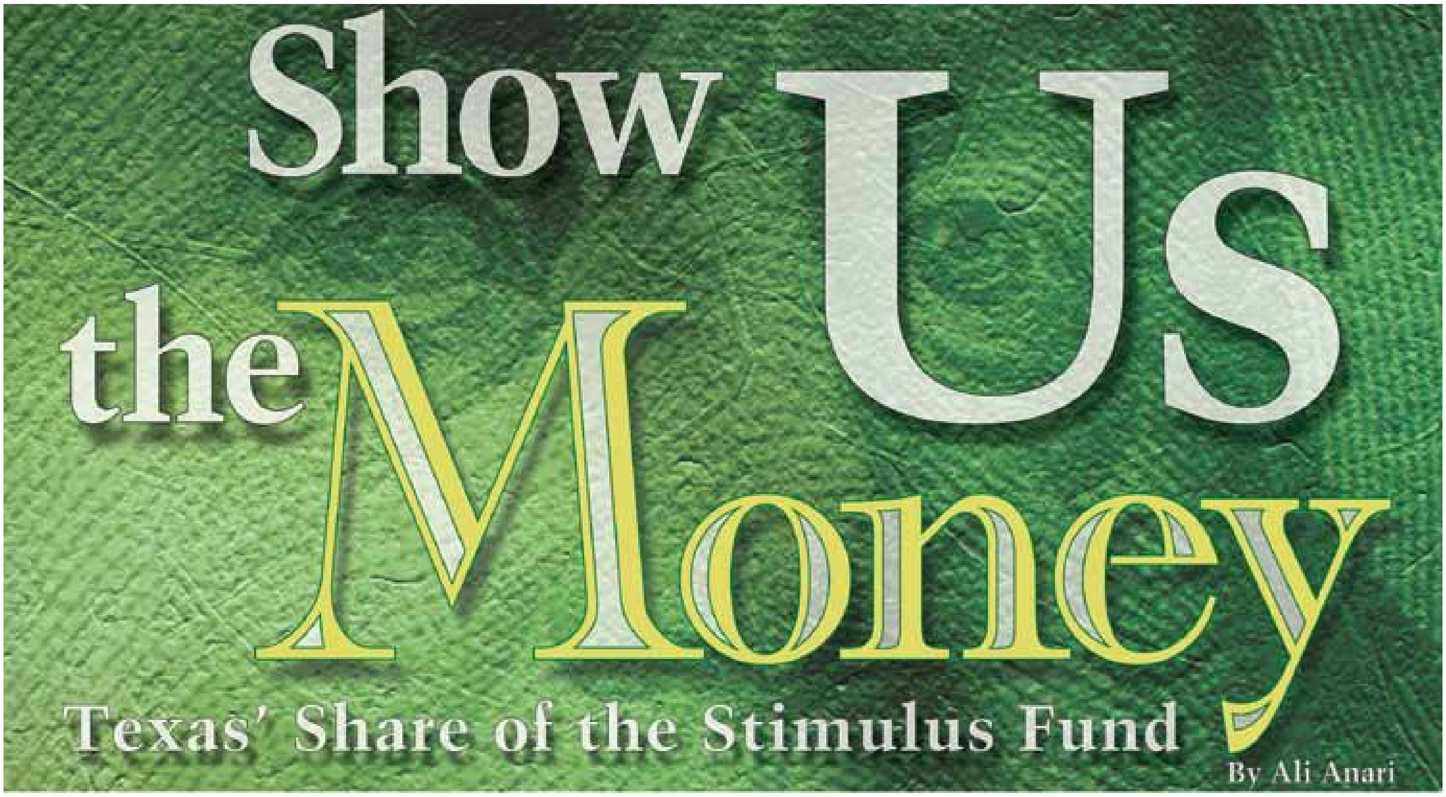
A Reprint from *Tierra Grande*



The American Recovery and Reinvestment Act of 2009 (ARRA) has been one of the most analyzed and debated pieces of legislation in recent history. People of all socioeconomic groups, regardless of their political leanings, are wondering how the stimulus plan will affect the Texas economy. This article explains how stimulus funding will be distributed and both short- and long-term effects of the spending.

Governmental Intervention

In the current recession, the Federal Reserve Bank and the U.S. Treasury let 158-year-old Lehman Brothers Holdings Inc. file for bankruptcy on the presumption that the firm should pay for its past wrong investment decisions. But the Fed and the Treasury soon realized that the Lehman Brothers liquidation could lead to more business liquidation and then spread to the rest of the economy. They quickly learned that in a deep recession we cannot afford to let the Schumpeterian idea of "creative destruction" deepen the recession by liquidating more markets.

Creative destruction and survival of the fittest are good ideas for good times. But in a recession so deep that some are calling it the "Great Recession," it is tempting to paraphrase Milton Friedman and say, "We are all Keynesians, Again" (see "Primer on Keynesian Economics").

In response to the downturn, the Republican administration offered the Economic Stimulus Act of 2008. The Democratic administration followed by enacting the ARRA.

The Economic Stimulus Act of 2008 was basically a federal tax rebate program implemented by sending tax rebate checks to taxpayers. ARRA consists of domestic spending, tax cuts and social welfare provisions.

About $357 billion (45 percent) of the ARRA fund is allocated to federal spending programs (Table 1). Tax cuts for individuals and companies total $288 billion or 37 percent of the stimulus fund. The third-most significant portion of the package is $144 billion (18 percent) allocated to states and local governments to help alleviate budget deficits.

Table 1. Key Areas in the American Recovery and Reinvestment Act of 2009

Area	$Billion	Percent of Total Funds
Tax Relief	288	36.6
State and Local Fiscal Relief	144	18.3
Infrastructure and Science	111	14.1
Protecting the Vulnerable	81	10.3
Health Care	59	7.5
Education and Training	53	6.7
Energy	43	5.5
Other	8	1.0

Source: Recovery Accountability and Transparency Board

Economists tend to disagree with each other on any economic issue and the stimulus package is no exception. A number of prominent economists, notably Martin Feldstein, Joseph Stiglitz and Paul Krugman welcomed the stimulus package and even proposed larger funds to stimulate the U.S. economy. Another 200 economists published advertisements in the *Wall Street Journal* and the *New York Times* expressing their views against the plan, citing the failure of the Hoover and Roosevelt administrations to stimulate the U.S. economy by increasing government spending during the Great Depression. An important part of the debate among economists who favored more government spending was the size of the stimulus package.

For more than a year after the national recession began in December 2007, the Texas economy defied the downward trends and in fact continued to grow, according to the Business Cycle Dating Committee of the National Bureau of Economic

Research. Net job creation in the United States halted in April 2008. Since then the nation has experienced steadily escalating job losses. The Texas economy continued to generate jobs until January 2009.

But the state's economy did not remain immune to the national recession (see figure). The annual growth rate of U.S. nonfarm employment fell from 1.5 percent in January 2007 to –4.4 percent in August 2009. Over the same period, Texas' nonfarm employment growth rate fell from 3.1 percent to –2.8 percent.

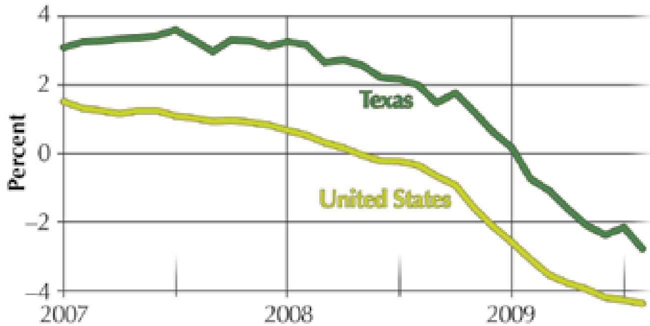
Texas' Share of Stimulus Fund

Each state's share of the stimulus fund depends on the state's population and its gross domestic product (GDP) as well as how well states' governors and legislatures utilize all the provisions of the Recovery Act. A "use it or lose it" clause in the stimulus plan means that states risk losing funds if they do not spend them.

Texas is one of 16 states selected by the Government Accountability Office to be subjected to bimonthly analysis of funding use under the Recovery Act. These states produce two-thirds of the U.S. GDP and are estimated to receive the same proportion of recovery funds.

At the time of this writing, the Real Estate Center's analysis of Texas' share of ARRA funds suggests that the projected initial impact of the funds on the state's economy will be in the range of $35.3 to $38.2 billion, the lower range consisting of $16.6 billion in federal spending through state government and state agencies, $3.7 billion in federal spending not through state government and $15 billion in tax cuts and tax credits.

Nonfarm Employment Growth Rates for Texas and United States, 2007–09



Sources: Texas Workforce Commission and Real Estate Center at Texas A&M University

Projected distribution of ARRA funds among Texas state agencies is shown in Table 2. As of January 10, 2010, Texas had received about $6.08 billion of the funds to be spent through state agencies and public institutions.

The $3.7 billion federal spending not through the state government comprises $1.7 billion for Food Stamp benefits, $510 million in Pell Grants, $900 million in payments to beneficiaries of Social Security and $510 million in other programs.

The $15 billion tax cuts and tax credits are expected to consist of $8.5 billion for the Making Work Pay Tax Credit, $4.6 billion for the Alternative Minimum Tax and expansion of the Earned Income Tax Credit.

Economic Impacts of ARRA Spending

In the short run, how much the stimulus fund spending will affect the Texas economy depends on the size of the increase in government expenditures and the ripple effects of those expenditures. The magnitude of the ripple effect depends on the size of the average government expenditure multiplier.

For instance, $8 billion increases in Texas' government spending in fiscal years 2010 and 2011 are expected to boost the state's GDP by more than $8 billion per fiscal year through the ripple effects of the spending. With a GDP of about $1.2 trillion in 2008 and an average expenditure multiplier of 1.9, the Texas stimulus spending is expected to increase the annual growth rates of Texas' GDP by 1.2 to 2 percent in current dollars in 2010 and 2011.

The long-run impacts of stimulus plan spending on the Texas economy depend on the sustainable portion of economic growth generated by investing the stimulus funds in various economic activities. Stimulus funds may be used for social and infrastructure expenditures, and the latter can contribute more to sustainable long-term economic growth.

Texas' share of ARRA funds for social spending is expected to be about $10 billion for programs in the areas of public education, Social Security, public housing, public health, crime fighting, job training and other social programs (Table 3). Expenditures for social programs are helpful for alleviating a number of social problems during a period of economic hardship. ARRA funds for infrastructure total about $5 billion to be spent on the transportation system, energy and water resources and defense infrastructure (Table 4).

Infrastructure spending programs can contribute to higher levels of output and employment by increasing productivity in the private sector. They can also generate nonmarket benefits, such as decreasing commuting time through infrastructure projects that reduce traffic congestion.

Table 2. Recovery Act Funds for Texas Through State Government as of August 2009

Agency	ARRA Funds (in Thousands)	Percent of Total Funds
Department of Education	$6,919,321	41.5
Department of Transportation	2,716,387	16.3
Department of Health and Human Services	2,401,980	14.4
Department of Defense	1,103,735	6.6
Social Security Administration	835,510	5.0
Department of Energy	755,718	4.5
Department of Housing and Urban Development	517,102	3.1
Environmental Protection Agency	354,529	2.1
General Services Administration	325,996	2.0
Department of Labor	248,222	1.5
Department of Justice	199,991	1.2
Department of Agriculture	73,729	0.4
U.S. Army Corps of Engineers	71,225	0.4
Department of Veterans Affairs	55,139	0.3
National Aeronautics and Space Administration	50,000	0.3
Department of State	22,434	0.1
Department of the Interior	20,399	0.1
Other state agencies*	11,451	0.1
Total	$16,682,868	100.0

Source: Recovery Accountability and Transparency Board

* Includes Corporation for National and Community Service, Department of State, Department of Commerce and Railroad Retirement Board

ARRA and Texas Real Estate Markets

All sectors of the Texas economy, including the state's real estate industry, are expected to benefit from the additional jobs and incomes generated from stimulus spending. Several Real Estate Center research studies have found that employment and per capita or per family income are the most important determinants of home sales, home prices and occupancy rates in residential rental and nonresidential real estate markets (office, retail, and industrial).

Table 3. Stimulus Funds for Social Spending

Area	Texas	All States	Percent of Texas Funds
Education	$6,580,534,065	$79,338,719,825	8.3
HUD	517,101,969	10,072,200,002	5.1
Health	1,557,989,950	27,712,033,529	5.6
Crime Fighting	168,865,887	2,699,921,509	6.3
Job Training	222,997,546	3,876,276,972	5.8
Arts	427,300	16,780,000	2.6
Food and Farming	63,144,216	1,427,223,357	4.4
Social Security	832,590,000	13,005,500,000	6.4
AmeriCorps	3,016,729	85,517,992	3.5
Total	$9,946,667,662	138,234,173,186	7.2

Sources: Recovery Accountability and Transparency Board and Departments of U.S. and Texas Governments

ARRA contains several provisions aimed at spurring a housing market recovery. Texas is expected to receive between $330 and $440 million through the Texas Department of Housing and Community Affairs to be spent on a homelessness prevention and rapid re-housing program, along with weatherization and community services grants. The homelessness prevention and rapid re-housing program provides financial assistance to people on the brink of homelessness and those already homeless. The program also provides credit repair counseling, rent assistance and financial assistance for utility deposits and moving expenses.

Table 4. Stimulus Funds for Infrastructure Spending

Area	Texas	All States	Percent of Texas Funds
Transportation	$2,624,539,848	$34,286,200,000	7.7
Water	354,096,600	6,137,930,000	5.8
Energy	754,517,632	17,249,252,640	4.4
Military	960,905,000	6,548,635,000	14.7
Veteran Spending	59,066,203	1,134,021,651	5.2
Government	325,997,000	5,009,422,000	6.5
Outdoors	20,346,000	2,644,837,000	0.8
Emergency-shelter	6,152,075	97,175,988	6.3
Total	$5,105,620,358	73,107,474,279	7.0

Sources: Recovery Accountability and Transparency Board and Departments of U.S. and Texas Governments

The weatherization assistance program is administered by the Texas Department of Housing and Community Affairs with funds from the Department of Energy to help low-income families reduce their energy bills by making their homes more energy efficient. These measures are expected to increase demand for marketability of the state's residential properties.

The HOME Investment Partnership Program (HOME) provides loans and grants to fund affordable housing to very low-income families through rental housing assistance, homebuyer assistance and occupied housing assistance. Under ARRA, Texas is expected to receive $150 million for this program to be spent by local governments and public housing agencies along with for-profit and not-for-profit entities.

The first-time homebuyer tax credit is another provision in the Recovery Act that is expected to generate more demand for residential properties. The tax credit of up to 10 percent of the purchase price of homes cannot exceed $8,000 for homes purchased between Jan. 1, 2009, and Dec. 1, 2009. Dr. James Gaines, the Center's housing research economist, says this first-time homebuyer tax credit may boost the Texas Housing Affordability Index by about 8 percent.

ARRA includes several business incentive provisions designed to help small businesses (those with fewer than 500 employees) weather the down market. The most significant provisions include:

- accelerated depreciation rules,
- using current losses to offset profits made in previous years,
- changes to small business loan rules,
- tax credits for hiring employees from certain qualified groups, such as veterans,
- a capital gains tax break for investment in small businesses and
- allowing small businesses to expense qualified capital expenditures in the current fiscal year rather than depreciating them over time.

Texas' real estate and construction industries will no doubt benefit from these provisions because more than 93 percent of the state's construction and real estate firms are small businesses.

Lessons From History

According to economists Milton Friedman and Anna Schwartz, authors of *Monetary History of the United States, 1867–1960*, the Fed's inaction in the 1930s turned a normal recession into the Great Depression. The most important lesson from the Great Depression, they say, is that the Fed and the government cannot sit idly by and wait for market forces to pull the economy out of its tailspin.

Fed chairman Ben Bernanke spoke at Friedman's ninetieth birthday celebration. He concluded his remarks with, "Let me end my talk by abusing slightly my status as an official representative of the Federal Reserve. I would like to say to Milton and Anna, regarding the Great Depression: You're right, we did it. We're very sorry. But thanks to you, we won't do it again."

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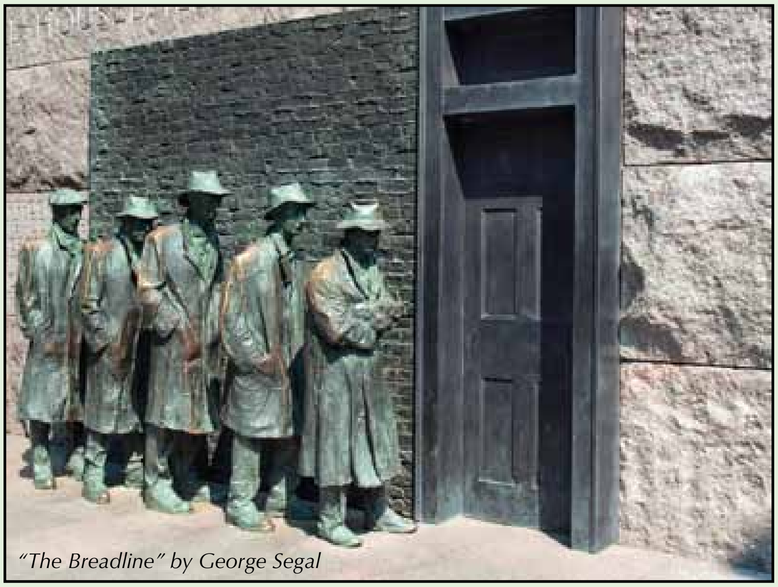
THE TAKEAWAY

Texas' share of stimulus funds under the American Recovery and Reinvestment Act of 2009 (ARRA) will be based on the state's population and gross domestic product, and on how well Texas government officials use the funds allocated. ARRA provisions include some that are expected to spur a housing market recovery and others that benefit small businesses.


"The Breadline" by George Segal

Primer on Keynesian Economics

In the aftermath of the Great Depression, British economist John Maynard Keynes published *The General Theory of Employment, Interest, and Money,* a book that laid the foundation of modern macroeconomics.

According to Keynes, the total (aggregate) demand for goods and services in an economy is the sum of expenditures by households, businesses, government and net exports (exports minus imports). When household consumers and businesses cut back on spending, government can play an important role in stimulating the economy by purchasing more goods and services and investing in infrastructure projects.

Government expenditures have a ripple effect — that is, one dollar initially spent by government can result in more than one dollar's worth of sales of goods and services as the revenues generated from the first round of government expenditures generate more incomes and expenditures. Higher levels of government spending can generate new demand for goods and services, leading to more capital investments by firms. Eventually, the government spending may help the economy come out of recession and embark on a more sustainable growth path.

More government purchases of goods and services obviously can lead to more sales of goods and services by businesses. But total sales of goods and services are computed using two factors: the quantity of goods sold and the price of the goods.

To jumpstart an economy stuck in a recession, government expenditures must lead to higher quantities of goods and services sold rather than higher prices for goods and services. If increased government spending leads to higher prices with little impact on the quantities of goods sold, higher inflation rates and lower employment rates would result. Thus, macroeconomic policies employed for using government spending to stimulate the economy bear the risk of higher inflation rates and of driving the economy deeper into recession.

During the three decades after the second World War, most countries, including the United States, employed Keynesian policies of economic stabilization by using public sector spending to fine-tune their economies. They experienced some successes in the 1960s. Keynes appeared on the cover of *Time* magazine at the end of 1965 accompanied by an article entitled "We Are All Keynesians Now." This phrase initially was coined by Milton Friedman and was later used by President Nixon when he announced the ending of the gold standard.

However, the Keynesian experiments went disastrously wrong in the 1970s and early 1980s when the U.S. economy and other industrialized economies were plagued with high inflation and unemployment rates, an economic situation known as stagflation. Keynesian economics came under attack by monetarists and suffered severe setbacks on both theoretical and political grounds.

Monetarists, led by Milton Friedman, argued that higher economic growth rates cannot be attained by more government spending and that Keynesian macroeconomic policies lead to higher inflation rates and lower economic growth rates in real terms. According to monetarists, economic stabilization is attained by controlling the money supply rather than by government spending.

Herbert Hoover in his memoires wrote about Treasury Secretary Andrew Mellon:

> …Mellon had only one formula: 'Liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate.' He held that even panic was not altogether a bad thing. He said: 'It will purge the rottenness out of the system. High costs of living and high living will come down. People will work harder. Live a more moral life. Values will be adjusted, and enterprising people will pick the wrecks from less competent people.'

But the Great Depression taught that a "do-nothing" approach to an economic recession — letting businesses die and liquidate on the presumption that the recession results in survival of the fittest and most efficient firms — may lead to economic disaster.

— Ali Anari

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