . . roughly a third of the $787 billion took the form of tax cuts for American families and businesses. Another third was aid to state governments to help them keep workers employed, to not raise taxes, and to aid people directly hurt by the recession through 5 programs such as extended unemployment insurance. . . . roughly one-third of the stimulus package was for public investment. Now, much of this spending was for conventional infrastructure – roads, bridges, water projects. But some was more uniquely 21st century – investments in R&D, health information technology, and a smarter electrical grid.

The program is working. Millions of unemployed workers will have seen an extra $25 a week in their unemployment insurance checks, and 95% of American households saw a tax cut in their paychecks starting on April 1st . My father and all the other Social Security recipients and veterans got their $250 stimulus check in May. State and local government employees like teachers, firefighters, and police officers who were scheduled to be laid off are still working because of the increase in federal spending to the states. Twenty-five hundred boat construction projects are under way.

It is true that the U.S. and world economies went down much faster last fall and winter than we and almost all forecasters expected. The revised GDP statistics show that the actual decline in GDP growth in the third and fourth quarters of last year was about twice as large as the preliminary estimate we had at the time indicated. And the rise in the unemployment rate has been exceptionally large, even given the large fall in GDP that we now know occurred. The fact that the economy deteriorated between January, when we were doing our forecast, and the end of March simply reinforces how crucial it was that we took action when we did.

. . . after falling considerably and indeed progressively more deeply in each of the three quarters before the most recent one, the falling GDP moderated substantially. After declining at an annual rate of 6.4% the first quarter of 2009, it fell at a rate of 1% in the second quarter. Now, to be sure, the economy is far from healthy. And we obviously have a tremendous distance to go. Real GDP, after all, is still declining. But economies don’t switch from rapid decline to robust growth all at once. Given what we now know about the frightening momentum of economic decline in the first quarter, it would’ve been hard for the economy to stabilize much faster than it has.

A key indicator of just how brutal this recession has been is the fact that in the first quarter of this year, we lost nearly 700,000 jobs per month. In the second quarter, we lost on average 436,000 jobs per month. This rate of job loss is horrendous. But the change does suggest that we are on the right trajectory.

The movement in job loss from the first quarter to the second was the largest in almost 30 years. In other words, after we administered the medicine, the economy that was in free fall stabilized. It stabilized substantially and now looks as though it could begin to recover in the second half of the year.

. . . something unusual happened in the second quarter. GDP growth was 2.3 percentage points higher than the usual time series behavior of GDP would lead one to expect. Private forecasters across the political and methodological spectrum attribute much of the unusual behavior of GDP to the Recovery Act. As this table shows, analysts estimate that the fiscal stimulus added somewhere between 2 and 3 percentage points to real GDP growth in the second quarter.

. . . the role of the Recovery Act is clearest in state and local spending. Sharp falls in revenues and balanced budget requirements have been forcing state and local governments to tighten their belts significantly. But state and local government spending actually rose at a healthy 2.4% annual rate in the second quarter of 2009. No one can doubt that the $33 billion of state fiscal relief that’s already gone out thanks to the Recovery Act is a key source of this increase.

On average, a country with a stimulus that’s larger by 1% of GDP has expected real GDP growth in the second quarter that’s about 2 percentage points higher relative to the November forecast.

The impacts of the Recovery Act will almost surely increase over the next several quarters. We expect the fiscal stimulus to be roughly $100 billion in each of the next five quarters. The impact of this steady stimulus, however, will increase over time, because the multiplier effect tends to rise for a substantial period before it begins to wane. Also, the composition of the stimulus will be changing towards components of larger short-run effects. The early stimulus was weighted more heavily towards tax changes and state fiscal relief, whereas going forward there will be more direct government investment. This direct investment will have a short-run effect roughly 60% larger than the tax cut.

Because of the Recovery Act, other rescue measures that we've taken, and the economy's natural resilience, most forecasters are now predicting that GDP growth is likely to turn positive by the end of the year.

It's important to realize that job growth will almost surely lag the turnaround in real GDP growth. The consensus forecast is for the employment and unemployment statistics that we get tomorrow to show that the U.S. economy continued to lose hundreds of thousands of jobs in July. Given that GDP growth was still negative in the second quarter, this is all but inevitable and it's unacceptable. Unfortunately, even once GDP begins to grow, it will likely take still longer for unemployment to stop rising, or for employment to stop falling and begin to rise.

Given how far the economy has declined, the recovery will be a long, hard process. Even if GDP growth is relatively robust going forward, it will take a substantial time to restore employment to normal and to bring the unemployment rate back down to usual levels. . . . The bottom line is, we are no doubt in for more turbulent times.

[The President] is urging healthcare reform to slow the growth rate of spending and provide all Americans with secure health insurance coverage. We're working with Congress to pass financial regulatory reform to make sure that we never again walk as close to the edge of a cliff as we did last September. And we're committed to comprehensive energy and climate legislation to stimulate the move to renewable energy and combat climate change. In short, we are urging serious medicine for serious economic problems.