THE DISTRIBUTIONAL EFFECTS OF THE STIMULUS[1]

Ajit Zacharias

Thank you very much for inviting me for this conference, it is nice to be back at the New School. I present here some joint work with some of my colleagues at the Levy Economics Institute. I would like to shift the focus of discussion somewhat from the more theoretical aspects of earlier speakers to a more empirical and policy-oriented approach. I will provide an assessment of the employment and distributional outcomes of the Obama stimulus package.

In a nutshell, my argument is that the package is seriously deficient in terms of meeting the challenges of the grave and enduring employment crisis that this country is in, and in addressing the gross maldistribution of income, of which evidence was presented by Ed Wolff. This naturally raises the question what, if anything, can be done to turn things around. I believe that changes can be effected, but economic policy makers need to think big, and they need to think different. I'll touch upon our ideas for economic policies towards the end of my presentation. The next question is whether this will happen, and that is where I am pretty pessimistic. Stimulus is a political question, as we all know.

Let me start with an assessment of the ARRA, the American Recovery and Reinvestment Act, as the stimulus package is formally known. I will give you a breakdown of the stimulus. The basic objective here is to distill the net injection of aggregate demand from the gross figure in the legislation, about $800 billion. To begin with, one has to make some adjustment for the fact that some of this money is intended to offset expected budget cuts at the state and local level. This amount makes up about 20 percent of the total, and it constitutes mainly money for the Medicaid program and for keeping the schools running. Next, there are some coverage differences that result from the fact that one is translating from the budget categories to National Income Product Account categories, and then there are timing differences because the estimate of the $800 billion is over a ten year period, from 2009 to 2019. The time horizon used in this analysis is much shorter, 2009 to 2011. Thus, the bottom line is that about $530 billion or about 57% of the amount that is in the legislation is the net injection of aggregate demand that comes from the Obama stimulus plan over the next three years.

Next I break this total amount down in terms of outlays and tax cuts. Outlays is split into two separate categories, the purchase of goods and services which makes up about 22 percent of the total amount, and transfers which makes up about an equivalent amount. Tax cuts thus

actually make up about more than half of the stimulus plan. This was a big mistake on the part of the Obama Administration to start with. If one recalls the discussions around that time, this was basically a concession to the blue dog democrats and others who thought that tax cuts rather than spending was the solution. The original versions of this stimulus plan, which was disseminated during the campaign time, had a much larger share of expenditures, while the final legislation was skewed more towards taxes.

In order to derive the creation of new jobs from the spending, we use a method for figuring out the job creation impact of purchase of goods and services. The estimation was carried out under two assumptions regarding the distribution of the new final demand among industries, for which we use the U.S. input-output table. The first assumption reflects the current national income and accounting convention, which sees general government as a producer of services not as a mere consumer, and the second assumption is that most of this spending goes to the private sector as final demand for private industries. One should note that this actually reflects the older national income accounting convention, which views government only as a consumer.

To estimate the effects of transfers and tax cuts one needs to make assumptions concerning the size of the multiplier associated with each type of tax cut and transfer. For this we use the numbers of the Congressional Budget Office, which publishes medium and high values. We did the estimates under both those assumptions in order to get an idea of the range of these numbers, since there is a strong speculative element involved in this type of calculation in which one is undertaking an evaluation of the employment effect of fiscal policy. We thus prefer a range of numbers.

This combination of assumptions and method produces four different scenarios. We compared the results for all four scenarios against the Congressional Budget Office (CBO), and the estimates of the administration which is the Council of Economic Advisors (CEA). Now, in a kind of event which is unusual in economics empirical research, our Levy estimates under medium assumptions turned out to be about 6.1 million, which is very close to what the Administration's estimates was. The difference in methods did not lead us to expect such a close outcome, so we were happy about it.

In terms of unemployment outcomes, one should note that the number of jobs lost since the start of the recession until January 2010 amount to about 7.8 million. It is pretty sobering that the jobs that are likely to be created by the stimulus plan will mainly have a palliative rather than a curative effect on the employment problem that we are facing. The prospects appear even bleaker when we consider this in terms of the size of the reserve army of labor, the employable pool that is out there. There are about 15 million people who are unemployed by the conventional, official measure of unemployment, but one can add to that the 9.4 million

people who work part time because of economic reasons and about another 2.5 million people who have looked for work last year, but are not counted as part of the official unemployed. If one compares this to the 6 million created jobs, or even the higher end of the CBO or our Levy estimates of about 8.8 million created jobs, then this appears pretty puny.

We can move on to the distributional aspect of the story now that we found the estimates of the total amount of jobs created. Because we created the number of new jobs using the input-output matrix, we have very detailed estimates on the industry and occupational groups in which these jobs will be generated. Next we incorporate that information into microdata. Our modeling strategy thus combines input-output methods with methods of micro-simulation. We create an employable pool or reserve army of labor, and then estimate a labor response supply model which is part parametric, part non-parametric to identify who gets the newly created jobs. The assumption here is that those jobs will be filled, which I believe is reasonable in a situation of unemployment.

To assess the equity aspect of job creation once we determined who is likely to get these jobs, we ask whether the stimulus creates jobs for those hit hardest by the recession and whether it creates jobs for groups who are as a whole traditionally considered disadvantaged in the labor market. Regarding the first criterion, whether the jobs going to go to those hit hardest by the recession, we find that job creation under the ARRA is likely to favor women over men, nonwhites over whites, and those who attended or graduated from college over the less educated. In contrast, the second criterion of equity, that is, whether job creation favors those traditionally considered as disadvantaged in the labor market, indicates that the jobs created will not favor women and nonwhites as opposed to the first criteria. Both criteria are relevant, I think, in terms of assessing equity.

The picture is bleak by either criterion for those without a college degree. They made up about 70 percent of total employment at the start of recession and they accounted for almost all of the job losses as of November 2009. In fact, the level of employment for college graduates in November 2009 was higher than it was at the start of recession, but still the share of those without a college degree in the new jobs that are likely to be created under ARRA is only around 60%. That is a serious distributional problem.

Once we found who gets the jobs, the model then runs ahead to determine what the earnings will be and what the resulting household income will be. Again, we use a variety of statistical modeling techniques that I will not go into in detail here. Rather, I will move right to the results. As Ed Wolff showed, the median household income series from 1967 to now peaked at about $52,600 in 1999. Since then, there has been a decline in median household income during the 2000's. The 2008 median household income dropped substantially, by about three and a half percent, from its 2007 level.

Our simulation suggests that the ARRA might have ameliorated the crushing blow that was being delivered to the middle class somewhat, but has not mitigated its force entirely. Even with the ARRA, income is about $1,400 lower than the 1999 level. The distribution of these losses can be investigated by looking at the growth in income quintiles. All income quintiles gain under the ARRA. In relative terms, the top quintile actually sees its share in total income reduced. However, this is hardly a compensation for the losses in relative income that the bottom 80% suffered during the period 1999 to 2007. The only group that saw an increase in their share of income is the ones at the very top. The overall assessment is thus that the stimulus package will only have a modest effect on slowing down the decline in median household income and reversing the income gains that have so disproportionately gone to the rich in the recent past.

Finally, I would like to make some suggestions as to what can be done to improve things for the working people in this country by the current administration. I think policy makers need to think big and think differently.

The main focus of the ARRA and the stimulus package so far has been aimed at infrastructure, especially with respect to the government purchases. There has been highway construction and public transit. This is definitely needed, but these investments are hardly sufficient to meet the estimated deficits in American infrastructure. The report card from the American Society of Civil Engineers give the U.S. infrastructure pretty low grades, an overall grade of D with a required amount of investment of about $2.2 trillion over the next five years. Even adjusting for some self interest on the part of the American Society of Civil Engineers, in comparison to that sum the Levy estimate of the infrastructure provisions in the ARRA of about $80 billion is a puny amount.

We need to think big to tackle the infrastructure deficit. I would argue that the vast improvement that took place in American infrastructure following the initiation of major public works program in the 1930's is a worthy precedent to consider here. Between 1933 and 1940, the government directly employed about 3 million people annually on average during that period. The total, direct and indirect, estimated job creation under the ARRA only amounts to about 2.2 million jobs per year, a much smaller number.

Let me end with a second policy suggestion. While physical infrastructure is important, we must not forget about the social care deficit in America. This is the other aspect of job creation where we need to think differently and go beyond infrastructure and green jobs. The job creation potential of social care is grossly neglected in most policy discussions. This is unfortunate because there are serious deficits in social care, such as early childhood education and home-based care for the elderly. These deficits like deficits in the physical infrastructure impose palpable economic and social costs. The other reason why this neglect

is unfortunate is that the job creation potential of social care spending is much bigger on a dollar-to-dollar basis than the one of green jobs or of infrastructure. Comparing the results of a simulation using our model using public investment in social care and in infrastructure, and numbers for investments in green energy from a 2009 study of the Political Economic Research Institute (PERI) shows that social care generates more jobs per dollar spent. And it creates more jobs for the least educated, so it is more equitable and efficient.

To sum up, the current stimulus package is insufficient related to the size of the employment problem and relative to the glaring deficit in physical infrastructure and social infrastructure. A second stimulus package is definitely needed with a two pronged strategy which addresses the task of providing immediate relief to the unemployed and addressing the more structural problems of employment crisis in this country.

END NOTES

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