Understanding the Stimulus: A Primer for Connecticut Citizens on the American Recovery and Reinvestment Act of 2009

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Executive Summary

This report is a non-partisan effort to increase the public's and policymaker's understanding of the recently enacted American Recovery and Reinvestment Act of 2009 (ARRA), the so called "stimulus bill," as well as some of its fiscal and economic impacts in the State of Connecticut. The report highlights economic conditions that helped propel passage of the stimulus bill, discusses some of the economic principles behind the use of fiscal policy as an economic stimulus and presents key arguments for and against the ARRA. The report broadly classifies and summarizes key ARRA provisions and their timing nationally and in Connecticut. To help bring coherence to nearly 300 separate spending measures we present a simple taxonomy that describes how the measures will affect government and their potential to stimulate economic activity. We compare the volume of known stimulus funding allocated to Connecticut with the amount allocated to other states and we estimate the value of individual and corporate tax breaks Connecticut citizens and businesses will receive as a result of ARRA's provisions. Finally, we suggest benchmark metrics from which to evaluate the job creation impacts of the ARRA and highlight some of the difficulties inherent in and urge caution in evaluating the employment impacts of the stimulus.

Key Findings Of The Report Include:

- Combined, increased federal funds allocated to the state as well as individual and corporate tax breaks, Connecticut will receive at least $5.1 billion over three years (and likely more) as a result of the stimulus package.

- The volume of stimulus funds the state will receive will equal about 0.6% of Connecticut's gross state product in 2009, 1.1% in 2010, and about 0.4% in 2011.

- Two industries, health care and public education, least affected by the current recession will receive the largest source of stimulus funding in Connecticut.

- Connecticut residents, primarily lower and middle class individuals, will receive an estimated $1.5 billion in tax breaks over the next three years as a result of the ARRA. By comparison, Connecticut residents received $1.1 billion in rebate checks in just 2008 from the previous administration's and congress's 2008 stimulus measure.

- Less than 40 percent (38.2%) of the non-tax break stimulus funding allocated to Connecticut from the ARRA will supplement or increase state government purchasing of goods and services. About 62 percent of the stimulus funding (not including tax breaks) allocated to Connecticut will "supplant" or replace existing state funds, meaning it will have no job creation impact (although it may prevent job losses). Over $1.3 billion of stimulus funding, especially infrastructure spending, will impact job creation in the state, as will individual and corporate tax breaks. In total, only about 25 percent of the funding Connecticut will receive will be in the form of funds that result in increased government spending on

goods and services that could result in the overall aggregate demand in the economy and potentially increase jobs in Connecticut.

- Because the federal government's fiscal policy is fundamentally redistributive, with less wealthy states receiving more in federal spending than they contribute in taxes, Connecticut receives less stimulus funding than neighboring New England states on a per capita basis.

I. Introduction and Overview

Few economic or political issues have generated as much anticipation, discussion, and concern among as broad a segment of policymakers and the public as the American Recovery and Reinvestment Act of 2009 (ARRA), the so called "stimulus package." A weak economy with rapidly rising unemployment, concerns about the viability of the U.S. financial system, and state and local governments facing well publicized record deficits created a climate where a massive package of federal government spending could be enacted without a widespread public understanding or discussion of its provisions and with limited consensus on its short and long term impacts of the policy. Without a solid understanding of the ARRA and the economic context in which it was enacted, as well as the empirical measures by which it will be evaluated, judgments about the efficacy of the ARRA, and deficit financed stimulus more broadly, will largely be made based on political and ideological perspectives rather than on economic criteria.

President Obama signed the $787 billion American Recovery and Reinvestment Act of 2009 (the ARRA) into law on February 17, 2009. The legislation covers a long list of programs but for purposes of understanding its structure, objectives, and for evaluating its ability to impact our nation's economic performance, it is helpful to start by focusing on four fundamental initiatives it takes. In broadest terms, the package seeks to help revitalize the nation's economy by:

- Providing *aid to state governments* to help them meet large fiscal obligations such as education aid Medicaid, as well as other smaller categories of state expenditures.
- Providing *infrastructure grants to states* to undertake highway, transportation, water, sewer, environmental, telecommunications and other projects.
- Providing *expanded or increased income support to individuals and families*, via such programs as unemployment insurance, food stamps, and temporary assistance to needy families.
- Providing *individual and business tax breaks* in forms such as temporary reductions in payroll taxes, expanded child tax credit eligibility, increased credits for college tuition and for home and automobile purchases.

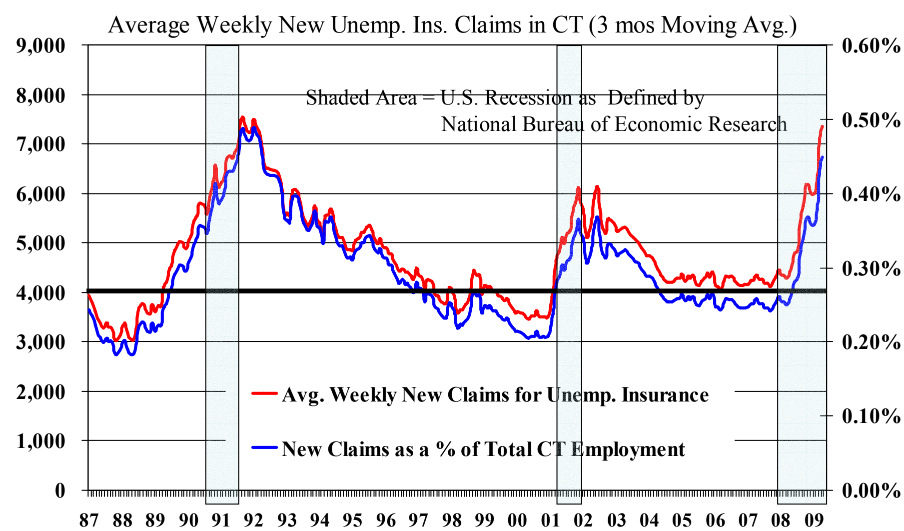
The dramatic downturn of the U.S. economy that occurred during the second half of 2008 created a sense of urgency that led many to adopt a "doing anything is better than doing nothing" attitude toward enacting an economic stimulus plan. At a price of at least $787 billion, and with reports of large "pots of money" available to state and local governments, the ARRA risks being viewed as a fiscal trough more characteristic of the recent trend toward excess and bailouts than of reasoned economic policy. The size of the ARRA and the potential for unintended consequences that afflict large-scale public policies argue for a greater understanding of the stimulus package, its objectives, and the methods that will be used to evaluate the economic impacts of its provisions.

To date, there has been no independent, apolitical analysis of how ARRA's provisions will affect Connecticut. This paper is not intended as a comprehensive guide to the ARRA or any particular stimulus program or expenditure. It is designed to inform, to help policymakers, media, businesses, and citizens develop enough understanding and perspective of the ARRA, free of political or ideological rhetoric, to assess its efficacy in addressing our nation's and Connecticut's economic problems. The report highlights the current economic climate and the rationale behind key ARRA provisions designed to boost economic performance. The report broadly summarizes key ARRA provisions and their timing nationally and in Connecticut. To help bring coherence to nearly 300 separate spending measures we present a simple taxonomy that describes how the measures will affect government and their potential to stimulate economic activity. We compare the volume of known stimulus funding allocated to Connecticut with the amount allocated to other states and we estimate the value of individual and corporate tax breaks Connecticut citizens and businesses will receive as a result of ARRA's provisions. Finally, we suggest benchmark metrics from which to evaluate the job creation impacts of the ARRA and highlight some of the difficulties inherent in and urge caution in evaluating the employment impacts of the stimulus.

II. <u>Did The Connecticut Economy Need a Stimulus?</u>

Prompted by a dramatic deterioration in the housing market and subsequent mortgage loan defaults, the U.S. financial panic that peaked in the Fall of 2008 set off a

In the Wake of the U.S. Financial Panic in 2008 and Subsequent Credit Crunch, The Number of New Unemployment Claims Exploded in CT



Source: Federal Reserve Bank of Boston "New England Economic Indicators" database, PolEcon calculations

Figure 1

chain of events leading to a rapid deterioration in economic activity that turned an expected mild U.S. recession into a threat of a decline unprecedented since the 1930's, darkening Connecticut's economic outlook along the way.

Figure 1 shows how rapidly Connecticut's labor market deteriorated during the second half of 2008 and how dramatically new claims for unemployment assistance have accelerated in the state. New claims for unemployment in Connecticut have now reached levels last seen during the state's deep recession of the early 1990's, however, as a percentage of employment in Connecticut, new unemployment claims still remain below levels seen in 1990-91. Connecticut begin having negative employment growth in the second half of 2008, but while employment decline began later in 2008 than did the decline nationwide, the downturn has been sharper (Figure 2).

The Rate of Employment Decline Has Accelerated In Connecticut

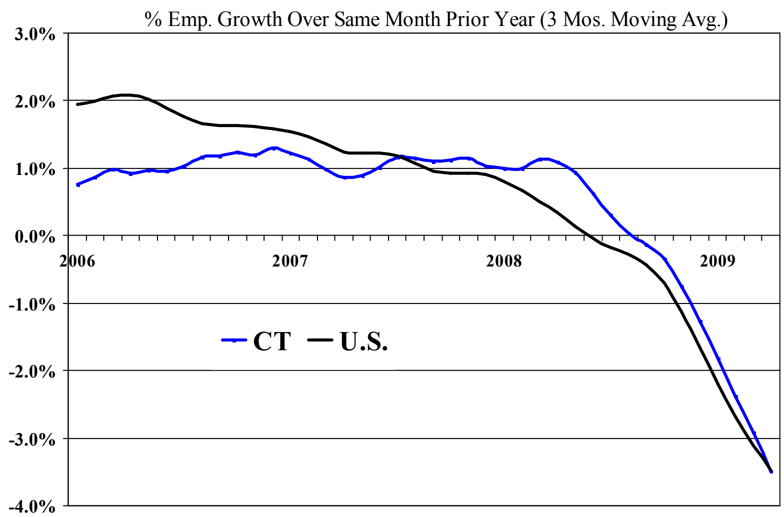


Figure 2 Source: U.S. Bureau of Labor Statistics, PolEcon

Past U.S. recessions did not invoke calls for a stimulus package of a magnitude similar to the ARRA. However, the speed with which the U.S, economy deteriorated in late 2008 along with the breadth and depth of decline resulted in a continuous downgrading in the national and Connecticut economic outlook (Figure 3) and created a climate of urgency that led to the passage of the ARRA.

The mix of measures (specific spending, fiscal aid, tax cuts, etc.) that comprise the ARRA was hurriedly debated but arguably few citizens, media, or even policymakers understood its fundamental foundation. The urgency surrounding economic conditions precluded the kind of careful consideration required to craft an optimal stimulus. The ARRA was subjected to little debate on its potential short and long-term impacts and its efficacy as an economic stimulus. Instead, specific programs and expenditures, as well as how one geography, industry, or group of individuals would benefit were highlighted. These efforts to ‘sell” the stimulus appear to have replaced serious policy debate on the plan. One result was that the ARRA took on the appearance of a massive expenditure containing separate, unrelated, or isolated spending and social policies rather than a coordinated set of fiscal policies directed at providing support to an economy in decline.

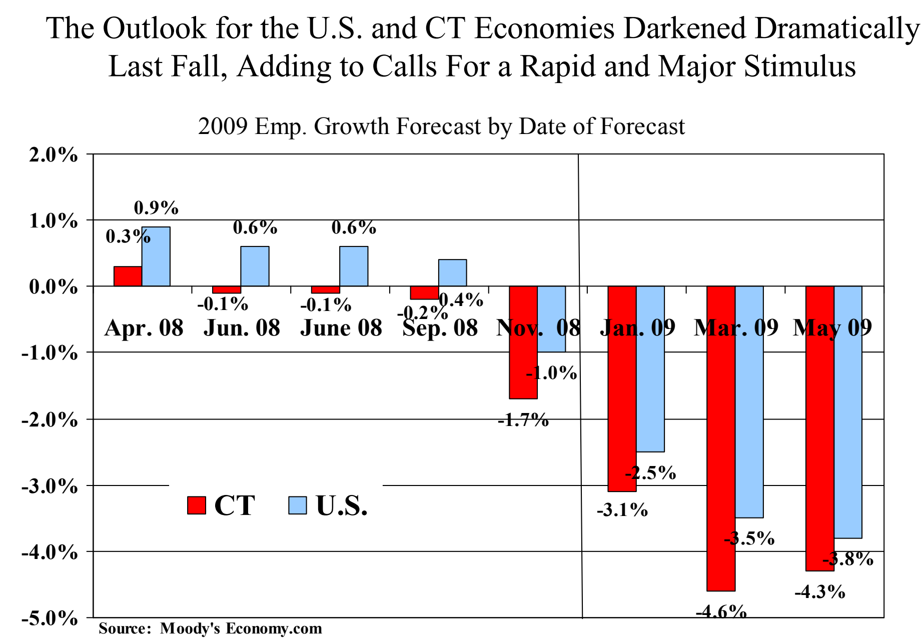


Figure 3

The ARRA contains measures that are widely supported across a broad spectrum of economic theories, but it also contains measures that appear to have little economic justification for their inclusion in the package. The percentage of the package that lacks an economic rationale as a stimulus is a debate that will not be resolved but in a time of general hardship any percentage seems egregious.

III. Economic Arguments For And Against Stimulus

Governments use four tools to stimulate a weak economy. Broadly, they include; monetary policy, credit policy, inflation, and fiscal policy. For reasons beyond the scope of discussion in this report, the most common and most preferred stimulus method, monetary policy, is less available to policymakers at this point in the recession, as is credit policy. Inflation as a stated policy is abhorrent and counterproductive over time, leaving fiscal policy as the remaining tool for policymakers to use to attempt to stimulate an eroding economy.

The basic rationale for using fiscal policy to stimulate an economy is as follows:

- Fiscal policy temporarily stimulates the economy by borrowing and deficit spending that lead to an increase in total spending and aggregate demand in the economy either through:
- Direct spending on goods and services by the government, or:

- Spending by the recipients of tax cuts or government transfers (such things as food stamps, Social Security, public assistance, or unemployment benefits).

In addition, proponents of the stimulus argue that some of the legislation's provisions, such as funding for improvements to roads and highways, might add to the economy's potential output in much the same way that private capital investment does. Other provisions, such as funding for grants to increase access to college education, could raise long-term productivity by enhancing people's skills. According to Congressional Budget Office estimates, provisions that could add to long-term output account for between one-fifth and one-quarter of the ARRA's budgetary cost.

Fiscal stimulus is only effective when it increases aggregate demand in the economy. Economists generally see fiscal policy as less effective than monetary policy in providing a near-term lift to economic activity but several monetary policy options have already been employed for many months. Fiscal stimulus can involve tax cuts, spending, or a combination of both and much of the relatively brief debate over the ARRA was concentrated on the relative weighting of tax cuts versus spending in the proposal.

The challenge to spending programs is that there may be a lag time for planning and administration before the money is spent. Tax cuts can be implemented quickly, increasing individual's disposable income but they lose some effectiveness in increasing economic activity when some of the tax cut is saved. The receipt of tax cuts can also be delayed. For example, according to Joint Committee on Taxation estimates of the Making Work Pay credit revenue losses, 17% of the total would be received in FY2009. In the second year, 57% would be received. The benefit is provided in the form of withholding; since the measure was not in place on January 1, some benefit would be delayed until tax returns are filed. Close to 50% would be received in FY2009 if a rebate mechanism were used (based on estimates of a similar provision considered in 2008 at about the same time of the year, 93% of the rebate was projected to be received in the current fiscal year). Some argue that tax cuts that are temporary, that appear in a lump sum rather than in withholding, or that are aimed at higher income individuals are more likely to be saved. There is some limited evidence that periodic payments are more likely to be spent than lump sum payments, but that evidence is subject to uncertainty and is not of a magnitude that the withholding approach would result in a larger short run stimulus than a rebate.

The income support and aid to state and local governments could relatively quickly help the economy. Without some of these measures workers losing their jobs would cut back on spending even more, costing the economy more jobs. State and local governments facing falling tax revenues must balance their budgets by cutting payrolls and other programs and raising taxes, both policies that would reduce overall levels of spending in the economy. Thus helping unemployed workers and other individuals struggling to meet their obligations as well as deficit-burdened state and local governments can potentially lessen the severity of job losses.

Arguments Against the Stimulus

There are also important arguments against the ARRA or a similar large-scale fiscal stimulus to combat recession. Broadly they take three fundamental forms:

- The ARRA will encourage growth and waste in already bloated and inefficient governments.
- The deficit spending on which the ARRA is based will have long-term negative economic consequences and burden future generations with enormous debts.
- The ARRA will be ineffective in stimulating the economy and job growth in the short-term, either because of the nature of the expenditures or their timing.

The first category are political and ideological arguments against the stimulus that believe the ARRA will fundamentally increase the size and growth of government that has already grown too much or too fast. Even when this argument acknowledges that forcing state governments to cut back may further reduce spending and employment in the economy, it is justified by suggesting that helping state and local governments today will only encourage more spending and larger government in the future. These are important policy arguments but difficult to evaluate in this report and in the current context.

The second category of arguments against the ARRA is based on fundamental economic principles and long-standing concerns about growing federal government budget deficits, as well as the magnitude of our nation's accumulated debt. They include:

- World economic conditions currently allow the U.S. government to borrow at favorable interest rates but there is a fear that ARRA deficits could become much more burdensome to service when interest rates return to normal.
- Larger deficits could eventually crowd out private investment; act as a drag on economic growth, and increase reliance on foreign borrowing. (The CBO's basic assumption is that, in the long run, each dollar of additional debt crowds out about a third of a dollar's worth of private domestic capital.)
- The deficit places a burden on future generations, and could further complicate the task of coping with long-term budgetary pressures caused by the aging of the population.
- In a worst case scenario, if too much pressure is placed on the deficit, then investors could lose faith in the government's ability to service the debt, and our nation would face borrowing constraints and interest rates could spike.

The final argument against the stimulus, that it will be ineffective in increasing economic activity and creating jobs, can be evaluated in the most straightforward manner. Over the next few years, analysts will be examining evidence in the labor market of stimulus funding impacts.

IV. Components of The Stimulus Package

The ARRA is the largest fiscal stimulus effort undertaken since the 1930's but the fundamental economic perspectives behind the ARRA are the same as those that have been employed in fiscal policy efforts to stimulate the economy for decades. The Congressional Budget Office estimates that the ARRA will cost the U.S. $787 billion dollars.

The ARRA's nearly 300 specific spending and tax provision can be broadly categorized into four basic initiatives:

- Direct government spending on infrastructure and other goods and services
- Aid to state governments
- Direct assistance (income support) to individuals
- Tax breaks for individuals and businesses

Figure 4 provides an overview of the major categories of expenditures contained in the ARRA.

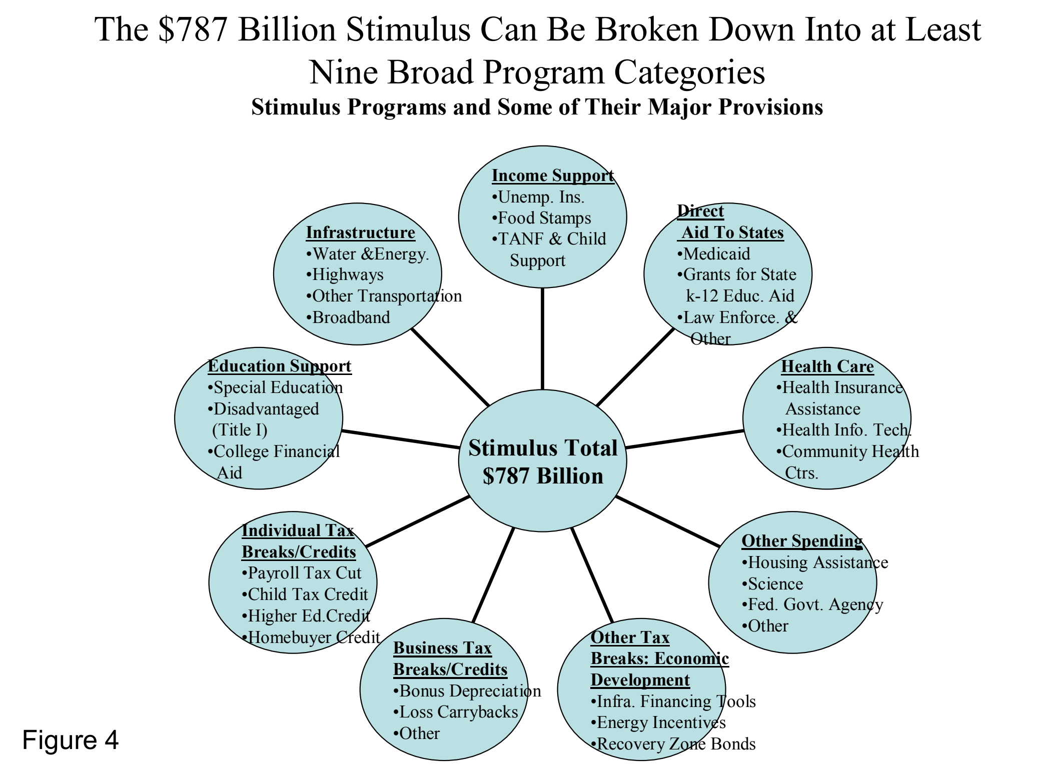
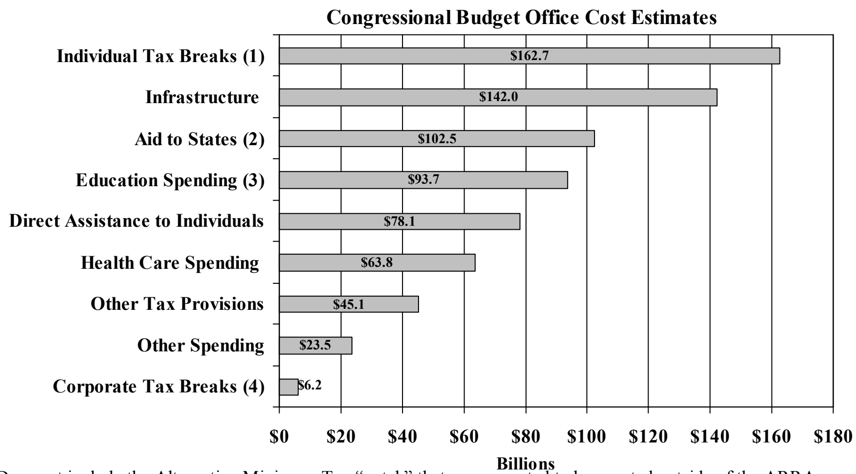


Figure 4

The relative magnitude of each of these broad program areas is presented in Figure 5. The figure includes a number of adjustments noted at the bottom of the chart which we believe are necessary to better understand to what purposes funding is allocated. As Figure 5 shows, individual tax breaks, largely in the form of the "Making Work Pay" provision (reducing payroll taxes), and several provisions targeted at lower income households as well as credits for specific activities such as auto and first-time home buying, comprise the single largest category of ARRA expenditures according to the CBO.

Tax Breaks Targeted at Lower and Middle Income Households are the Largest Cost Item in the ARRA According to the CBO



(1) Does not include the Alternative Minimum Tax "patch" that was expected to be enacted outside of the ARRA
(2) This amount excludes the stabilization funding that is required to be spent on education which is reported under education
(3) Includes the amount from "Aid to States" that is required to be spent to support state education aid formulas
(4) The cost during the first two years is $74 billion but beginning in the third year revenues are increased

Figure 5

The Timing of Spending Matters

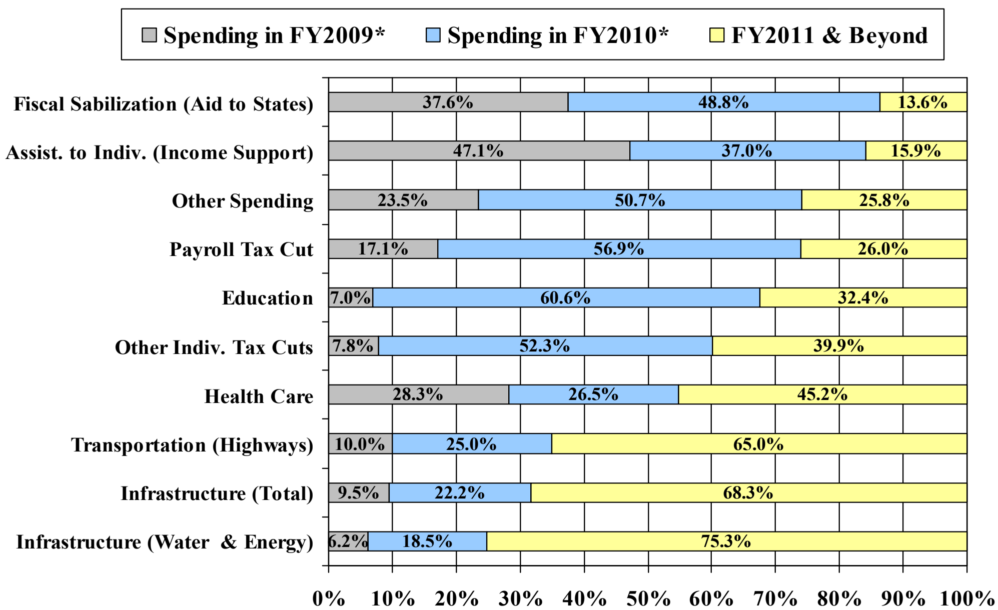
Whether the ARRA provides a timely boost to the economy and employment during a period of recession will largely determine the public's acceptance of the policy over the next two years. More broadly, the wisdom and value of deficit financed fiscal stimulus will likely be evaluated on the basis of the perceived impacts of the ARRA.

A primary criticism of the current and past fiscal stimulus efforts is that their provisions cannot be enacted in a timely enough manner to influence an economy in recession. With the current recession expected to be protracted, that criticism may be more muted but the considerable emphasis in the ARRA that is placed on getting stimulus funding quickly "out-the-door" creates an increased risk that questionable, inappropriate or ill-considered expenditures find their way into the use of stimulus funds. That concern has been echoed in statements about "transparency" of ARRA expenditures and warnings by President Obama about inappropriate uses of the funds. The bully pulpit aside, it is difficult to imagine a spending package of such magnitude that will not produce some level of abuse and misconduct that may influence public acceptance and evaluation of the package.

The Congressional Budget Office analysis of ARRA spending measures (not tax breaks) estimates that about 21% will be spent in FY2009, and 38% in FY2010. Overall, including individual and corporate tax breaks, about 70% of the spending and tax provisions are estimated to reach the public by the end of FY2010 (not including the AMT "patch").

Figure 6 highlights the timing of key program expenditures included in the ARRA. The chart uses the federal government fiscal year that runs from October 1st to September 30th as the basis for annual estimates. Overall the chart shows that spending on programs that are most identified with the ARRA, such as infrastructure projects, will be the slowest to work their way into the economy, while less touted policies such as income support and the payroll tax cut will more quickly exert an impact on individuals and the economy. Aid to state governments will also be implemented quickly, but as we discuss later in this report, much of that ARRA spending will replace or "supplant" existing state spending, providing limited if any employment stimulus. The funds will, however, likely prevent some job losses in state and local governments.

Aid To State Governments and Income Support Will Be the Fastest "Out-The-Door" Stimulus Spending



Source: Congressional Budget Office

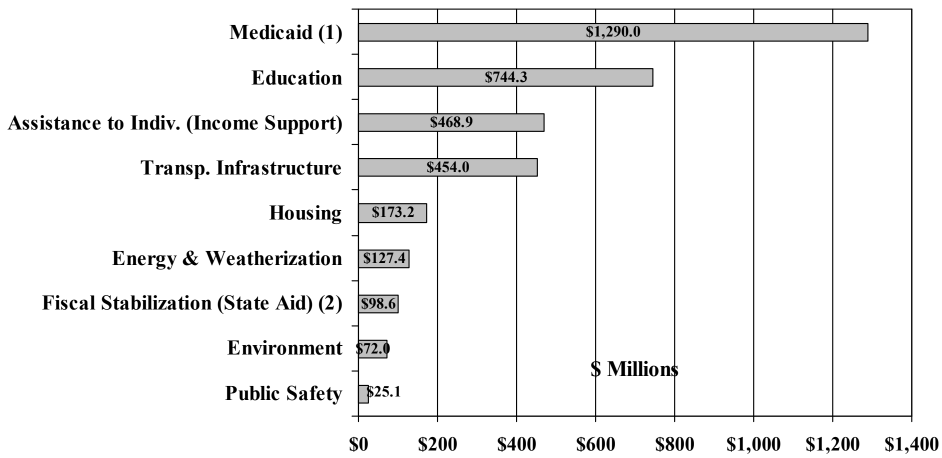
* Based on Federal Gov. Fiscal Year (Oct.1 through Sept. 30). Thus FY2009 spending would occur by Sept. 30, 2009

Figure 6

V. Connecticut's Share of the Stimulus Funds

Connecticut citizens and policymakers want to know how much of ARRA funding will be allocated to the state. As importantly,they will want to know how the state's allocation compares with those of other states. Using information available from federal and state government agencies respsonsible for distributing and applying for ARRA funds, we identified over $3.5 billion in stimulus funds allocated to Connecticut. This total includes all of the major sources of stimulus funds but is incomplete because it does not include some funds for which Connecticut must submit competitive grants or funds for some programs.

The Largest Portion of Stimulus Funds Allocated to CT (Not Tax Breaks) Will “Supplant” (Replace) or Maintain State Funding



(1) CT State Officials Estimate $1.33 billion rather than the $1.29 billion used here. The $1.29 billion figure is reported by the Council of State Governments (CSG). We the CSG figure to be consistent with the state-by-state comparisons in other sections of this report.
(2) This amount excludes the stabilization funding that is required to be spent on education which is reported under education
(3) Estimated based on CT population

Figure 7 Source: Federal agency economic recovery websites, State of CT recovery website and PolEcon

As Figure 7 shows, the two largest sources of funds allocated to Connecticut, increased Medicaid funding and money for education (including the portion from the ARRA’s “state fiscal stabilization” aid that is required to be used to support the state’s k-12 funding formula), both primarily supplant state dollars. Thus states receive targeted dollars to assist them in meeting the two largest financial obligations of state government (k-12 education and Medicaid), perhaps avoiding cutbacks in these programs or harmful tax hikes to maintain curent levels of these expenditues. These funds will not increase aggregate demand or stimulate job creation but they may prevent some job losses in state and local government.

Connecticut is expected to receive over $744 million in funds to support k-12 education, with the largest portion being comprised of funds that are required to be used to fund the state’s share of local education expenses (the state’s education funding formula). Figure 8 shows how public k-12 education funds from the ARRA will be allocated in Connecticut. The largest portion of education funds will support the state’s education aid distribution formula and will provide funding to support changes in the distribution formula enacted prior to the ARRA but which the state lacked funds to pay for.

The Vast Majority of Funds for Education Will Be Used To: a) Maintain CT's State Education Aid Distributions; b) Fund Local Special Education Programs; c) Provide Additional Services to Economically Disadvantaged Students

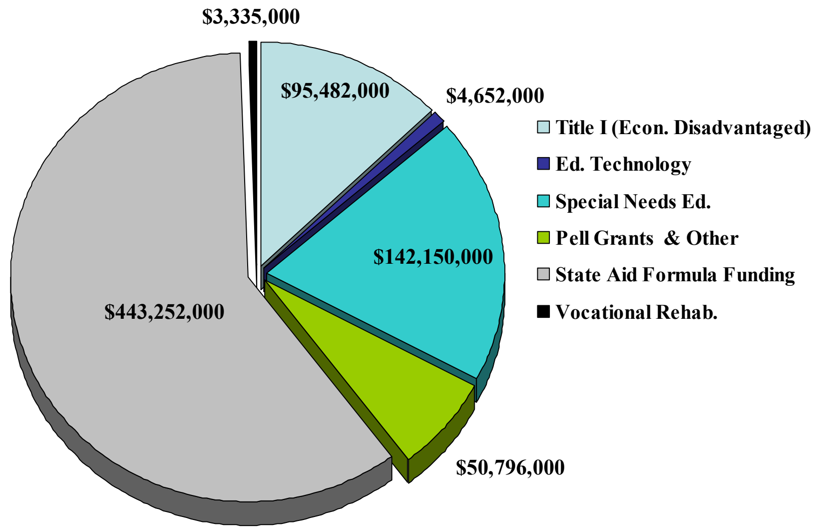


Figure 8

Source: Recovery.gov & U.S. Dept. of Education, PolEcon

The Value of ARRA Tax Breaks in Connecticut

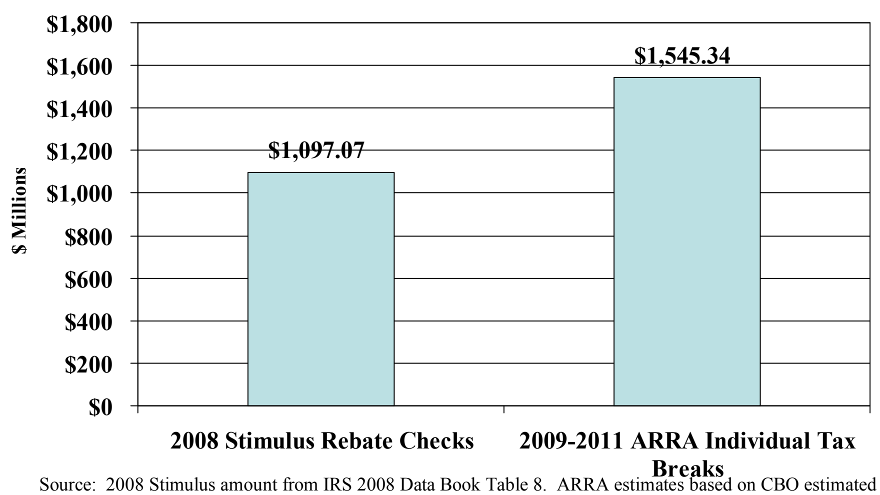
There are no official estimates (that we are aware of) of the value of the ARRA tax breaks on a state-by-state basis yet tax breaks account for about 30 percent of the cost of the ARRA according to the Congressional Budget Office.

We estimated the value of individual tax breaks to Connecticut residents using 2008 data on the percentage of total U.S. tax collections (individual and corporate) that are paid by Connecticut individuals and business. Because the ARRA's individual tax provisions are weighted more toward lower and middle class individuals, we adjusted the percentage to account for Connecticut's relatively smaller percentage of lower income households. We then applied the individual and corporate percentage to the CBO estimated cost of the tax breaks to produce an estimated value of Connecticut tax breaks. Applied to all 50 states, this procedure will allocate the total cost of tax credits across the 50 states.

Using the above procedure, we estimate that the value to Connecticut residents of the individual tax breaks contained in the ARRA between 2009 and 2011 to be approximately $1.5 billion, and the value of corporate tax breaks to be $1.4 billion in the first two years, followed by 8 years when corporate taxes will be higher than without the ARRA, for a net 10 year tax reduction of just $111 million. In calculating the total stimulus funding Connecticut will receive we use this "net" corporate tax reduction rather than $1.4 billion of corporate tax breaks in the first two years. Thus we estimate $5.1 billion in stimulus funds will be received by Connecticut, its residents, and corporations ($3.5 billion in program funding + $1.5 billion individual tax breaks + $111 million "net" corporate tax breaks).

Figure 9 adds some perspective to the individual tax breaks contained in the ARRA package. The figure shows that compared to the $1.1 billion received by Connecticut residents in 2008 as a result of the prior administration's and congress's one-time stimulus rebate checks program, ARRA provides tax breaks totaling $1.5 billion over three years, or just $448 million more than 2008's one-time rebate checks which provided $1.1 billion to Connecticut residents..

Over 3 Years, The ARRA's Individual Tax Breaks Will Allow CT Residents to Keep About $1.5 Billion More of Their Income, or $448 Million More Than the Recent 2008 Stimulus Rebate Checks



Source: 2008 Stimulus amount from IRS 2008 Data Book Table 8. ARRA estimates based on CBO estimated cost and CT's percent of U.S. income and income taxes, adjusted for CT's percent of low income households

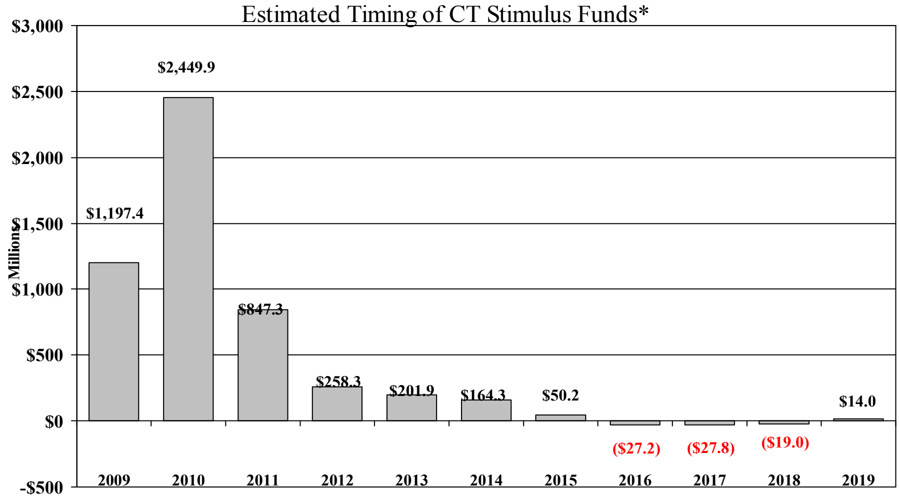
Figure 9

The Timing of Connecticut's Stimulus Funds

We assume that the timing of the funds available to Connecticut will follow the same pattern of ARRA costs by expenditure category outlined by the Congressional Budget Office. Using federal and state agency reports, we have identified about $3.5 billion in ARRA expenditures allocated to Connecticut. There will be additional funds allocated via competitive grants as well as programs where allocation guidelines have yet to be finalized but this amount contains all the major program sources of stimulus funds. Adding individual and corporate tax breaks, the value of the stimulus to Connecticut is estimated at $5.1 billion.

Based on Connecticut's 2008 gross state product (GSP) of over $216 Billion, the value of the stimulus in each of the first three years of the ARRA (2009-2011) is .55% of Connecticut GSP in 2009 (adjusting ARRA spending to a calendar year from a federal fiscal year basis – which also improves the apparent timeliness of ARRA spending), in 2010 the stimulus is equal to 1.13% of Connecticut GDP, and in 2011 value is 0.39% of GDP.

About One-Quarter of CT's Stimulus Funds Will Occur in Federal FY 2009 (Ending Sept. 30)



* The timing of CT funds is assumed to follow the same national pattern estimated by the CBO

Figure 10

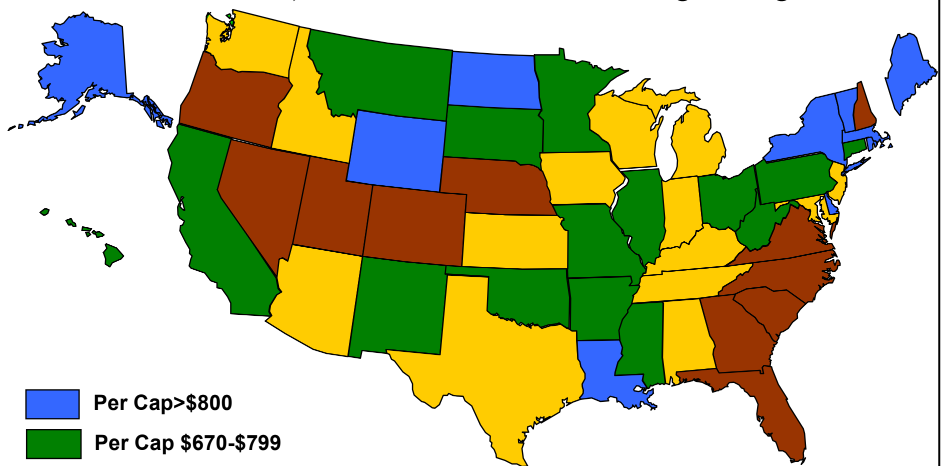
Connecticut's Share of ARRA Funds Compared to Other States

In the coming months more organizations nationally and in Connecticut will be developing estimates of the total allocations of stimulus funds across states. To increase the accuracy of our state comparisons we include only spending measures where federal agencies have provided state allocation tables. This includes most of the largest spending measures (fiscal stabilization, Medicaid, education, transportation, and environment) but not tax breaks and many of the numerous smaller ARRA spending categories. Nevertheless the comparison is useful and final state funding totals are determined, it is likely to reflect Connecticut's overall position among states.

Figure 11 presents the per capita ARRA funding allocated to states for the ARRA major spending programs. As the chart shows, Connecticut receives less than some neighboring states in terms of the amount of stimulus funds the state will receive on a per capita basis. In New England, only New Hampshire receives less stimulus funding than Connecticut on a per capita basis. The fiscal policies of the federal government are generally redistributive, with resources transferred from wealthier individuals and states to less wealthy states. States with higher incomes, like Connecticut and New Hampshire generally pay more and receive fewer resources in return from the federal government. Yet Massachusetts is also a "wealthy" state and it appears to receive more funding than Connecticut. New Hampshire receives among the least stimulus funds on a per capita basis because, in addition to being a relatively wealthy state, it has relatively fewer social and economic problems that are the target of federal programs and funding. Whether the

ARRA exacerbates this aspect of the federal government's fiscal policy and whether the ARRA should be designed to counteract more economic rather than social problems is the subject for another study. What is clear is that ARRA does not fundamentally change the redistributive properties of intergovernmental relations between the states and the federal government.

There are Regional Patterns in the Stimulus's Formula-Based Spending (Combined Transp., Edu., Medicaid, Energy, Environ.,& Fiscal Stabilization). <u>CT Receives Less Than Neighboring States</u>



The Three States With The Highest Formula-Based Stimulus Spending (Alaska, NY, VT) Each Receive More Than $1,000 Per Capita, While Utah Receives Less Than $500. CT Receives $769

Figure 11

Source: PolEcon calculations

VI. <u>The Job Creation Potential of The ARRA</u>

Employment numbers will soon begin to suggest whether the ARRA is effective at increasing employment but a critical task will be to sort out how the categories of ARRA expenditures (direct government spending, tax cuts, state aid, or income support) influence any job impacts and more fundamentally, the role of the ARRA and factors external to the ARRA play in labor market conditions in the coming years.

The ARRA, like any significant policy measure, is particular vulnerable to a temporal fallacy in assessing its impacts. The temporal fallacy occurs when "B" follows "A", and "A" is assumed to have caused "B". Because some level of job creation or loss will follow the enactment of the ARRA, much of what follows in terms of economic conditions may be assumed to have resulted from its enactment. This issue will be the focus of follow-up analyses to this report but the reality is that the issue will likely be the subject of analyses and debate for decades to come.

The ARRA contains approximately 300 specific spending and tax provisions with spending that touches most major areas of state and local government services, and tax provisions that reach almost almost all households and businesses. In this enviroment almost any evidence of improving economic conditions and job creation is likely to be touted as evidence of the postive impacts of the ARRA. The temporal fallacy is prevalent in politics and public policy but is likely to be even more prevalent with a measure as controversial as the stimulus package.

"Jobs saved" has long been the last refuge for policies designed to improve economic conditions which appear to create few if any new jobs. Because there is no way to assess how many jobs might actually have been lost if a policy had not been enacted, claims of jobs saved are difficult to verify or refute. But few individuals, businesses, or policymakers will consider the ARRA a success unless the labor market begins to improve and offer new or increased job opportunties, to a broad segment of the population.

To assess the job creation potential of the stimulus it is first necessary to divide ARRA spending into broad categories according to how the spending fits into current state budgets. ARRA funds that simply supplant or replace existing state funds, such as those that pay a larger share of Medicaid costs or which help pay for the state's share of public education expenditures, will not create jobs. Funds that supplement existing state funds, such as funding that increases the amount of highway construction or paving a state can complete in a year, will create jobs for as long as the supplemental funding is available. Tax breaks that result in additional spending or investment will also result in job creation to the extent that the money is spent or invested and not saved.

The Job Impacts of Stimulus Funding Will Depend, in Part, on Whether Funding Replaces, Supplements or Increases State Spending and Whether Tax Breaks Increase Spending and Investment

Job Impacts By Type of Stimulus Funding

- Stimulus Funds That *Supplement* State Funds (e.g. Highways & Water & Sewer Project Spending) Should *Increase* Jobs.
- Funding That *Supplants* State Funding (e.g. Medicaid, Education Aid, etc) Could *Maintain But Not Increase Jobs*
- *Tax Break* effects will depend upon how much is spent or invested.

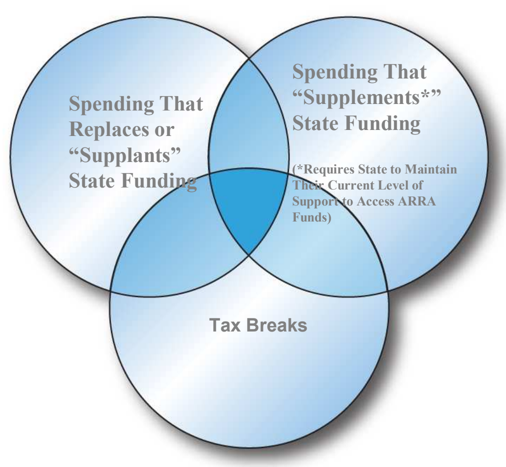


Figure 12

Several studies have estimated the effects of the proposed package on the economy. Administration officials Christina Romer and Jared Bernstein estimate an increase of 3.7

million jobs by the fourth quarter of 2010, 41,000 of which are expected to occur in Connecticut. Mark Zandi of Moody's Economy.com estimates 3.3 million in 2010 and 46,000 in Connecticut. Citing uncertainty surrounding the effects of fiscal stimulus, the CBO projects fewer (0.8 million to 2.3 million) jobs overall but does not provide a state-by-state estimate.

The job impacts of specific spending proposals can be estimated for Connecticut but there are still too many unknowns and possible unintended consequences to accurately forecast the total expected job creation of the plan in Connecticut. We do, however, estimate that 2,075 construction jobs will be supported over the next 3 years in Connecticut, or about 700 per year, as a result of the ARRA's increased highway funds for Connecticut. Water and sewer infrastructure projects will support about 435 jobs over three years, or about 145 per year, while the individual tax breaks, depending upon the percentage of tax cuts that get spent versus saved, could have the largest impact, supporting another 7,310 jobs in Connecticut, not including any multiplier effects.

But the largest portion of stimulus spending (not tax breaks) that will be allocated to Connecticut will supplant or replace state dollars with federal dollars. While this will ease some of the fiscal pressures facing state and local government, it will have little or no job creation impact (although it may prevent some job cuts). Further, it is questionable whether it would even be desirable to stimulate job creation in two sectors of the economy (public education and health care) that have experienced among the fastest job growth over the past decade.

Stimulus funds for education will be welcome and have a significant impact on the finances of the state and local school districts, but the nearly $745 million is unlikely to stimulate job creation even on a temporary basis. State and local policymakers wisely appear wary of increasing employment on the basis of a temporary funding increase.

Allocating our current estimate of $5.1 billion in stimulus funding that will be received by Connecticut individuals, businesses, and government according to whether the funds supplant or supplement state funds, or occur as tax breaks, provides some indication of the potential the stimulus has to increase rather than "save" jobs.

As Figure 13 shows, only about one-quarter of ARRA funds for Connecticut are likely to stimulate the economy via increased government purchases of goods and services. Depending on the percentage that is spent (as opposed to saved or used to pay down debt) tax breaks for individuals may be the largest source of job creating stimulus contained in the ARRA. If the ARRA's programs to assist individuals (income support) are considered similarly to individual tax cuts (that is treated as increases in disposable income) rather than as a program expenditure, then putting more money in the pockets of individuals and families is far and away the largest source of economic stimulus and job creation in the stimulus package.

Funds That Will "Supplement" or Increase State Spending Comprise About 25% of State Stimulus Funds

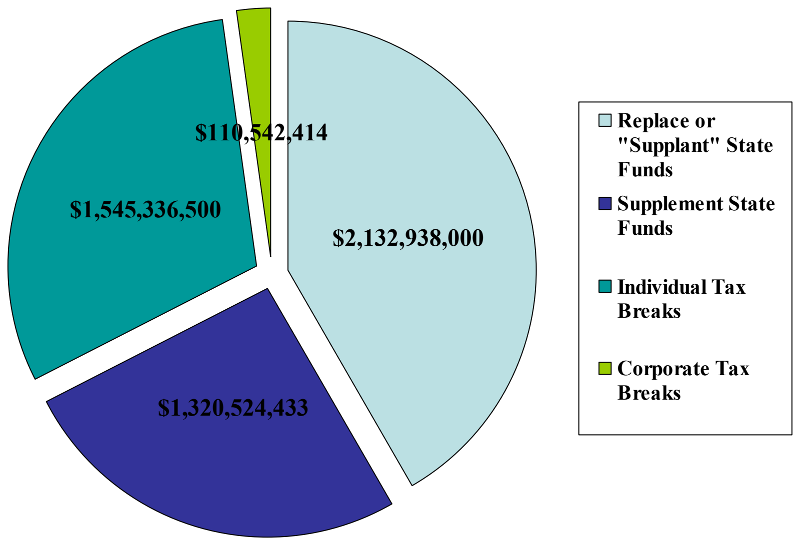


Figure 13

Source: PolEcon calculations

The real (as opposed to forecast) job impacts will be evident soon enough and it will be more important and productive to determine the role that stimulus spending played in job creation/decline and the overall condition of the labor market over the next few years. For industries such as construction that have been especially hard hit by downturns in the residential and commercial real estate market, as well as the fiscal stresses of state and local governments, stimulus funds are likely to have a demonstrable impact on employment. The impact on other industries in Connecticut will be more difficult to discern and developing methods to sort the influence of the ARRA from other economic forces that will affect the labor market over the next few years should be a focus of future research on the impacts of the ARRA in Connecticut.

We begin that process by highlighting job growth in Connecticut by industry over the past two years (Figure 14). As the chart indicates, industries that have been relatively less affected during the current recession, especially health care, state government, and local government which includes public k-12 education employees, receive the largest non-tax break portion of stimulus funding. The notable exception is the construction industry which has experienced a 30 percent decline in employment in Connecticut since the beginning of 2007 and which will receive a boost under a number of stimulus funding programs, including highway and bridge projects, water and sewer infrastructure, and some energy, weatherization and housing project funding. Over the next two years employment in these industries should be compared with the current (April of 2009) levels. More specifically, econometric models should be used to determine the expected job impacts, by industry, of the various ARRA expenditures and tax breaks (as we did with transportation funds and individual tax breaks). That is, it is not enough to claim every new job as resulting from ARRA expenditures. Evaluating the effect of the stimulus requires that more detailed employment impacts, benchmarked against current employment levels, be forecast and those forecasts compared to the actual performance of the labor market in Connecticut.

We know that the U.S. and Connecticut economies will get better. We also know the likely cost of the ARRA. To asses the true benefit/cost ratio of the ARRA, we need to know how much of the inevitable improvement that will occur in the economy is attributable to the stimulus.

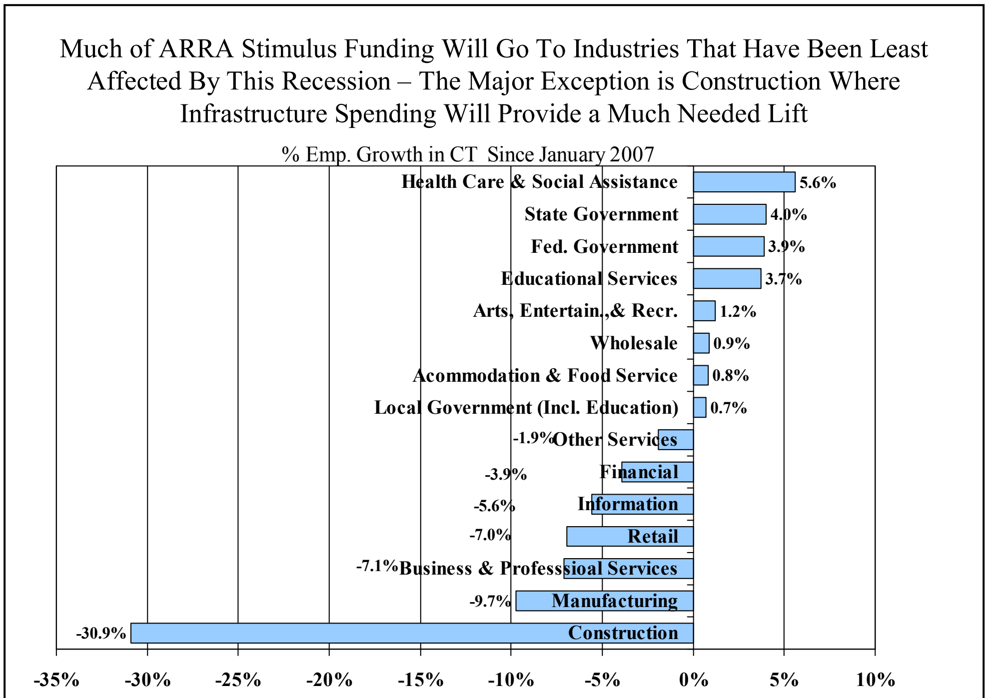


Figure 14

VII. Conclusions

The national and Connecticut economies experienced a rapid decline in 2008 that provided the momentum for a massive fiscal policy stimulus package that is still being debated after its passage. Arguably few Connecticut residents and many policymakers have a limited understanding of the ARRA and the economic rationale for its adoption or rejection. This report informs the public debate about the ARRA, its costs and potential benefits. We conclude that Connecticut's share of the $787 billion stimulus package will be more than $5.1 billion, a figure that is lower than all other New England states except New Hampshire but ranks the state 15th in the amount of stimulus funding it receives on a per capita basis. We find that with the notable exception of infrastructure spending, the largest sources of stimulus funds to Connecticut will go to industries that are the least affected by the current recession. We also conclude that less 40 percent (38.2%) of the stimulus funds for Connecticut for purposes of state spending (not tax breaks) will likely have any potential for creating new jobs in the state. Nevertheless we also find that the ARRA contains provisions that will likely increase employment in the state, particularly infrastructure projects, income support payments to individuals in need of assistance, and individual tax breaks. Only with a careful tracking of employment changes in Connecticut's labor market over the next few years, with particular attention to industries that benefit from stimulus funds, can Connecticut citizens and policymakers determine whether the benefits of the ARRA will outweigh the longer-term costs of the package identified by the Congressional Budget Office and others.

About the Author

Brian J. Gottlob is the Principal of PolEcon Research. For 18 years Brian has analyzed economic, demographic, labor market industry and public policy trends for private sector, government and not-for-profit organizations. Brian is also a Senior Research Fellow at the Milton and Rose D. Friedman Foundation of Indianapolis Indiana. He has completed economic and policy studies and developed analytical models for private and public sector clients on a range of economic, labor market, demographic, real estate, fiscal, energy, education, and health and human service issues in 24 states. In 2007 he was invited to testify before the Committee on Ways and Means of the U.S. House of Representatives. He has undergraduate degrees from the State University of New York and a MPA Degree from the University of New Hampshire with a concentration in public finance and economics.