Congressional Budget Office

IMF Fiscal Affairs and Research Departments Conference on Fiscal Policy

Implementation Lags of Fiscal Policy

Doug Elmendorf

Director

June 2, 2009

The American Recovery and Reinvestment Act (ARRA)

- During Congressional debate from mid-December to mid-February, the U.S. economy was contracting rapidly.

- The Federal Reserve cut the funds rate essentially to zero in December and thus was out of ammunition for its principal policy weapon.

- As a result, there was a perception of great urgency in providing fiscal stimulus.

How Important Was Timeliness?

- Many forecasters expected a large gap between actual and potential output to persist for some time. (In CBO's forecast the output gap was 7 percent of potential in 2009 and 2010 and 5 percent in 2011.) Therefore, policies that provided stimulus for an extended period of time seemed appropriate.

- Moreover, fiscal stimulus that ends before the economy has started to regain its footing runs the risk of exacerbating economic weakness when the stimulus ends.

- Still, with the economy contracting rapidly, many analysts (and politicians) wanted stimulus to work quickly in order to mitigate further deterioration in the economy.

Components of the ARRA

	Total Amount	Share Disbursed by End of Fiscal Year		
	($ billions)	2009	2010	2011
Discretionary spending (Highways, mass transit, energy efficiency, broadband, education, state aid)	308	11%	47%	72%
Entitlements (Food stamps, unemployment compensation, health IT, Medicaid matching rate, refundable tax credits)	267	32%	73%	91%
Revenues (Personal tax credits, business, energy, infrastructure)	212	31%	116%	119%
Total	787	24%	74%	91%

Estimated Budgetary Effects of ARRA

Billions of Dollars
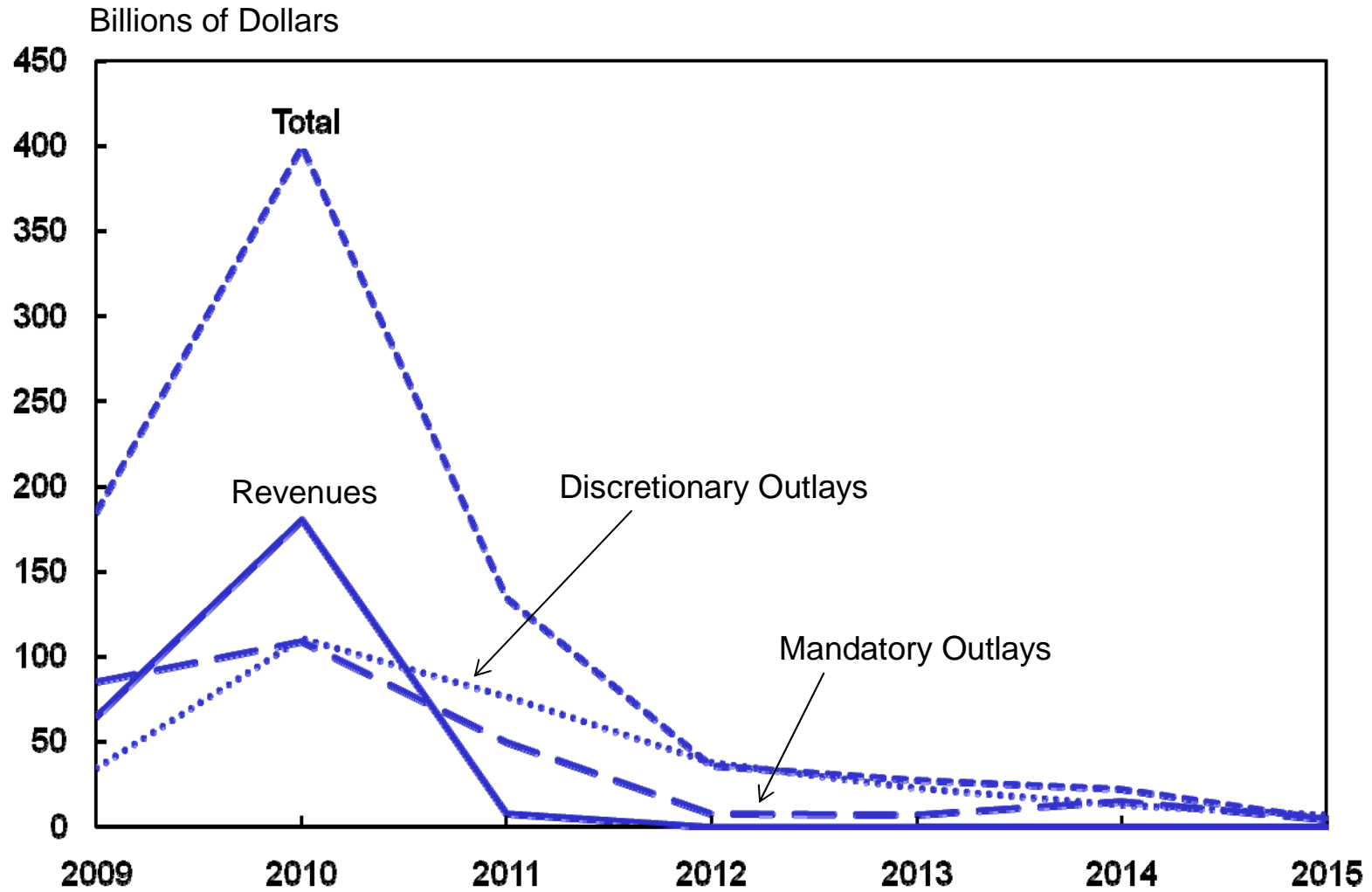
Spend-Out of Discretionary Budget Authority Usually Takes Time

|	Share spent by end of:		
	1st year	**2nd year**	**3rd year**
Highways	27%	68%	84%
Water Projects	4%	24%	54%
Defense	65%	88%	96%
Average	60%	85%	95%

Special Factors for ARRA

- ARRA included a number of greatly expanded or brand new programs, which slows spend-out.

- Can the White House apply pressure so that spending occurs more quickly?

- Legislation could:
    - Waive environmental reviews
    - Allow contracts to be awarded without competitive bidding
    - Award money to fastest movers rather than by formula across jurisdictions
    - Offer financial incentives to contractors for faster completion
    - Give deadlines for states to obligate money

Infrastructure Outlays as a Result of ARRA

Billions of Dollars
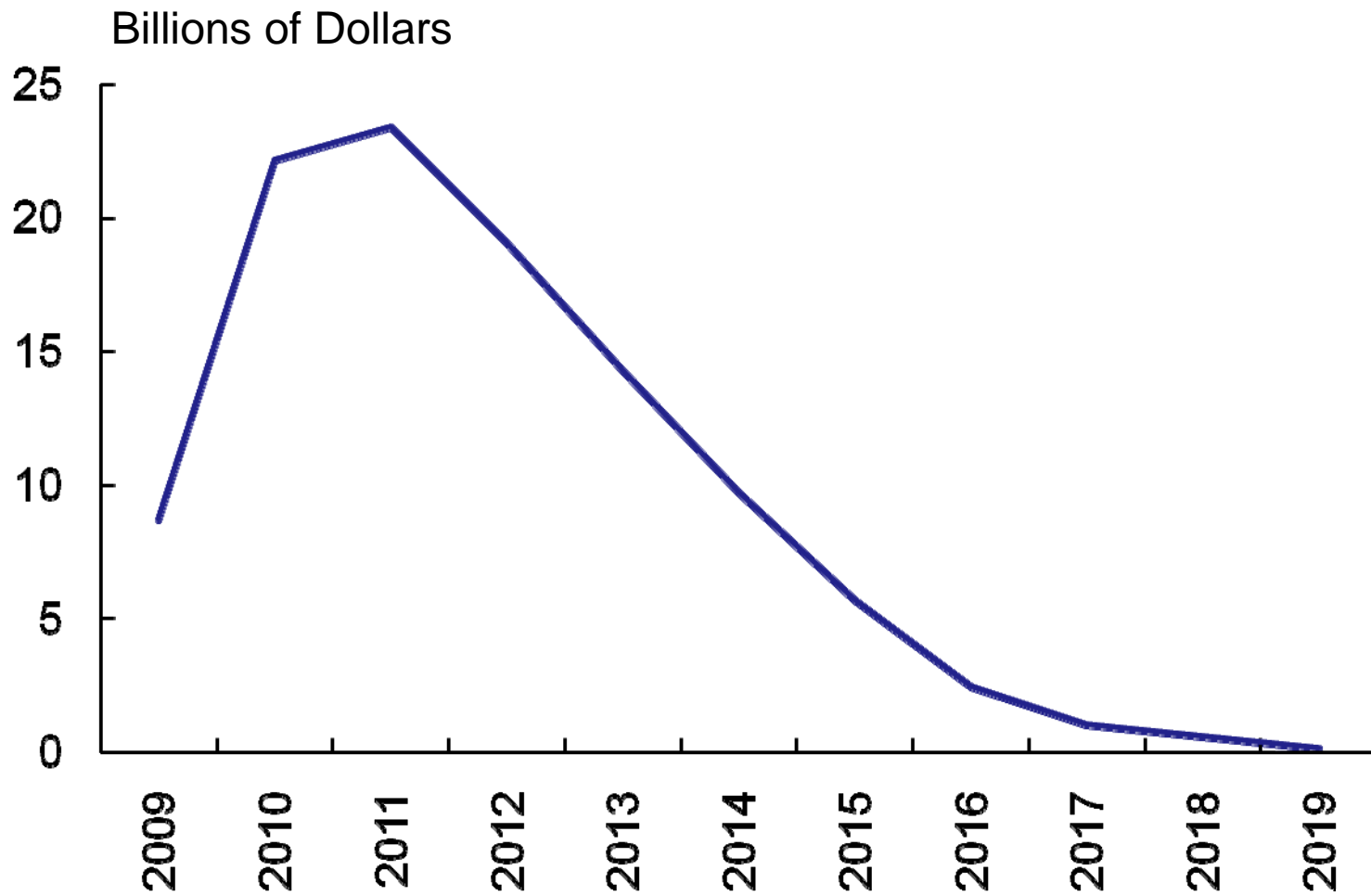
Entitlements

- Transfer payments to individuals (such as unemployment benefits) go out from the federal government quickly.

- Aid to states goes out quickly if it builds directly on existing formulas (such as increased federal support for Medicaid) but more slowly otherwise (such as education support).

  - Key macro question: How quickly and how much do state budgets respond? Implementation lags include not just time between enactment and changes in federal outlays or receipts, but also time between federal budget changes and changes in GDP.

ARRA Outlays to Date (Through May 22nd)

Millions of Dollars

| Agency	Budget Authority	Outlays Through May 22nd	Outlays as a Percentage of Budget Authority
Education	97,407	1,735	2
Health and Human Services	62,279	17,674	28
Transportation	48,120	69	<1
Energy	38,735	44	<1
Labor	36,423	3,695	10
All Other Agencies	96,077	13,476	14
Total	**379,041**	**36,693**	**10**

Revenues

- Changes in withholding occur quickly.

- Rebates take several months, and more during tax-filing season.

- Deferring or eliminating future tax increases affects the budget only with a lag. How quickly does it affect household spending?

Estimated Effect of 2008 Rebates
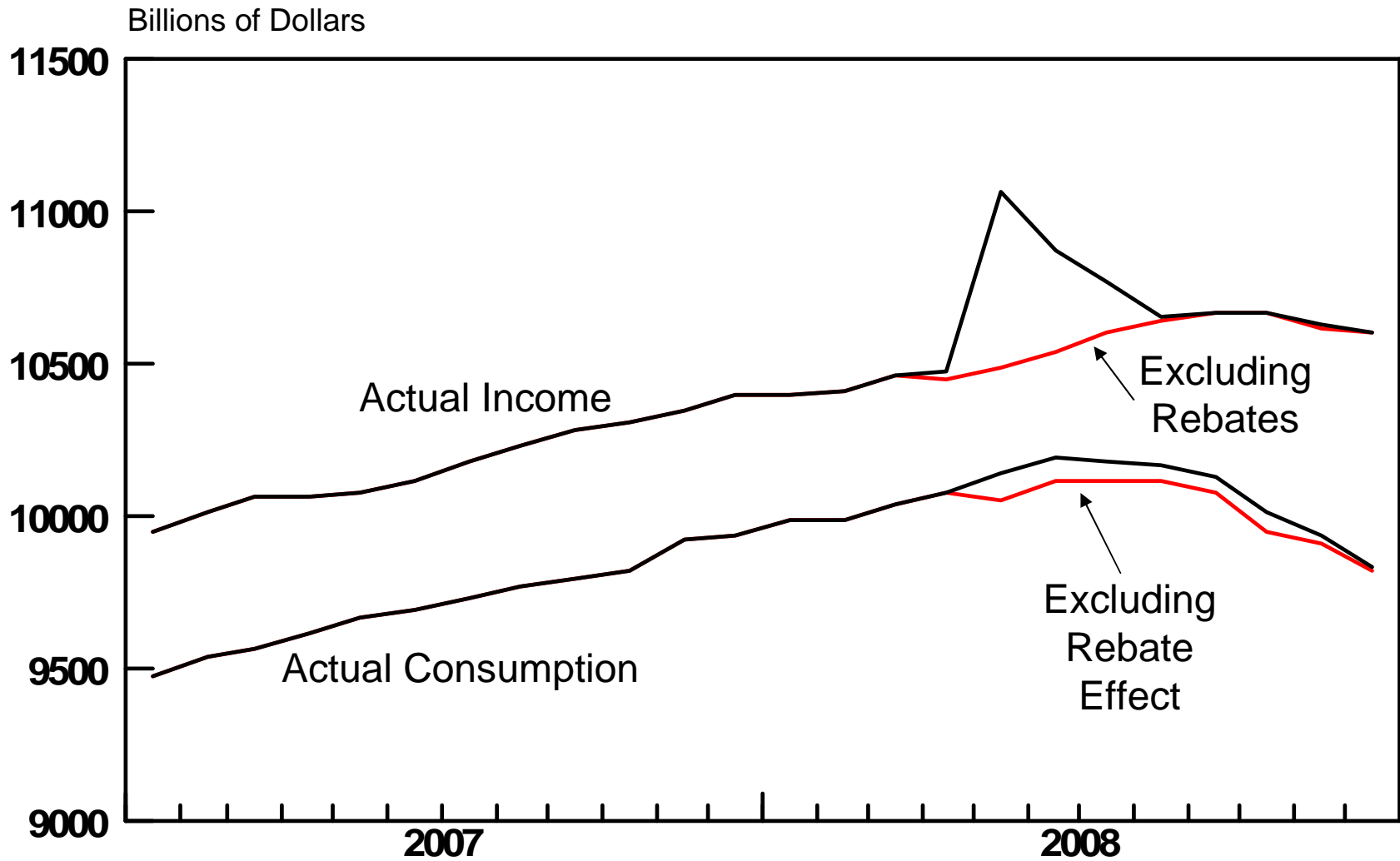
How Can Implementation Lags Be Reduced?

- Have projects "shovel-ready." But is this practical on a large scale?

- Pick tax and spending changes on the basis of implementation speed. But this requires compromise on other aspects of desirable fiscal policy: Who would be helped? What additional goods and services would society consume?

Estimated Macroeconomic Effects of ARRA

	Fourth Quarters of Calendar Years				
	2009	**2010**	**2011**	**…**	**2019**
Real GDP (Percentage change from baseline)					
Low estimate of effect	1.4	1.1	0.4		-0.2
High estimate of effect	3.8	3.4	1.2		0
Unemployment Rate (Percentage-point change from baseline)					
Low estimate of effect	0.5	0.6	0.3		0
High estimate of effect	1.3	1.9	1.0		0
Employment (Millions of jobs change from baseline)					
Low estimate of effect	0.9	1.2	0.6		0
High estimate of effect	2.3	3.6	1.8		0

Effect of ARRA on the Output Gap

Gap Between Actual and Potential GDP as Percentage of Potential GDP

With Stimulus Legislation

Without Stimulus Legislation